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**WALKING AWAY FROM THE PRE-
ACQUISITION PHASE**

Master's Thesis
in International Business

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1 INTRODUCTION

1.1 Amplitude of mergers and acquisitions

In 2004 approximately 30,000 acquisitions were carried out all over the world – that is to say, one acquisition took place every 18 minutes (Cartwright & Schoenberg 2006, S1). An implicit assumption is that with the assistance of merger and acquisition activities more value is created than either through organic growth or through other internationalization strategies (De Mattos, Salciuviene & Pugliese 2008, 247). Despite the fact that the world is undergoing the consequences of the financial and credit crisis, it is suggested that in 2010 one out of five companies is planning to acquire a business with sales of more than EUR 500 million (Kronimus, Roos & Stelter 2009). In 2007 before the crisis, the value of cross-border mergers and acquisitions reached its new peak; the proportion of these was 21 percent higher than in 2000 when the previous record was witnessed (World investment report 2008, xv, 5–6). Furthermore, the magnitude of mega-deals¹ has enhanced the peak and they accounted for a third of the total value of mergers and acquisitions in 2006 (Mergers & acquisitions... 2006, 1). De Mattos et al. (2008, 247) conclude that the increase both in the value of and in the number of mergers and acquisitions is mainly due to the competitive pressures for globalization, and it is enhanced by the liberalization of markets.

History has shown that mergers and acquisitions occur in cyclical waves (Whittington & Bates 2007, 39). In 2006 it was still stated that a slowdown both in the economy, unstable stock markets, problems in lending markets and overleveraged deals could be the turning point of merger and acquisition activity (Mergers & acquisitions... 2006, 6–7). Accordingly, in the newest World investment report (2009, 3) it is revealed that the current financial and credit crisis has had a huge effect on foreign direct investments. Both the value and scope of cross-border mergers and acquisitions, which is the most popular method of foreign direct investments both in developed countries and gradually also in developing countries, have decreased owing both to falling corporate profits and to unsteady stock prices. It is obvious that the current crisis has caused liquidity problems for the companies in developed countries (World investment report 2008, xv, 5–6). Furthermore, companies have delayed their investments, regardless of whether they are made either in the form of a greenfield investment or in

¹ The combined value of a deal is more than USD 10 billion (Mergers & acquisitions... 2006, 1)

the form of an acquisition (World investment report 2009, 3)². However, it is suggested that the situation can also be seen as a normalization and a turn to a more sustainable and stable situation (World investment report 2008, xv, 5–6; Mergers & acquisitions... 2006, 7). In addition, a slow recovery in the statistics of foreign direct investments is expected to take place as early as in 2010 and the acceleration in 2011. Kronimus et al. (2009, 2) even state that the upswing of merger and acquisition activities is going to be considerable in 2010 even though it will not amount to the same levels than in 2006 and 2007. For developing countries the global crisis has also brought possibilities. For example, the Chinese energy companies are exploiting low asset prices and they are continually searching for new acquisition targets abroad. (World investment report 2009, 3, 24.) Consequently, the year 2008 was the record year of acquisitions carried out by emerging market³ acquirers (Going West... 2009, 1). As expected, this also results in an increase both in cross-border deals and in cross-border negotiations (De Mattos et al. 2008, 247).

Despite both the huge value and considerable numbers presented in the statistics only less than one quarter of mergers and acquisitions achieve their targets and goals. Typical goals are, for example, an increase both in share value, in return on investment and in profitability after the transaction. Nevertheless, the decisions concerning mergers and acquisitions are unfortunately often characterized both by an overestimated price, a poor evaluation of a target and wrong assumptions underlying the appropriateness of the time for this kind of action. (Marks & Mirvis 2001, 80.) Furthermore, Pack (2002, 153) points out that conversations concerning merger and acquisition failures should be considered closely because the concept ‘failure’ is frequently understood to mean the results not achieved instead of a formal breakdown of the process. It is worth noting that even if the year 2007 represented a peak in merger and acquisition activities, there has never before been such a great number of walk-away attempts from these transactions (Aquila 2008, 3–4). Despite this statement, Haspeslagh and Jemison (1991, 5) draw attention to the fact that the aspects of these disappointing acquisitions are only rarely discussed directly.

The companies which have carried out successful acquisitions are characterized among other things by the following factors: they have experienced deal teams, they always set a walk-away price and they are prepared to walk away from a deal if it is no longer sensible. The walk-away price refers to the highest acceptable price which an acquirer is willing to pay for a target. After the price exceeds this predetermined level,

² Greenfield investment refers to an establishment of operations from the start without purchasing already existing operations and to grow from there. On the contrary, both a merger and an acquisition refer to growing by purchasing already existing operations or parts of them. (Boeh & Beamish 2007, 399.)

³ In emerging markets are included both countries and regions with high growth economies, for example, India, China, Russia, CIS, Latin America and Central and Eastern Europe (Going West... 2009).

the acquirer should leave the negotiation table. (Cullinan, Rovit & Tymms 2003, 181–182.) Nevertheless, Cullinan, Le Roux and Weddigen (2004, 97) comment that after an exhaustive analysis and evaluation of the target company, the deal is difficult to resist. The money and time which have already been invested in only hinder this decision. In a study of Bogan and Just (2009, 938–942), a similar view is expressed: it is more an exception than a rule that the executives would change their mind during the acquisition process.

Unsurprisingly, the high failure rates signify the riskiness of merger and acquisition activities. Accordingly, Pablo, Sitkin and Jemison (1996, 724–725) discover that the acquisition process is closely connected to the concept of a risk. The risk affects not only the acquisition outcome but also the other stages of the acquisition process. The scholars state that, for example, both the non-routine nature of the acquisition for most of the companies, the speed of the decision-making process, the limited access to information, and debates and negotiations are all sources of uncertainty and unpredictability. Furthermore, according to Hitt and Pisano (2004, 49), if the implementation of a successful merger or acquisition between the domestic firms is difficult, there is no doubt that the cross-border nature of a deal brings even more challenges with it. For example, both cultural differences, overcoming the liability of foreignness, institutional distances, and capacity to learn and adapt new are all challenging factors. In consequence, in particular the executives' attitudes towards the risks of acquisitions play a crucial role in managerial behaviour underlying the acquisition decisions (Pablo et al. 1996, 724–725).

Therefore, both in order to overcome this riskiness of mergers and acquisitions and in order to guarantee the deal completion, the acquisition parties have introduced the use of termination fees. With the assistance of termination fees and other kinds of indemnities, one of the parties tries to make sure that if one walks away from the deal or if due diligence reveals something unpleasant, the other must pay a break-up fee in order to cover the costs occurred (Wilkinson 2007a, 181–182). Both in a study of Bates and Lemmon (2003, 469–471) and in a study of Officer (2003, 431) it is noted that the probability of the deal completion increases with the usage of termination fees. There seems to be slight confusions about the utilization of termination fees but according to André, Khalil and Magnan (2007, 564), who study in particular Canadian targets between 1997 and 2004, all deals nowadays include termination fees except hostile deals and deals in which the acquirer has a major control⁴.

