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# Negotiating Cross-Border Acquisitions

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# Case Study
# Negotiating Cross-Border Acquisitions



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*The experiences of an Italian copper-products company yield lessons for firms engaged in global mergers and acquisitions.*

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Driven by competitive pressures for globalization and facilitated by the liberalization of markets worldwide, cross-border mergers and acquisitions grew explosively during the 1980s, paused in the early 1990s, and are again increasing. Particularly in Europe, the number of cross-border deals soared from around 400 in 1986 to almost 2,000 in 1991 — representing almost 60 percent of all deals in Europe — and are now around 1,500 annually. The value of such deals has grown proportionately more than their impressive raw numbers;[1] indeed, on a single remarkable day — "Mad Monday," 13 October 1997 — more than $120 billion in cross-border European mergers and acquisitions were announced. While analysts have dissected many economic and financial aspects of this powerful trend, they have paid relatively little attention to the negotiating processes involved in these transactions. In this case study, I explore a sequence of acquisition negotiations by one Italian firm, Societa Metallurgica Italiana SpA (SMI), that consistently overcame seemingly insurmountable obstacles. From SMI's skillful approach, I distill broad lessons for effectively negotiating cross-border deals.

Many companies negotiate cross-border transactions routinely, using familiar scripts for effective deal making: "map" or enumerate and characterize the parties, assess their interests and their no-deal alternatives, envision potential agreements and the bargaining range, craft processes for both creating value and claiming it, pay attention to the sustainability of agreements, and so on.[2]

Yet, when financial negotiations cross borders, this general advice needs elaboration to fit the context, especially for inherently challenging transactions. Another country's politics, culture, and corporate governance policies can erect nearly insurmountable obstacles. In "fortress" Germany, for example — in which one of SMI's most successful deals was consummated — only three hostile takeovers have been completed since 1945, despite numerous attempts. Even friendly mergers occur far less frequently in Germany than in the United Kingdom or the United States.[3]

Italian tire manufacturer Pirelli's abortive effort to acquire German competitor Continental Gummiwerke exemplifies the efforts of many outsiders to make acquisitions in Germany. In 1990, Pirelli — with full financing and the apparent support from a majority of Continental's shareholders, including Deutsche Bank — tried to negotiate a merger with Continental. The process triggered a widely publicized, acrimonious confrontation, and Pirelli failed to secure a sufficient voting stake in its German competitor, suffering a humiliating rebuff from Continental management and a loss of more than $430 million.

The German "fortress" can prevent even its own firms from mounting hostile acquisitions of domestic competitors. In March 1997, German steel manufacturer Fried. Krupp AG Hoesch-Krupp launched a hostile takeover bid for compatriot rival Thyssen AG, a publicly traded company in the unusual position of having 80 percent of its shares widely disbursed among German investors. The bid — which, if successful, would have eliminated thousands of jobs — triggered fierce retaliation from Germany's steelworking unions and strong opposition from political leaders. Steelworkers staged massive strikes to protest the takeover plan, and approximately 30,000 union members demonstrated at the headquarters of Deutsche Bank and Dresdner Bank, the two German institutions financing Krupp Hoesch's bid. Within days, Krupp Hoesch rescinded its bid and was cowed into establishing a friendly joint steel manufacturing venture with Thyssen.

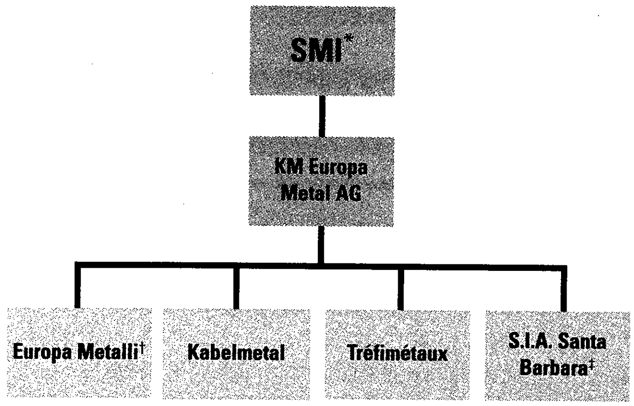
Like Pirelli, Assurances Generales de France (AGF), the second-largest French insurer, was repulsed by the German "fortress" when it attempted to forge an equity-linked strategic alliance with German insurance giant Aachener and Munchener Beteiligung in 1990. Three years after AGF's overtures were blocked, Michele Albert, chairman of the French insurer until 1994, commented:

