

campus

Farsam Farschtschian

Abandoning  
the Myth of  
**Board Influence**

The Secret  
of Successful  
Acquisitions

edition

MALIK

The Secret of Successful Acquisitions

*Dr. Farsam Farschtschian* is an Investment Advisor at Morgan Stanley in London, covering German speaking Europe. He holds a PhD degree in Business Administration from the University of St. Gallen and is a Research Associate at its IFPM Centre of Corporate Governance. Farsam Farschtschian first wrote about his empirical findings in his thesis *The Role of Boards in Directing and Controlling Acquisitions* in 2010. Previously, he studied at the Universities of Geneva and Berkeley and holds a Master's degree in Political Science with a focus on International Relations.

Farsam Farschtschian

# The Secret of Successful Acquisitions

Abandoning the Myth of Board Influence

Campus Verlag  
Frankfurt/New York

© Campus Verlag GmbH

ISBN 978-3-593-39438-1

Das Werk einschließlich aller seiner Teile ist urheberrechtlich geschützt.  
Jede Verwertung ist ohne Zustimmung des Verlags unzulässig. Das gilt  
insbesondere für Vervielfältigungen, Übersetzungen, Mikroverfilmungen  
und die Einspeicherung und Verarbeitung in elektronischen Systemen.

Copyright © 2011 Campus Verlag GmbH, Frankfurt am Main

Umschlaggestaltung: Guido Klütsch, Köln

Satz: Fotosatz L. Huhn, Linsengericht

Druck und Bindung: Beltz Druckpartner, Hemsbach

Gedruckt auf Papier aus zertifizierten Rohstoffen (FSC/PEFC).

Printed in Germany

**© Campus Verlag GmbH**

*For my parents*



# Contents

German preface for editionMALIK . . . . .	9
Preface by Helmut Maucher . . . . .	11
Acknowledgements . . . . .	13
 <b>1. From Abandoning the Myth to the Required</b>	
<b>»Leadership Environment«</b> . . . . .	15
1.1 Abandoning the Myth . . . . .	15
1.2 Required »Leadership Environment« . . . . .	16
1.3 Two Polar Opposite Key Case Studies: an Introduction . . . . .	17
 <b>2. The Key Facts of Corporate Governance</b> . . . . .	18
2.1 Introduction to Corporate Governance . . . . .	18
2.2 An Agency Perspective . . . . .	19
2.3 Whose Interests Are Served? . . . . .	20
2.4 A Third Approach . . . . .	22
2.5 Boards of Directors Come into Play . . . . .	24
 <b>3. The Key Facts of M&amp;A</b> . . . . .	32
3.1 Developments in M&A Analysis . . . . .	35
3.2 Approaches to Acquisition Success . . . . .	40
3.3 Normative Approach to M&A: Peter Drucker's Acquisition Success Factors . . . . .	43
 <b>4. Prime Examples of Good and Bad Acquisition Management</b> . . . . .	51
4.1 Board Management Background of the Case Studies . . . . .	51
4.2 Important Background Information about the Case Studies . . . . .	53
4.3 Remarks about the Period of Focus in the Two Case Studies: the Era of Chairmen During the Period of Acquisitions . . . . .	54
4.4 Best Case Scenario: Nestlé . . . . .	54
4.5 Worst Case Scenario: Swissair . . . . .	86



<b>5. Lessons Learned About an Optimal</b>	
<b>»Leadership Environment«</b> . . . . .	110
5.1 Comparing Nestlé and Swissair Acquisitions Using Drucker's Framework . . . . .	110
5.2 Creating an Environment that Enables the Acquisition Principles to be Successfully Implemented: A Comparative Analysis of the Case Study Boards . . . . .	128
<b>6. Twelve Best Practice Recommendations for Boards</b> . . . . .	135
6.1 Creation of a »Leadership Environment« Which Enables the Acquisitions Principles to be Fulfilled . . . . .	135
6.2 A Dynamic Board-Management Relationship . . . . .	146
6.3 Summary . . . . .	151
<b>7. Conclusion</b> . . . . .	153
7.1 Outlook: The Changing Nature of M&A . . . . .	153
7.2 Current Corporate Governance and Future Challenges . . . . .	157
Discussion Partners . . . . .	163
Bibliography . . . . .	165
Index . . . . .	177

# German preface for editionMALIK

Die alte Welt vergeht,  
weil eine neue Welt entsteht.

Wirtschaft und Gesellschaft gehen durch eine der tiefgreifendsten Umwandlungen, die es geschichtlich je gab. Als Begriff wählte ich 1997 dafür »Die Große Transformation«, denn bereits damals war das Ausmaß des herausziehenden epochalen Wandels deutlich zu sehen. Was heute lediglich als eine finanzielle und ökonomische Krise zu eng gesehen wird, kann weit besser als die Geburtswehen der neuen Welt des 21. Jahrhunderts verstanden werden.