⁴ For example, Officer (2003) shows smaller utilization percentages than André et al. (2007). Nevertheless, the differences are due to different databases as the Thomson Financial Securities Data's SDC Platinum™ *Worldwide Mergers & Acquisitions Database* employed by Officer (2003) underestimates the extent of termination fees (André et al. 2007, 544).

1.2 Previous research and research gap

Mergers and acquisitions are not a new phenomenon at the academic research field; they have been a subject of several studies for over 30 years (see, for example, Bogan & Just 2009; Sebelius 1998; Jemison & Sitkin 1986). Despite this huge interest in the topic, the failure rates of mergers and acquisitions seem to be as high as before. (Cartwright & Schoenberg 2006, S4.) Marks and Mirvis (2001, 80) explain this by arguing that mergers and acquisitions are extremely difficult topics to analyze. Nevertheless, Boeh and Beamish (2007, xi) insist that when considering both the value of cross-border mergers and acquisitions, which is approximately one third of the total number and value of deals, and the rate of globalization, it is crucial to continue the discussions on the phenomenon.

So far the studies have focused both on financial (see, for example, Angwin 2007; Officer 2003), strategic (see, for example, Bower 2006; Marks & Mirvis 2001), behavioural (see, for example, Bogan & Just 2009; Ang, Cheng & Nagel 2008), operational (see, for example, Wilkinson 2007a; Cullinan et al. 2004) and cross-cultural (see, for example, Fang, Fridh & Schultzberg 2004; Erkkilä 2001) aspects of mergers and acquisitions, and on the question of how to manage problems arising from these aspects (Cartwright & Schoenberg 2006, S1–S4). Very and Schweiger in turn (2001, 12–14) observe that there are studies both on the fit of two companies, on the structure of the deal, and on the hostile nature of the deal in addition to other financial, organizational and strategic issues. Haspeslagh and Jemison (1991, 338–339) point out that the most visible research stream is the financial research which concentrates on the question of whether an acquisition creates value or not. The strategic research stream addresses the question of strategic fit, and the stream of organizational behaviour analyzes both cultural differences, organizational constraints, and implementation problems. Nevertheless, Cartwright and Schoenberg (2006, S1–S4) point out that the failure rates of mergers and acquisitions cannot be explained solely by ‘the unsuitability of strategic fit’; nor does the knowledge of how the outcome of an acquisition can be affected by different integration approaches guarantee success. Nevertheless, it is generally agreed that unsuccessful decision-making, negotiation and integration processes lead to unwanted outcomes.

Negotiations and their problems are a popular research topic among the organizational and behavioural academics (see, for example, Hendon, Hendon & Herbig 1996; Dupont 1991). According to Saorín-Iborra (2008, 285), acquisition negotiations are recognized as a crucial stage in the acquisition process because these can have an effect both on the post-integration stage and on the implementation of the strategy. So far the emphasis of the studies concerning acquisition negotiations has been placed on the outcome of the negotiations. For example, the effects of culture (see, for example,

Beaufort & Lempereur 2003), time pressure (see, for example, Angwin 2001), experience (see, for example, Erkkilä 2001), and power relationships (see, for example, Wilkinson 2007a) during the negotiation phase have been studied. (Saorín-Iborra 2008, 285–286.) Reynolds, Simintiras and Vlachou (2003, 248) express the opinion that within the negotiation literature two aspects may be distinguished: on the one hand, there are the empirical studies which emphasize the negotiation outcomes and, on the other hand, there are the non-empirical studies which focus on the cultural factors. These scholars conclude that the research is in general fragmented and a-theoretical. De Mattos et al. (2008, 247, 249) express a similar view by stating that acquisition negotiations have received little attention despite the fact that they are vital for a company's successful business, and that the importance of the pre-negotiation phase is generally agreed but the underlying literature is frequently prescriptive, that is to say, giving a list of major points. Furthermore, Ang et al. (2008, 7) report that regardless of the fact that the deal-making ability is 'a traditional folklore at Wall Street', it has gained little academic validation. However, an important exception is the study of Fang et al. (2004) concerning the termination of Telia-Telenor merger negotiations. In conclusion, De Mattos et al. (2008, 247) argue that by understanding the negotiation process, the outcomes of mergers and acquisitions could be improved and, thus, the failure rates could be decreased.

Pablo et al. (1996, 723) show that the major contributions of the finance and strategic management research fields to the merger and acquisition literature are noteworthy. Similarly, in a study of Haleblan, Devers, McNamara, Carpenter and Davison (2009, 471, 494) it is indicated that it is the management and finance aspects which have been the most visible categories within the published acquisition literature since 1992. These scholars draw attention to the fact that these two schools focus on different sides of the same coin, generally with different research approaches. In addition, Very and Schweiger (2001, 12–14) find that there is a lack of empirical studies both on the acquisition process itself and on the challenges faced even if the importance of the process is acknowledged. Therefore, according to Cartwright and Schoenberg (2006, S4), there is still a lack of research pooling the acquisition performance models discussed in the finance and strategy fields with the human and organizational aspects analyzed in the behavioural field. It is argued, thus, that more cross-disciplinary integration would be valuable (Haleblan et al. 2009, 494; Angwin 2007, 408). In other words, the process and organizational aspects of mergers and acquisitions should also be emphasized.

The option of terminating the acquisition process and of walking away from the deal is mentioned briefly by some scholars (see, for example, Morrison, Kinley & Ficery 2008; Cullinan et al. 2004; Cullinan et al. 2003; Jemison & Sitkin 1986). The study of Very and Schweiger (2001, 18–21) discusses general problems associated with the

acquisition process and points out that certain of them can also be called as ‘deal-killers’. Nevertheless, their study is more focused on the learning possibilities deriving from these problems and the emphasis is on all phases of the acquisition process. There are also studies (see, for example, Going West... 2009; Kronimus et al. 2009) on general challenges and obstacles for mergers and acquisitions but they are always discussed as unfortunate possibilities without noting their role as actual deal breakers. Therefore, this research is limited to narrower phase of the acquisition process and the focus is on terminated acquisitions.

1.3 Purpose of the study

The purpose of the study is *to understand acquirers’ walk-away⁵ actions from the pre-acquisition phase and the factors underlying this procedure*. The sub-objectives are: (1) to describe in which stage of the pre-acquisition phase acquirers can still walk away, (2) to explain the reasons for these walk-away actions, and (3) to describe how acquirers prepare for possible deal breakers and walk-away actions. It is a fact that a firm has invested a considerable amount of money in the acquisition before the final transaction contract is even signed. However, sometimes for example due diligence can reveal problems which make it pointless to carry on the acquisition process any longer. Therefore, the purpose is to analyze what kind of problems can force the executives to forget the costs already incurred and, thus, what kind of problems can be regarded as deal breakers. Moreover, it is discussed in the study when this termination is most likely to be executed and whether companies prepare for it in advance. Figure 1 represents the combination of the fields which are taken advantage of and which, at the same time, act as a basis for the formation of the theoretical framework of this study.