"[The] takeover bid . . . is virtually unknown in Japan, Switzerland, and Germany. Approximately a third of German companies issue registered shares which may not be sold or transferred without the express authorization of the company. What is more, the board of directors (in its capacity as legal representative of the firm) may in some cases withhold its reasons for turning down a share-transfer request. This prerogative is a highly effective delaying tactic: you have no vote and no right to join in an increase in capital as long as the share transfer has not been approved by the company in question."[4]

Of course, takeover bids, especially hostile ones, typically stimulate aggressive negotiations, but Albert underscores the potential influences of differences in corporate governance and political economy on negotiating strategy for cross-border deals. The Italian firm I examine here has quietly shown a mastery of such difficult negotiations and completed major deals in its home country and in France, Spain, and Germany. Its success is all the more remarkable given that Italian firms are generally underrepresented acquirers in Europe (accounting for only 3 percent to 6 percent of cross-border purchases from 1991 to 1994, despite its 15.5 percent share of EU GDP). Furthermore, its most significant acquisition — a German firm that propelled the combined group to European dominance — occurred in what Albert and others have described as the world's most forbidding setting for would-be acquirers.

As a student of negotiations, I was intrigued by SMI's history of acquisitions. SMI, the holding company that owns KM Europa Metal, belongs to the Orlando group, headed by Luigi Orlando. (For SMI's organizational structure, *see Figure 1*.) SMI is in the copper transformation business, purchasing refined copper and its alloys and converting them to rolled form, tubes, laminates, and brass bars. In 1965, as one of many small and medium-sized Italian competitors, SMI had four plants and 3,800 employees, and produced 63,000 tons of copper products annually. At a

Figure 1
**SMI Organizational Structure**




*SMI owns 77%; dispersed German shareholders hold the balance.
†Includes La Metalli Industriale (LMI) and other SMI subsidiaries in Italy.
‡The group's Spanish subsidiary.

time when privatization was anathema in Italy, SMI nevertheless acquired and effectively privatized the copper division of the state-owned Finmeccanica, its primary Italian competitor, significantly rationalizing the Italian market and strengthening its position.

In 1986, in a second round of negotiations, SMI acquired its major French competitor, Tréfimétaux, a subsidiary of Pechiney, the vast French aluminum concern. SMI skillfully acquired the company over the staunch objections of most Tréfimétaux managers and with the unlikely but necessary blessing of the French government, which had nationalized the parent, Pechiney, only four years earlier. This was, again, an unlikely outcome: a *private Italian firm* acquiring a *state-owned French firm* that opposed the deal.

In 1990, SMI set its sights on Kabelmetal AG, a German competitor producing nearly 14 percent of Europe's semifinished copper. To many, Kabelmetal was a more audacious acquisition target than Tréfimétaux. The scale of this prospective transaction was daunting, but even more formidable were the traditionally high barriers to cross-border acquisitions in Germany. This was, after all, only several months after Pirelli's ill-fated attempt to merge with Continental. Yet SMI, with a carefully orchestrated negotiating strategy played out among multiple layers of shareholders and managers at its German target, prevailed, successfully acquiring Kabelmetal toward the end of the year.

On 5 October and 21 December 1995, I interviewed Sergio Ceccuzzi, Vorstand (management board) member of KM Europa Metal AG (responsible for strategy, financial policy, and management control) and chairman of Europa Metalli SpA, a KM Europa Metal subsidiary in his office, part of the Palazzo della Gherardesca. This ornate fifteenth-century Medici palace has served as the Florence headquarters of SMI since 1939. Our discussion centered on his firm's approach to negotiating a relentless series of acquisitions, mostly across national borders, that led SMI from its roots as a minor Italian player in the copper transformation business to its current industry-leading incarnation as KM Europa Metal AG. Viewed narrowly, this is but the parochial story of a minor Italian firm in a series of consolidating industry transactions. To cogniscenti of negotiation, however, this is like classifying Machiavelli as an adviser to sixteenth-century art collectors. Following this shortened, edited version of our conversation, I summarize some lessons from SMI's experiences. In the *sidebar*, I recount SMI's growth and performance.



**James Sebenius:** *Could you please tell me about SMI's main thrusts and approach to acquisitions?*

**Sergio Ceccuzzi:** SMI's business mainly involves the purchase and transformation of refined copper and scrap, not mining, raw material, or refining. Obviously, this business is very capital intensive. The Italian industry in the 1960s was composed of numerous small and medium-sized enterprises, quite unlike Kennecott or Anaconda in the United States, which were vertically integrated, often from mining through finished products. In formulating a fundamental strategy for growth, we at SMI made two basic decisions. First, we had to continue investing heavily in existing operations to ensure that we had the latest technologies and processes. Second, we had to grow through acquisition. We were *not* interested in growth by acquiring unrelated businesses in order to diversify; rather, we sought to acquire only firms that amplified our line of business.