In dieser neuen Welt werden Organisationen eine höhere Ebene des Funktionierens erreichen. Sie werden doppelt so gut wie bisher funktionieren, aber nur die Hälfte des Geldes dafür benötigen. Die universelle Herausforderung wird für sie das Meistern von bisher noch nie erfahrener Komplexität durch neues Management sein.

Geld ist dafür aber weit weniger wichtig als Intelligenz, Vorstellungskraft, Information, Kommunikation und Gestaltungswille. Das neue Wissen hierfür und darauf gestützt neue, biokybernetische Lösungen sind bereits da. Deren Kern sind die \*Evolutionären Naturgesetze aus Kybernetik und Bionik für das Selbstorganisieren und Selbstregulieren. Diese Gesetze zu verstehen und sie zu nutzen ist das neue Kapital der neuen Welt und die Grundlage für Leadership von Personen und Organisationen.

Die editionMALIK ist die Plattform für das zuverlässige Funktionieren von Organisationen in der hochkomplexen Umwelt des 21. Jahrhunderts. Sie ist die systemische Orientierungs- und Navigationshilfe für Leader, die den Wandel vorausdenken und -lenken.

*Fredmund Malik*  
St. Gallen, Januar 2010

Über Malik sagt der Doyen des Managements, Peter F. Drucker:

»Fredmund Malik has become the leading analyst of, and expert on, management in Europe as it has emerged in the last thirty years – and a powerful force in shaping it ... . He is a commanding figure – in theory as well as in the practice of management.«

# Preface by Helmut Maucher

Farsam Farschtschian's analysis of M&A and the board of directors' evolving responsibilities addresses the subject in a way that has never been done before.

Studies of M&A typically only take strategy, objectives and the related roles and actions into account. To date, these studies have not considered the way in which the board and management cooperate on these questions or the division of their roles and responsibilities. He illustrates, in a very striking way, the difference between the way in which legislation views these roles and the reality, and what should, practically, be done. In this way, Farsam Farschtschian has identified a crucial gap in current research.

Mr. Farschtschian's analysis demonstrates that today's business world is becoming progressively more diverse, there are not only clear so-called traditional acquisitions, but new diverse forms are emerging in the shape of co-operations, joint ventures, alliances, participations and so on. This, in turn, implies new forms of corporate governance and organisational structures, which he argues require, to a certain extent, different qualities in top managers. He also explores the elements of a productive leadership environment created through board-management interactions, which differ according to the firm's structure and the quality and philosophy of the CEO.

I believe that this analysis is, in many ways, highly original. Farsam Farschtschian's work is greatly enriched by the detailed depiction of the reality of top management's work in the context of M&A and by the exploration of how experienced business leaders think about these matters and have dealt with them.

This book deserves a broad readership and I hope that many managers dealing with such matters benefit from this research.

*Dr. h.c. Helmut Maucher  
Honorary Chairman of Nestlé*



# Acknowledgements

First and foremost, I would like to thank Prof. Dr. Martin Hilb and Prof. Dr. Fredmund Malik at the University of St. Gallen. Their contribution to my understanding of the board room was critical to my work.

It is not matter of course that internationally renowned business leaders who shaped some of today's most successful multinational companies showed interest and committed their time and knowledge to this book. In particular, I would like to thank Dr. h.c. Helmut Maucher. He made this work possible, practical and, most importantly, relevant in the context of the changing face of leadership and corporate governance in the 21<sup>st</sup> century. Many of his ideas on leadership informed the conclusions of this work.

I am also very grateful to board directors who gave me access to unique company sources that are selectively incorporated in this book. I would especially like to acknowledge the contributions of Philippe de Weck, Bruno de Kalbermatten and Dr. h.c. Fritz Gerber. In addition, Dr. h.c. Thomas Thomas Schmidheiny's valuable insights, along with contributions from other senior executives, lawyers and academics enriched my research markedly.

I would like to thank Ms. Deirdre Mullins. Her contribution was beyond editorial, and her critical questioning of my arguments made her an indispensable resource.

Finally, I would like to thank my team and colleagues at Morgan Stanley. Their support along with many discussions over the last couple of years was vital to completing this book alongside my daily professional duties.

*Dr. Farsam Farschtschian  
London, 2011*



# 1. From Abandoning the Myth to the Required »Leadership Environment«

## 1.1 Abandoning the Myth

Acquisitions are one of the most important business activities that a company conducts: they represent the most visible part of firm strategies, and as a complex phenomenon, they are proof of companies' capabilities and ultimately of leadership. At the same time, they are one of the most risky strategic manoeuvres. Despite the fact that acquisition success factors are known, the majority of acquisitions still fail. Surprisingly, there are still no adequate theories to explain this phenomenon, despite the tremendously negative impact of these failures and the vast amount of academic and practical research on M&A.