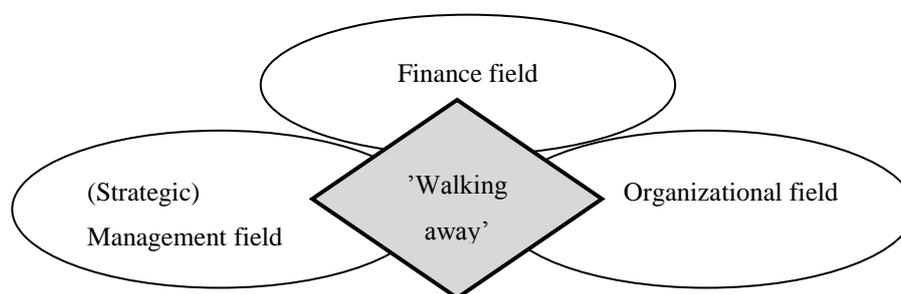


Figure 1 Fields of research employed in the study

⁵ The concepts ‘to walk away from the deal’, ‘to terminate the pre-acquisition phase’, and ‘the breakdown of the pre-acquisition phase’ are used interchangeable in the discussions (see, for example, Bernstein 2008; Morrison et al. 2008; Cullinan et al. 2004; Bates & Lemmon 2003). Therefore, these are used as synonyms also in this study even though it can be argued that minor nuances of meaning exist.

Figure 1 expresses the fact that mergers and acquisitions can be studied only rarely with the assistance of one academic discipline. In order to build up the theoretical framework of this study, different fields of academic research must be exploited. Firstly, with the assistance of the management literature the process perspective of mergers and acquisitions can be discussed. Secondly, the finance literature is required in order to reveal the disciplines both behind the valuation of the target company and behind the determination of the walk-away price. Thirdly, the organizational literature gives insights to acquisition negotiations. Because there is no theory of ‘acquisition failures’ the theoretical framework is built on acquisition challenges which are interpreted to have a possibility of leading the acquisition process to the termination.

Even though the whole acquisition process is discussed shortly in the chapter 2.2 in order to give a comprehensive view on the acquisition, the focus is on the pre-acquisition phase and, even more precisely, on the process occurring from the acquisition negotiations to the announcement of the deal. This is because if a company decides to walk away from the deal during the post-acquisition phase, it is a question of totally another type of a transaction, namely a divestiture⁶. Figure 2 clarifies the interfaces of this study.

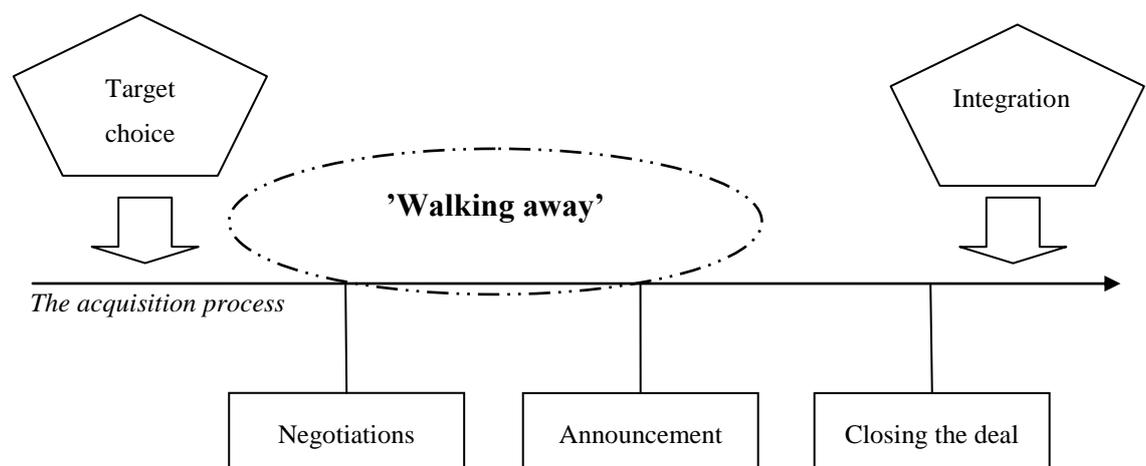


Figure 2 Interfaces of the study

Figure 2 illustrates the acquisition process and the ellipse describes the scope of the research within it. Accordingly, it can be seen that the problems faced in the phase of the target selection are not subject of this research. For example, delaying the acquisition process because there is no suitable target at sight is not yet considered as a walk-away action. Accordingly, Pablo et al. (1996, 734) demonstrate that *the final choice of the company to be acquired is followed by a pre-acquisition phase which*

⁶ Divestiture is used to refer to the sale of a part of a company. It can refer, for example, to the sale of a business unit, asset, product line and so on. (Angwin 2007, 427.)

involves, for instance, due diligence and negotiations. These aspects are discussed among other matters in the following chapters. Furthermore, the possibilities of walking away are not analyzed further than until the announcement of a deal. Aiello and Watkins (2000, 105) note that acquisition processes can break down also between the final agreement and the closure of the deal⁷. However, deal breakers discovered between these stages are not discussed because after the signing of the final transaction contracts, it is generally the competition authorities and regulatory issues which can break off the acquisition deal. Thus, the acquirer is not able to make the walk-away decision voluntary.

Picot (2002a, 18) reports that merger and acquisition transactions proceed only rarely according to some fixed rules. Consequently, this thesis is not limited to any transaction type, for example, either to an auction or to a bilateral negotiation situation. This is common among the merger and acquisition literature because several scholars frequently note and explain these types shortly without scrutinizing them more carefully (see, for example, Wood & Stevenson 2007, 168; Blomquist, Blummé, Lumme, Pitkänen & Simonsen 2001, 10–13; Aiello & Watkins 2000, 102). In addition, Erkkilä (2001, 66–67) shows that particularly in cross-border deals auctions are popular. Relating to this, the findings of the research are applicable both to domestic and cross-border deals. Furthermore, the research is not limited to any line of business because in general it can be argued that, for instance, the pre-acquisition phase in the electronics or in the food industry does not vary substantially. On the contrary, it is the expertise of the employees involved in mergers and acquisitions which is more notable to the research. Nevertheless, the thesis is limited only to the acquirers' points of view.

This study is not conducted in order to be able to compile an inclusive list of the challenges in the pre-acquisition phase or neither does it try to explain what is typical or untypical for successful mergers and acquisitions. Moreover, the purpose is not to find out how companies can either avoid or overcome these deal breakers. On the contrary, the purpose is to collect empirical, objective evidence supported by theoretical considerations. Most importantly, Very (2009) stated during his guest lecture at Turku School of Economics that merger and acquisition literature is in a lack of both research of actual company issues and research of people's actual behaviour during the deal preparation, negotiation and integration. Accordingly, this study is concerned exactly with actual company issues.

In order both to demonstrate and to guarantee the logic of the study, operationalization chart is taken advantage of. This operationalization chart is described in table 1.

⁷ Closure of the deal is understood to mean the same as the transfer date of assets (Picot 2002b, 97).