We felt that no one knew our business better than we did — from our technology to our markets to our competitors. So we decided to employ advisers in our transactions only *after* we had directly approached the people on the other side — whom we typically knew well — and had negotiated a positive conclusion, at least in principle. Afterward, of course, the bankers and lawyers could craft an appropriate financial and legal structure to support the business arrangement we had already worked out. Often they added a great deal to the process, but we did not want to cede control of the negotiations to the merchant bankers. We wanted to call the shots until it was appropriate, nearer the end, for them to help.

## The "Delta" Acquisition

*Could you take me back to the late 1960s, when SMI was but one competitor among many in the Italian market?*



At that time, we faced a major competitor in the copper-transformation business — Finmeccanica, a nationalized conglomerate. It was losing its entire share capital each year — some 3 billion lira on sales of about 50 billion lira — and every year, it was replenished by the government. Finmeccanica's production volume and pricing policies were causing "storms" in the market. Yet, to mention privatization at that time in Italy was to go against all major political and ideological currents.

*So how did you proceed?*

The Finmeccanica chief executive naturally did not enjoy the continual losses from what, for the conglomerate, was a noncore business. Likewise, the Italian Treasury did not look kindly on continual losses that it had to replenish annually. So we decided to provisionally acquire Delta, Finmeccanica's copper transformation operation for a modest sum, invest heavily in it, and after three years, if it had reached break-even, we would acquire it for a previously agreed-on price.

*For Finmeccanica, then, the worst outcome would have been that it reacquired a firm in which substantial investments had been made?*

Yes, and the government would have been spared ongoing losses.

*That makes sense, but a similar argument could have been made about virtually any money-losing, publicly owned enterprise at the time. Why was this argument persuasive in your case?*

For more than five years before the agreement, SMI had publicly called attention to Finmeccanica's losses and the costs to Italian citizens of replenishing its share capital. Thus, even though Delta was not a quoted company, its dismal results were well known.

**"Our investment proposals enabled us to overcome the resistance of Delta's trade unions, which had been ideologically opposed to any privatization."**

Further, this was a noncore part of an industrial group; we proposed making investments in Delta that its parent company had not been making or was making ineffectually. Our investment proposals enabled us to overcome the resistance of Delta's trade unions, which, in the past, had been ideologically opposed to any privatization. Overall, our plan would bring improvements for both workers and management, not to mention the government's fiscal situation. In effect, these players eventually functioned as our allies.

SMI had a relatively apolitical image. Except for a very small defense business, the government was not one of our major customers — unlike the automobile, construction, or electronics businesses, which sold to the public sector and often were quite active politically. Our technical image and lack of political involvement sometimes hurt us here in Italy when it came to winning certain contracts, but in this case, our Delta proposal was seen as the right thing to do, both technically and managerially. And our big bet on Delta, embodied in the three-year formula, was by no means a sure thing.

## The TLM Acquisition

*Where did your acquisition strategy lead after the Delta transaction?*

We turned our attention to our other major Italian competitor, Trafilerie e Laminatoli di Metalli SpA (TLM). Before World War II, an Italian family had owned it. After the war, it became part of Tréfimétaux, the French company that was part of the Ugine Kuhlmann group owned by Pechiney, the huge French company with a dominant presence in aluminum.

*How did you approach TLM?*

Initially, instead of contacting TLM's parent corporations in France (Tréfimétaux and Pechiney), we approached TLM directly, proposing to the company's Italian/French management a merger of our firms, thus allowing both SMI and TLM to become more competitive in the Italian market. We had ideas for a strong restructuring that would lead to a more competitive combined entity. Of course, we knew the managers personally and felt that they understood both the market and the logic of the proposal. However, when we quietly raised the possibility, they were sharply divided. For one thing, we had been their competitors for decades, and naturally, they had seen us as the enemy. For another, an acquisition would almost certainly have led to the replacement of several of their senior managers.

*So where did you go from there?*

We approached Pechiney, not Tréfimétaux management, which would have opposed the idea strongly. Pechiney senior managers were interested, so we began discussions.