Some supporting *structural management elements* must be lacking therefore. Either the board or the management body must not be functioning properly, and hence their interaction is not optimised. In other words, the »*leadership environment*«, in terms of the company's orientation, TMT structure, power relations and interaction, is not facilitating successful acquisition. In order to change this, the vital question, therefore, is »*Who is responsible for creating this environment*«?

Prima facie, the board of directors.

Backed by academic research illustrating the board of directors as the highest governing authority within the management structure with ultimate, overall responsibility for the management of the company's business, my analysis began by looking at the role of boards in acquisitions.

But as a result of many discussions with business leaders who have created some of today's leading multinational companies, I discovered that literature with regard to boards' roles was largely inadequate and *counter-intuitively* boards were not, in practice, as significant to the acquisition process as initially presumed despite their status in the law and emphasis in corporate governance.



Indeed, considering the board's theoretical importance perhaps the most surprising thing about all of this is that the role of boards of directors in acquisition has barely been researched to date. Instead, most work concentrates on generating key acquisition success factors without concomitantly touching upon *the necessary leadership environment that enables effective implementation of these factors*.

## 1.2 Required »Leadership Environment«

As a result of this insight, my analysis shifted to the top management team (TMT) as a whole, which includes the board and the CEO with his team. This enables a holistic perspective of how acquisitions are run and should be run *as an extension of a constructive leadership environment*.

In order to identify the key conditions for this, I carried out extensive qualitative field work and analysed two specific case studies in depth. Peter Drucker, as a management thinker widely accepted and recognised by academics and foremost practitioners, established six principles for successful acquisition. These are used to analyse the way in which the board and the management interacted in their relative fulfilment of each of these six acquisition principles, which ultimately allowed to qualify the leadership environment.

In this way, this book aims to make a significant contribution to practice by striving to provide boards and managers with tools enabling them to perform more effectively within acquisitions, ultimately leading to higher acquisition success rates<sup>1</sup>.

---

1 From a stock market perspective and building on my professional background, time and time again, history has clearly demonstrated that companies with good management, where management adopt a long-term approach, deliver superior returns to their shareholders. Nestle is an outstanding example of the beneficial impact that long-term strategic management can have on shareholder returns, delivering nearly 70 % share price outperformance relative to world markets over the last 10 years. Despite the evidence, analysts and investors frequently ignore this factor when making investment decisions, instead preferring to rely on short-term valuation and earnings momentum factors. This is arguably a key reason why these decisions frequently prove to be wrong.

### 1.3 Two Polar Opposite Key Case Studies: an Introduction

In order to do this, two cases are explored in this book, *Nestlé* and *Swissair Group*, as polar opposite examples. Nestlé's acquisition strategy, under the leadership of its long-standing chairman and CEO, Helmut Maucher, was highly successful not only in terms of acquiring companies, but also in their integration into the whole organisation. In contrast, the Swissair Group experienced the most dramatic bankruptcy in Swiss economic history as a direct result of its acquisition strategy.

Despite the current trend and bias towards quantitative lead research, it would be a scientific and methodological miscomprehension to believe that empirical research has to consist of mainly numerical quantification. In order to analyse the complex human relationships involved in board-management interaction, the qualitative method is a more appropriate approach in terms of its explanatory power. Hence, I made an attempt in this book to identify which board-management relationships positively contribute to a leadership environment that enables good acquisition results with the goal of proposing best practices in acquisitions for boards of directors.

Moreover, as the case studies will reveal, *the reality is markedly different to the theory of corporate governance in terms of the board-management relationship*. This raises fundamental questions about whether current corporate governance adequately reflects the reality of today's business world and the current structural transformations resulting from new types of business practices and methods (this is the subject of the outlook chapter of this book).

## 2. The Key Facts of Corporate Governance

The Cadbury Report, which is a Code of Best Practice formally entitled »The Report of the Committee on the Financial Aspects of Corporate Governance«, published in December 1992, was the first report aiming to improve corporate governance. The committee defined corporate governance as »the system by which companies are directed and controlled«. The Report presents recommendations for the executive directors, non-executive directors, and those responsible for reporting and control.

Corporate governance aims to discover what constitutes fair regulation of the power balance between a company's board and management. While corporate governance defines the roles of boards and recommends ways to actively animate them, it does not analyse their role in the face of a decisive kind of event such as M&A. This gap in the literature is reflected in the codes of corporate governance where there is no provision for dealing with acquisitions.

While TMT in literature often relates to the chief executive and his management team, for the purpose of this book TMT includes both the executive management body of a company as well as the board of directors.

### 2.1 Introduction to Corporate Governance

To understand the duties of a board of directors, it is important to contextualise the emergence of the board of directors as a controlling body, in the broader corporate governance discussion.

The subject of corporate governance has been discussed in literature for a long time. Debate most likely began with the emergence of larger corporations in which, for the first time, ownership no longer coincided with management and disunion between the owners and managers in organisations led to a principal-agent situation (»agency theory«). In the late 18th century, control over resources was thus transferred from owners to managers.