Table 1 Operationalization chart

Purpose of the study			
Understanding of acquirers' walk-away actions from the pre-acquisition phase and the factors underlying this procedure			
Sub-objectives	Theoretical framework, concepts and themes	Interview themes	Results
To describe in which stage of the pre-acquisition phase acquirers can still walk away	2.2, 2.3, 2.4, 3.1 pre-acquisition phase, preliminary agreements, due diligence, valuation	2, 3	5.1
To explain the reasons for these walk-away actions	2.3, 3.2 due diligence, purchase price, pitfalls in negotiations	3, 2	5.2
To describe how acquirers prepare for possible deal breakers and walk-away actions	3.3, 2.3.2 termination fees, indemnities walk-away price, preparation in advance	4	5.3

After the introduction, *chapter two* begins with a discussion on the acquisition process in general. Next the emphasis is shifted more to the specific phases of the process, namely to due diligence and to the valuation of a company (see also the concepts and themes stated in table 1), and to their resonance for the termination of the pre-acquisition phase. In addition, the typical documents of the pre-acquisition phase are explained shortly. *Chapter three* begins with a discussion on the possible deal breakers which might exist during acquisition negotiations. After this, the practices used in order to prepare for possible deal breakers are introduced. The theoretical part is concluded with a synthesis. As it can be seen in table 1, the grouping of chapters, concepts and themes into the boxes of the sub-objectives is overlapping to some extent. Furthermore, *chapter four* describes the conduction of the research. Relating to this, the interview framework can be seen in appendix 1. The main findings are discussed in *chapter five*, and the chapter follows the categorization of the sub-objectives of the study. Finally, in the *last chapters* the main conclusions are presented and the summary condenses the research.

2 ELEMENTS OF MERGERS AND ACQUISITIONS

2.1 Concept of mergers and acquisitions

According to Jagersma (2005, 14) *an acquisition* refers to a situation in which two companies of different sizes and different qualities combine. Morrison (2006, 406) in turn states that an acquisition is a situation in which a stronger company takes over a weaker company. Bruner (2005, 1) concludes that an acquisition is simply a purchase. On the contrary, *a merger* refers to a combination of equal firms, and the process is executed unanimously between the corresponding firms (Welch 2009, 877; Jagersma 2005, 14). Erkkilä (2001, 22) draws attention to the fact that in a merger, neither one of the parties is buying another. More importantly, it is more about combining, in other words, merging and consolidating the two organizations (Bruner 2005, 1). This merging can result either in a new or in an already existing legal entity (Picot 2002b, 102). A *cross-border merger and acquisition* refers to the situation in which an acquirer and a target are from different countries (Jagersma 2005, 14).

Clearly, as described above, there are different shades of meaning underlying the discussions on mergers and acquisitions. Nevertheless, Bruner (2005, 1) comments that when it comes to the economic impact of mergers and acquisitions, these relatively minor controversies can be overlooked. Similarly, Parvinen and Tikkanen (2007, 763) discover that mergers and acquisitions can be studied as a single concept because they have quite similar effect on an organization. Consequently, in practice the boundaries of these terms have become blurred, and they are used as referring to the same phenomenon (Welch 2009, 877; Angwin 2007, 385). For example, Boeh and Beamish (2007, 146) suggest that there are only different kinds of mergers and, thus, these scholars do not even use the word ‘acquisition’ at all. Furthermore, in many other languages there is no similar concept to the English term ‘mergers and acquisitions’ (Picot 2002a, 14). As a consequence, henceforth in this study, there is not drawn a distinction between mergers and acquisitions, and they are used interchangeably. It is, however, worth noticing that there are also dissenting opinions and some authors do emphasize the different meanings of these transactions (see, for example, Epstein 2005, 37–38).

Furthermore, Picot (2002a, 14) demonstrates that the concept of mergers and acquisitions consists of various kinds of undertakings and cooperation between

businesses. For example, takeovers⁸, management buy-outs⁹ and privatizations¹⁰ can all be discussed under the concept of ‘merger and acquisition’. Also Angwin (2007, 384) draws attention to the fact that when discussing of acquisitions, there can be remarkable variations in the matter of what is actually acquired. In principle, an acquisition can be carried out in two ways: On the one hand, an acquirer can purchase the shares of a target including all of its assets and liabilities. This is called *a share sale*. On the other hand, an acquirer can purchase only some assets and liabilities of target’s underlying business. This is called *a business sale*. (Wilkinson 2007a, 177.) For example, an acquirer can purchase either technological knowledge, new distribution channel or logistic set-ups (Erkkilä 2001, 21). According to several national law systems, in the business sale the assets and liabilities have to be determined in specific and concrete terms and, thus, it must be exactly settled which parts are to be transformed to an acquirer (Picot 2002b, 68). The choice between these structures is dependent on many matters, for example, on tax consequences and on whether it is possible to acquire just one business area or not (Wilkinson 2007a, 177). Nevertheless, these issues are not discussed in this study and there is no limitation on what is actually acquired. Overall, Wilkinson (2007a, 178) states that despite the two transaction types, there are number of similarities between them and, thus, only the most obvious distinctions are discussed in the study.

The second type of division, which is frequently utilized, is horizontal acquisitions versus vertical acquisitions. Horizontal acquisitions, frequently also known as consolidation, refer to the fact that the acquirer and the target operate in the same industry. On the contrary, in vertical acquisitions the companies operate in different phases of the production or distribution chain. (Morrison 2006, 406.) This aspect is not analyzed further either because it can be assumed that the termination of the pre-acquisition phase is not affected significantly by the company’s position in the business chain.

2.2 Acquisition process

The process perspective has gained attention to a considerable extent, and there are several points of view on how the acquisition process can be described (see, for example, Picot 2002a; Marks & Mirvis 2001; Very & Schweiger 2001; Jemison &

⁸ Takeover is understood to mean the situation in which the target company’s board of directors rejects the acquisition proposal. Therefore, the proposal is posed directly to the shareholders of the target company. (Morrison 2006, 407.)

⁹ Management buy-out is understood to mean the private purchase of a business unit (BU) of a public firm by the BU’s management team (Angwin 2007, 430).

¹⁰ Privatization implies the transfer of ownership from the public sector to the private sector (Morrison 2006, 490).

Sitkin 1986). However, Marks and Mirvis (2001, 81) state that even the concept of the process itself is not unambiguous because, for instance, acquisitions can be viewed to commence either from the initial plan, from the legal approval or from the announcement of a deal. Furthermore, these scholars conclude that the phases are overlapping with each other, and the precise dividing lines are difficult to determine. Accordingly, there is no clear end for the acquisition process either. In spite of the fact that Jemison and Sitkin (1986) use different kind of names for the phases than Marks and Mirvis (2001) do, Jemison and Sitkin (1986, 145–147) state that the process itself includes a large number of factors which affect the acquisition outcome. In other words, these scholars conclude that the process is a major determinant of the acquisition success. Carbonara and Rosa (2009, 93) express a similar view by commenting that mergers and acquisitions cannot be analyzed only as a transaction but also, maybe even more importantly, as a process. In figure 3, a simplified acquisition process is described.