*TLM was the Italian subsidiary of Tréfimétaux, which, in turn, was the French copper subsidiary of Pechiney?*

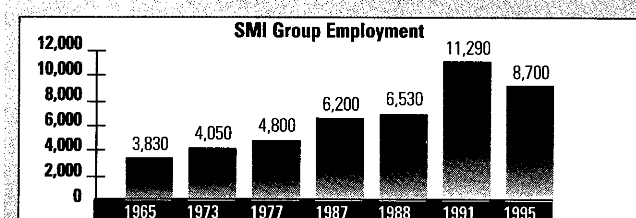


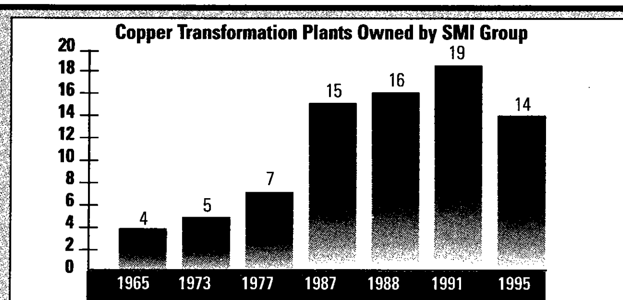
## SMI's Performance Record

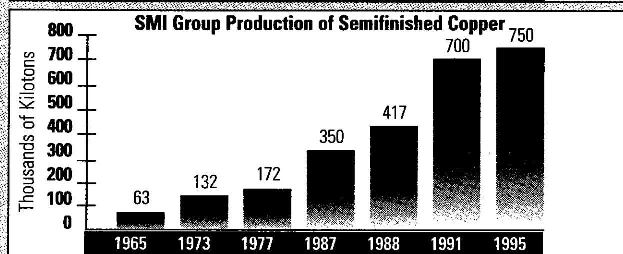
In making its acquisitions, SMI succeeded not only at negotiations, but also in folding acquired companies into its industrial group. Typically, SMI's major acquisitions have been followed by a gestation period during which SMI incurs short-term declines in profitability while absorbing and streamlining a newly consolidated competitor, after which the SMI group emerges larger and more profitable. When SMI acquired Tréfimétaux, the French company was suffering extensive losses. SMI invested heavily in the company and thoroughly restructured it. As a result, within three years, Tréfimétaux was producing significantly more semifinished copper with far fewer workers and had become the most profitable company in the SMI group, achieving a return on equity in excess of 15 percent in 1989.

The acquisition of Kabelmetal again evinced the long-term effectiveness of SMI's acquisition and rationalization strategy. In 1989, the year before the Kabelmetal acquisition, the SMI group as a whole achieved a return on equity of approximately 5 percent. With the acquisition, employment swelled from slightly more than 5,500 to over 11,000. The costs of absorbing such a large competitor were high, and the impact was exacerbated by widespread recession in Europe during the early 1990s. Nonetheless, SMI methodically adhered to its strategy, streamlining the combined operations, eliminating redundant assets and employees, and riding out short-term surges in costs to achieve long-term growth in profitability.

Between 1991 and 1995, SMI reduced groupwide employment from 11,290 to 8,700 workers while increasing annual output from 700,000 to 750,000 metric tons *(see the figures)*. At the same time, the company achieved a near fivefold improvement in groupwide return on equity, which rose from less than 2 percent to more than 9 percent.




SMI is continuing its consolidation strategy with a mixture of Italian, German, and French management. In 1993, still top-heavy after acquiring Kabelmetal, the SMI group lost US $80 million but implemented major restructuring. The streamlined group, which SMI folded into the new intermediate holding company, KM Europa Metal AG, became Europe's main producer of semifinished copper and copper alloy products, accounting for more than 30 percent of European output, double that of nearest rivals, Outokumpu of Finland and Wieland Werke of Germany. Operating fourteen plants across Europe in 1995, the SMI group earned net income of $13.3 million on sales of slightly more than US $3 billion *(see table)*, and in mid-1996, the positive trend continued.

**KM Europa Metal AG: Financial, Production, and Employment Statistics (1995)**

| | Sales (Millions of US$) | Percentage of Group Sales | Percentage of European Output by Weight † | Number of Employees |
|---|---|---|---|---|
| Europa Metalli* | $749 | 24% | NA | 1,976 |
| Kabelmetal | $1,425 | 46% | NA | 4,556 |
| Tréfimétaux | $789 | 26% | NA | 2,132 |
| S.I.A. Santa Barbara | $128 | 4% | NA | 38 |
| KM Europa Metal AG | $3,092 | 100% | 29.3% ‡ | 8,702 |

*Europa Metalli includes La Metalli Industriale (LMI) and other SMI subsidiaries in Italy. Restructuring the group was effected in June 1995. Results for Europa Metalli in its subsidiary role during 1995 exist only for 1 July 1995 through 31 December 1995. Data in the table reflect an extrapolation of these results to cover the entire year.

†Production of semifinished copper and copper alloy products (excluding copper conductor).

‡15.0% of world output.