Very & Schweiger (2001)

Angwin (2000)

Marks & Mirvis (2001)

The phases of...(2009)

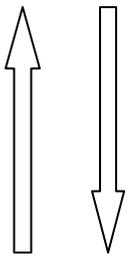
Acquisition strategy	Idea	Pre-acquisition (Precombination)	Pre-contractual phase
Identification of target			
Selection	Justification		
Analysis			
Establishing contact	Negotiations		
Valuation			
Structuring the deal			
Negotiation			
Integration	Integration	Combination	Post-contractual phase
	Results	Post-acquisition (Postcombination)	

Figure 3 Dimensions of the acquisition process (adapted from Very & Schweiger 2001, 12; Angwin 2000, 14; Marks & Mirvis 2001, 81; The phases of... 2009)

The acquisition process is described in figure 3 according to the perspectives of several scholars. The cornerstone of this study is the division presented by Marks and Mirvis. According to these scholars, within the acquisition process three different phases can be distinguished (2001, 81)¹¹:

- A pre-acquisition phase which is characterized by the planning and negotiation of a deal. Also the formal approval by the shareholders is essential.

¹¹ Marks and Mirvis (2001) prefer the terms 'precombination', 'combination', and 'postcombination'. Nevertheless, in this study only the terms 'pre-acquisition', 'combination', and 'post-acquisition' are employed henceforth because of their descriptiveness.

- A combination phase occurs when the integration planning and the implementation of decisions take place.
- A post-acquisition phase is the situation in which the new organization tries to settle in.

In figure 3, the pre-acquisition phase is described to belong to a *pre-contractual phase*. This implies that the pre-acquisition phase takes place before the final acquisition contract is agreed and signed. On the contrary, the combination and post-acquisition phases are included in a *post-contractual phase*, occurring only after the transaction agreement. Furthermore, Very and Schweiger (2001, 12) agree that the acquisition process is a complicated procedure, and it involves various activities which consist of sub-activities. For example, a target analysis, described in the box with spots, is still comprised both of a financial analysis, of an evaluation of organizational fit, and of a due diligence process. Each of these sub-activities has its own challenges and pitfalls (Carbonara & Rosa 2009, 93). In addition, the dash line in figure 3 describes that not only the commencement and the end of the acquisition process but also the division of the process into three phases is subject to a debate. For instance, Picot (2002a, 19–20) views that contractual negotiations are a part of the implementation phase, not the part of the pre-acquisition phase whereas, for instance, Marks and Mirvis (2001, 81) include them in the pre-acquisition phase. Pack (2002, 154), on the contrary, demonstrates that the agreement contract and closing are not a part of the pre-contractual phase – they belong to the post-contractual phase. In addition, for example, Erkkilä (2001, 16) acknowledges only two phases, namely, the purchase phase and the integration phase. Accordingly, henceforth the process is divided according to the categorization of Marks and Mirvis, and the correctness or the practicality of various ways both to categorize the process and to name the phases, is not discussed further in this research.

Despite the fact that Carbonara and Rosa (2009, 93–94) observe the acquisition process having three different stages, they clarify that these phases are not as independent in practice as it is suggested by the academics. First of all, a firm which has no effective organization behind the process and which has not communicated the rationale of the acquisition properly may find itself both in an unclear deal structure and in a sloppy negotiation process. Secondly, a deal negotiation team, which is not familiar either with the underlying business model or with the source of the value creation which is counted on, may negotiate a deal which hinders the integration. The reason behind this inappropriate contract can be found not only from the negotiation phase but also from the organization of an acquisition. Thirdly, the integration phase does not initiate from the closure and signing of the deal; it is commenced well earlier. (Carbonara & Rosa 2009, 93–94.) Parvinen and Tikkanen (2007, 773) express a supporting view by noting that distorted views on the appropriateness of the acquisition in the pre-

acquisition phase may lead to problems during the negotiation phase. These examples illustrate the fact that the acquisition process is not a compartmentalized activity. On the contrary, the phases are overlapping with each other.

There are different points of view on whether the acquisition is described as a project or as a process. Erkkilä (2001, 22–23) finds that when discussing of the acquisition more as a process, the long-lasting nature of the acquisition is emphasized. In other words, the acquisition becomes a process if a company's strategy is carried out by acquisitions and the company tries to develop its knowledge of the acquisitions continuously. A project concerns more a single acquisition. Nevertheless, Wood and Stevenson (2007, 166) express a contrary opinion by describing merger and acquisition transactions always as multifaceted projects. Even though these nuances of meaning seem to be quite superficial, it can be stated that the targets of the expert interviews carried out in this study can be found in companies which consider acquisitions as processes. That is to say, mergers and acquisitions are a natural part of the companies' growth strategy.

Because this thesis focuses on *the pre-acquisition phase* occurring before the completion of the final transaction contract, the sub-activities relevant to this research are accentuated in figure 3. During the pre-acquisition phase the following activities take place: external advisors are hired, due diligence is carried out, the target company is valued, negotiations take place, the bid is formed, the formalities for the regulatory regime are prepared, and the commitment towards the acquisition decision increases (Carbonara & Rosa 2009, 94; Pablo et al. 1996, 734). On the contrary, according to Marks and Mirvis (2001, 81–83), the pre-acquisition phase should include at least the following aspects: Firstly, the planning of the acquisition should be commenced with an analysis both of the company's own strengths and weaknesses, of the current market situation, of the top management's goals, and of the corporate strategy. Secondly, with the assistance of this analysis corporate leaders can form the criteria according to which target companies are screened. Thirdly, after it is known what is looked for, a thorough due diligence ensures that these objectives are met. Therefore, Erkkilä (2001, 65) shows that the aim of the pre-acquisition phase is to find out whether the deal, which brings additional value to the acquirer at a price which corresponds this additional value, comes true. Nevertheless, relevant for this study are the cases which will not come true.

Virtanen (1983, 19–20)¹² states that generally within the causes behind the failures of the investment processes three factors may be distinguished: (1) idea errors, (2) planning errors, and (3) completion errors. Significant for this study is the planning error which means that there are holes or flaws in some phase of the planning process.

¹² Honko, Jaakko – Prihti, Aatto – Virtanen, Kalervo (1982) *Yrityksen investointiprosessin kriittiset kohdat*. Joensuu, Finland.

For instance, prediction errors, miscalculations in the investment assessment, and flaws in the planning of the finance can result in the failure of the investment process. With regards to acquisitions, the proportion of planning and completion errors is higher than the proportion of idea mistakes. (Virtanen 1983, 19–20.) Accordingly, the acquisition is mostly a planning and completion challenge for an acquirer. This point of view supports the importance of the pre-acquisition phase. Furthermore, according to Carbonara and Rosa (2009, 94), the structure of a deal and the negotiation process comprise of various interconnected stages, and this together with the information asymmetry between the acquirer and the target makes the pre-acquisition phase extremely challenging. In addition, Erkkilä (2001, 25) points out that the duration of the pre-acquisition phase can vary from weeks to months, and it can be prolonged considerably because of the demands of the competition authorities. However, as stated in chapter 1.3, the deal breakers occurring because of the competition authorities or other instances are not analyzed further in this study. Otherwise the characteristics and challenges of the pre-acquisition phase are discussed further in the following chapters.

In brief, *the combination phase* includes, for example, decisions on the integration and the implementation of these decisions. In particular, the issues concerning the wished end state, the question of whether to integrate the target fully or whether to retain it as an independent subsidiary, are crucial. (Angwin 2000, 47–51.) There has been presented various possible post-acquisition integration styles (see, for example, Angwin 2000), and the decision is mostly influenced by the tensions between the strategic and organizational fit. The real integration situations frequently reveal that the implementation of the acquisition is extremely difficult. One of the most problematic situations occurs when the desired integration level is not analyzed carefully enough during the pre-acquisition phase. (Angwin 2000, 47–51.)

Lastly, the integration of two separate units into one company is full of challenges because it involves not only the management of two organizations but also the leadership of the people. These conflicts between two organizations are typical challenges faced during *the post-acquisition phase*. (Angwin 2000, 20–24.) Marks and Mirvis (2001, 87–88) argue that the acquisition situation is frequently characterized by two very different psychological mindsets: an acquirer side feels superiority and a target side goes into a state of shock. Furthermore, there is generally a duplication of resources which is mostly solved by combining the operations into a single centre. In this way the companies are also able to reduce costs. Employees' uncertainty and fear may result in a loss of employees. These employees take not only their skills and understanding but also their experiences and knowledge on previous mergers and acquisitions with them, which may hinder the forthcoming mergers and acquisitions. (Angwin 2000, 20–24.)

2.3 Examination of a target company

One of the major challenges faced by the executives planning an acquisition is the collection and analysis of the information on a target's assets and liabilities, on its future revenues and costs, and on its investment needs (Very & Schweiger 2001, 13). This procedure can also be described as a due diligence process, and its elements and issues are discussed in chapter 2.3.1. Furthermore, according to Picot (2002a, 22; 2002b, 71), a central problem both of the acquisition process and of the negotiation phase is to determine the purchase price. Some deals can be good acquisitions at one price but not any longer at another price, or some deals cannot be described good deals no matter the price level (Gaughan 2005, 159). Accordingly, chapter 2.3.2 focuses on the challenges both of the valuation and of the determination of the walk-away price. In conclusion, the following two chapters provide the framework for a closer examination of a target company.

2.3.1 Due diligence

Due diligence is carried out in order to ensure that the target company and its risks and possibilities actually correspond with the acquirer's perceptions on them (Blomquist et al. 2001, 9, 19). In other words, due diligence ascertains that the acquirer understands the value and risks associated with the target, and it justifies the arguments used in the negotiations (Angwin 2001, 35). Owing to this, Kaden (2009, 5) comments that as a result of due diligence the acquirer may decide to preclude proceeding with the acquisition transaction.

Within the due diligence process the following fields are frequently distinguished (Blomquist, Blummé & Simola 1997, 21):

- business due diligence
- legal due diligence
- financial due diligence
- other areas.

Business due diligence is a central contributor to the success of the acquisition. This field assures that the target meets the strategic aims which the acquirer has. This is also the sector in which the causes of the acquisition failures can generally be found. Furthermore, the matters which are scrutinized in this field, for example, strategic, technical and organizational issues, are aspects which are extremely difficult to cover in the contract only by different kinds of guarantees and assurances. Legal due diligence emphasizes liabilities which are challenging to find either in a balance sheet or in its notes. Financial due diligence, on the contrary, concentrates on the financial statements,

and also tax due diligence can be a part of it. Other areas might include issues such as environmental due diligence. (Blomquist et al. 1997, 21–23.)

According to Cullinan et al. (2004, 98–103), due diligence might reveal both pleasant and unwanted surprises. Wood and Stevenson (2007, 166) even express the view that it would be unusual if there was no surprises at all arisen during the process. Therefore, the specific targets of the due diligence process are: (1) to define deal breakers, (2) to define pricing issues, (3) to define factors which can affect the structure of a deal, (4) to define acquisition agreement issues, and (5) to define post-closing issues. (Blomquist et al. 2001, 9, 19.) Morrison et al. (2008, 24) emphasize particularly that the acquirer should be aware of potential deal breakers before the deal momentum (see chapter 3.2.2) drives the process to the point after which the companies are unwilling to walk away. Similarly, Cullinan et al. (2004, 98–103) note that in addition to the considerations on possible synergies, possible skeletons should also be discussed and the final walk-away price should be determined. The ultimate idea is to challenge the mental idea which the target company has created about itself.

These deal breakers may be uncovered logically and easily simply by considering the nature of the business process. For example, despite the fact that the target company may not want to share its ongoing business relationships with the acquirer, these can be revealed quite easily. Nevertheless, some of these deal breakers may not be so obvious. For instance, in a case introduced by Angwin (2007, 401), the acquirer emphasized in particular the environmental friendliness, and all the facilities of the target company seemed to be in good condition at first sight. In spite of this, the acquirer guessed that because the previous occupant's major shareholder worked in asbestos¹³ business, the roof of the target company's facility was made from asbestos. The detection of these deal breakers may be worth of money as it can also raise concerns about the competence and trust of the target management (Aiello & Watkins 2000, 104). In addition, Angwin (2001, 36) demonstrates issues which, for example, may terminate the acquisition process: ongoing litigation, puffed up financial accounts, weak cash flows, unethical practices, need for substantial future investment, tax contingencies, and inaccurate inventory assessment.

The above mentioned causes of terminating the acquisition process suggested by Angwin (2001) support the view of Carbonara and Rosa (2009, 94) who conclude that due diligence is traditionally seen as the formal gathering up of information which is frequently focused on accounting, tax, and contractual liability issues. For example, Marks and Mirvis (2001, 81) draw attention to the fact that in unsuccessful mergers and

¹³ Asbestos is understood to mean a set of silicate minerals which was exploited in the past in particular in manufacturing business because of its desirable physical properties. Asbestos causes serious illnesses. (Occupational Safety and Health Administration 2010.)

acquisitions, it is the financial vision which has monopolized the pre-acquisition phase. However, there is a factor supporting the emphasis of the financial issues because there is a large number of methods and accounting tricks which assist companies to transform the numbers look better (Elton & Weddigen 2006, 5; Cullinan et al. 2004, 98–103). Nevertheless, nowadays the scope of due diligence has widened and the role of due diligence as a contributor of a successful acquisition process has become widely recognized (Carbonara & Rosa 2009, 94). In the study of Cullinan et al. (2004, 98), there is expressed a similar view by reporting that the most successful acquirers consider due diligence as being much more than just obtaining and verifying information. Furthermore, Pack (2002, 153) notes that, for example, the risk of an overpayment, one of the main reasons for the disappointments in acquisitions, can be minimized to a large extent with the assistance of due diligence.

The most challenging aspect frequently is to gain an access to this information. Thus, it is expressed that the lack of information is frequently a cause behind the failure of negotiations (Ghauri & Usunier 2003, 462). For instance, in hostile deals there might not be a possibility for due diligence, and in the acquisitions considering the firms which are listed on the stock exchanges, due diligences tend to be deficient (Carbonara & Rosa 2009, 95; Pack 2002, 18). Moreover, Pack (2002, 156) states that getting information can be an obstacle merely because of the terms of preliminary contracts (see chapter 2.4). Nevertheless, even the access to information does not guarantee the trustworthiness of the information (Pack 2002, 156; Very & Schweiger 2001, 18).

All in all, it is considerable easy to list the matters which should be covered in due diligence. Accordingly, due diligence is the least creative part of the acquisition process but also the most time consuming (Aiello & Watkins 2000, 103). Nevertheless, it is argued that there is no accurate content or scope for the due diligence research (Blomquist et al. 2001, 19). Furthermore, countries have different practices and methods of carrying out the due diligence process. An acquirer which has carried out several acquisitions has developed its own means which are acknowledged to be good but these may not work out in another country. For example, the members of Finnish companies' boards and their chief executive officers do not always understand why they should separately attest the information revealed because according to the Finnish law they are accountable for it in every case. Accordingly, it is important that the differences between cultures are understood because cultural differences and language misunderstandings have caused the negotiations to break down. (Blomquist et al. 1997, 26–27.)

Generally lawyers and accountants are hired to assist in due diligence because it is rare that the acquirer would have enough capabilities and resources to analyze all the aspects of the deal by itself (Blomquist et al. 2001, 10). Morrison et al. (2008, 27–28) draw attention to the fact that it is crucial that operational experts are also involved

because they have the competence to evaluate both the likely risks and the areas which require investments in the future. Moreover, Picot (2002a, 16) expresses a view that the people involved in the evaluation of the target must not only have expertise in their specific fields but also have experience in mergers and acquisitions, knowledge on the branch of the business concerned, and international competence. In consequence, the challenge is to get all these people to coordinate in order to get a comprehensive view on the target company (Blomquist et al. 2001, 10). Aiello and Watkins (2000, 104) argue that if different people carry out the due diligence process and final negotiations, they must be somehow linked to each other. Accordingly, Erkkilä (2001, 15) demonstrates that a failure in the acquisition process can be due to the different people being responsible for the pre-acquisition phase and for the post-acquisition phase.

According to Picot (2002b, 64–65), due diligence should be carried out as early as possible during the negotiation phase but at least before a binding offer is given. Wood and Stevenson (2007, 164), in turn, argue that in the perfect situation due diligence would be carried out before the sale and purchase documentation, but the pressure of time frequently hinders this. Whittington and Bates (2007, 38) claim that the due diligence process is generally carried out after the agreement upon the outline offer. Nevertheless, due diligence can be carried out also in two phases: preliminary due diligence is executed in preparation for the Letter of Intent (discussed further in chapter 2.4) and confirmatory due diligence aims then at the validation of the management's assertions (Roberts 2009, 178–179). As a rule, Angwin (2007, 401) points out that the timing of due diligence is highly dependent both on the nature of the deal and on the openness of the target firm. Furthermore, in acquisitions considering public companies there is a significant time constraint set by the law which naturally varies between countries. This time constraint limits the time under which the acquirer can try both to acquire the company and to persuade the target shareholders. For example, in the UK, it is 60 days from the posting date of the offer document. In addition, Picot (2002b, 64–65) concludes that in rare cases the due diligence process can be carried out as a post-acquisition audit. In other words, due diligence takes place only after the completion of the transaction agreement. In this case contractual guarantees and assurances play a crucial role (see chapter 3.3). However, as Blomquist et al. (1997, 10–11) point out, at most occasions due diligence is carried out between the preliminary contracts and final contract.

Blomquist et al. (1997, 9) find that due diligence can be an extremely controversial subject because the acquirer's need for a preliminary inspection is much more profound than the seller's willingness to participate in the costs linked to this exercise. Moreover, Whittington and Bates (2007, 38) reveal that several off-the-record discussions with the experts who have been involved in due diligence gives an insight that due diligence is frequently rushed and undertaken with undue time pressure. However, when

considering that 80–90 percent of proposed deals which actually are finished take only approximately four months to complete (Welch 2009, 892), this is not surprising. Apart from this, Aiello and Watkins (2000, 103) argue that a deal which is terminated during due diligence phase almost always is terminated for the right reasons.

2.3.2 *Valuation and the price to be paid*

Acquisitions require tremendous discipline. That is, the courage to walk away from an acquisition opportunity that is attractive in every way except price. Over the years we have made that walk many times.

(Robert Cizik, Chairman & CEO, Cooper Industries (1995)¹⁴)

Accordingly, as Boeh and Beamish (2007, 182) note, the agreement upon the price is likely to terminate deals. The determination of the purchase price is frequently understood to be related to due diligence because with the assistance of due diligence, the acquisition parties get a comprehensive view on the value of a deal. Nevertheless, Pack (2002, 178–179) clarifies that the aim of due diligence is to obtain a complete picture of the target company at the present moment. In principle, due diligence is less focused both on the probability of future events and on their effects on the target company. Accordingly, there is basically a clear distinction between the due diligence exercise and the valuation of a company. (Pack 2002, 178–179.) It can be discovered from this statement that it is not critical whether the purchase price is determined before due diligence or only after it. However, Pack (2002, 179) comments that the results of due diligence are meaningful in the determination of the target company's future cash flows but the significance of these results varies between the valuation methods. Furthermore, Angwin (2007, 387) argues that acquisitions can be paid by shares, by cash or by a mixture of those. Boeh and Beamish (2007, 182) note that the details of different exchange mechanisms are frequently complex and become only more complex if matters such as contingent payments¹⁵ are negotiated as well. Therefore, this question of the deal structure is not discussed further in this study (see, for example, Epstein 2005).

The dominance of the finance field in the merger and acquisition literature has led to a number of different valuation techniques and methods (Angwin 2007, 399). Nevertheless, the most popular ones can be described: Firstly, *the discounted cash flow*

¹⁴ Sirower (1997, 75)

¹⁵ The purchase price can be paid also in instalments. The instalments can be either fixed or they can fluctuate according to the performance of the target company. (Wilkinson 2007b, 186–187.)

method evaluates the future cash flows and earnings, and then discounts them to the present value with a risk-adjusted discount rate. Secondly, *the comparable multiple method* takes advantage of similar companies on the markets and compares their value to the target's value. Thirdly, *the asset oriented method* means in its simplest form that the value of the company is the difference between the target's assets and liabilities. (Gaughan 2005, 162–163; Pack 2002, 179.) Accordingly, the relevance of due diligence to the determination of the purchase price is the highest with the asset value based method, whereas due diligence supports less the comparable multiple method (Pack 2002, 179–181). According to Haspeslagh and Jemison (1991, 333), the acquirer will probably choose the valuation method which promotes its own interests but is still understood by the target company's representatives. Consequently, due diligence can promote the determination of the value but most importantly it provides support for the price negotiations (Pack 2002, 179–181).

In addition to the discussions on the linkage between due diligence and the value determination, the connection between the value of the company and the purchase price must also be considered. Picot (2002b, 71) points out that there is a difference between the purchase price and the corporate value; the latter is a basis for the first but the purchase price takes also the future trends and prospects into consideration. Very and Schweiger (2001, 13) indicate that the aim of the valuation is that the price paid for the target accurately reflects the projected revenues and costs. If the purchase price is more than the valuation, value will be destroyed. Nevertheless, Cullinan et al. (2004, 100–101) argue that the price to be paid should be more based on the target's value at the moment, not on what it might be in the future. Thus, these scholars emphasize that it is crucial to reveal all accounting tricks in order to find out the stand-alone value. However, it is crucial to notice that the value of the target company to itself may differ from its value to the acquirer (Gaughan 2005, 161). In addition, Kaden (2009, 5) states that because of the throughout changing financial pressures, it is extremely difficult to make accurate predictions and calculations. In other words, the determination of the purchase price is a subjective exercise (Haspeslagh & Jemison 1991, 333), and may then cause disputes in the negotiations.

As noted earlier (see chapter 2.2), the pre-acquisition phase is characterized by planning errors. According to Carbonara and Rosa (2009, 95), the valuation of the target is extremely risky because all valuation models are characterized by imprecision and unreliability at least to some extent. In consequence, the acquirer is always exposed to a valuation risk. Arikan (2005, 185) argues that the valuation risk is closely linked to two concepts, namely to valuation errors and to managerial hubris. *Valuation errors* are due to heterogeneous expectations regarding the future. It is the view of Cullinan et al. (2004, 102) that, in general, the acquirers tend to overestimate synergies and underestimate challenges of achieving them. This is the reason behind the manner that

all firms do not even take these synergies into account when they are evaluating the value of the target and, further, the purchase price. Moreover, this overestimation of future synergies easily results in a *premium*. To put in its simplest form, an acquisition premium means that the purchase price is too high (Sirower 1997, 4). In more concrete terms, the acquisition premium is measured by the difference between the purchase price and the target's pre-acquisition stock price, divided by the target's pre-acquisition stock price (Haleblian et al. 2009, 485). Another determination is that the acquisition premium is measured by the difference between the pre-acquisition market price of shares and the market price at the time of a deal (Angwin 2007, 387).

According to Sirower (1997, 6, 79), the acquisition premium means that the acquirer must meet the expectations which are already expected for on the market and, in addition, to meet even higher expectations which are included in the premium. This scholar notes that the acquirer should not enter into the price negotiations before realizing this, and this is also why the premium is shortly discussed in this study. Moreover, Hitt and Pisano (2004, 55–56) state that in cross-border acquisitions the probability of the premium increases because of the difficulties in the valuation of assets. Erkkilä (2001, 67), in turn, points out that it is the interest of the selling party to pull up the price in order to get the maximum selling price. Thus, Aiello and Watkins (2000, 105) state that some acquirers avoid competitive auctions because they believe strongly that the winner is the one who overpays. Nevertheless, Angwin (2007, 387, 397) indicates that the premium is almost obligatory in order to convince the shareholders of the target company to convey their shares.

When an acquirer evaluates the purchase price, a *walk-away price* should also be determined. The walk-away price describes the highest price which an acquirer is willing to pay for a target. (Cullinan et al. 2004, 103–104.) Angwin (2007, 399) defines the walk-away price as the point after which the deal is not any longer feasible in financial terms for the acquirer. The walk-away price is closely connected both to the target's stand-alone value and to the purchase price because the walk-away price should not include all possible synergies and possibilities which are counted on. The challenge with the walk-away price is that in order to be a meaningful and useful tool during the acquisition process, the acquirer must be willing to walk away after this point. (Cullinan et al. 2004, 103–104.)

Elton and Weddigen (2006, 5) express an opinion according to which walking away from the deal is more difficult if there is a large amount of cash on the balance sheet waiting to be taken advantage of. According to the study carried out by Bain & Company¹⁶, the executives considered that the decision of walking away is one of the most difficult decisions to execute, and a third of 250 senior managers interviewed

¹⁶ Elton & Weddigen (2006, 5)

admitted that they had not walked away from deals even if they had some concerns concerning the deal. Haspeslagh and Jemison (1991, 50) point out that in particular in auction situations, there is a possibility of bargaining over all potential benefits because the target has different value for different acquirers (see, for example, Gaughan 2005, 161) and, thus, their walk-away prices can be settled to different levels. This is also the other side of the valuation risk to which Arian (2005, 185) refers, namely *the managerial hubris*. According to Gaughan (2005, 198) hubris-driven managers may get involved in the auctions from which they are not willing to walk away and, in that case, it is the duty of the board to prevent the overvalued bid.

There is a lack of research underlying the determination of the walk-away price. Haspeslagh and Jemison (1991, 333–335) suggest that the walk-away price should be determined by using net present values with free cash flows¹⁷. This is because then the managers have to evaluate and commit themselves on the future possibilities. Nevertheless, even this explanation is non-specific. However, Angwin (2007, 397–399) offers a more concrete view on the determination of the appropriate offer and walk-away price (see figure 4).

¹⁷ Free cash flows are used to refer to the situation in which all working capital requirements as well as reinvestment requirements are already taken into consideration and future cash flows are thus actually free (Haspeslagh & Jemison 1991, 333–335).

acquisitions (Cullinan et al. 2003, 182). For example, in a company there was promised a bonus for each of the upper level executives of major divisions if they could succeed in making an acquisition which would replace the lost occurred during the old business (Haspeslagh & Jemison 1991, 63). In other words, this example illustrates that the acquisition decision was encouraged despite the costs. This is why the walk-away price should not be determined only by the top management, that is to say, by the people whose careers may be bounded to the success of this merger or acquisition. (Cullinan et al. 2004, 103–104.) Furthermore, Angwin (2007, 402–403) points out that the importance of human factor, parties' negotiation skills and experience, and expectations held by both parties should not be neglected as they have an influence on the final price paid.

2.4 Contractual negotiations

Carbonara and Rosa (2009, 94) point out that the ultimate purpose of a deal is both to create value and to meet the strategic objectives. The commencement of negotiations means that both the concepts of trust and good faith, and various legal details must be observed. These aspects are crucial both for the implementation of the deal and for the protection against the claims in the event of a breakdown in negotiations. To overcome these uncertainties arising during the negotiations, the parties may compile *preliminary contracts*. The objective is to write down points of negotiations which may have been discussed earlier in order to include them in the prior negotiations. (Picot 2002b, 62–63.) Furthermore, Pack (2002, 154) concludes that preliminary contracts facilitate the acquisition process by making it simpler and more controllable. Figure 5 clarifies the contracts made during the pre-acquisition phase and their timing. However, Picot (2002b, 66–67) points out that there are no standard agreements which could be adopted to all situations; numerous documents are important and the requirements for the documentation differ depending on the deal (Boeh & Beamish 2007, 184). Accordingly, the list below is not inclusive and the figure describes the typical documents of the acquisition in which there is only one acquirer. Furthermore, there are minor differences in the most important legal documents between the share deal and business deal (see, for example, Wilkinson 2007a) and these are overlooked in this study.

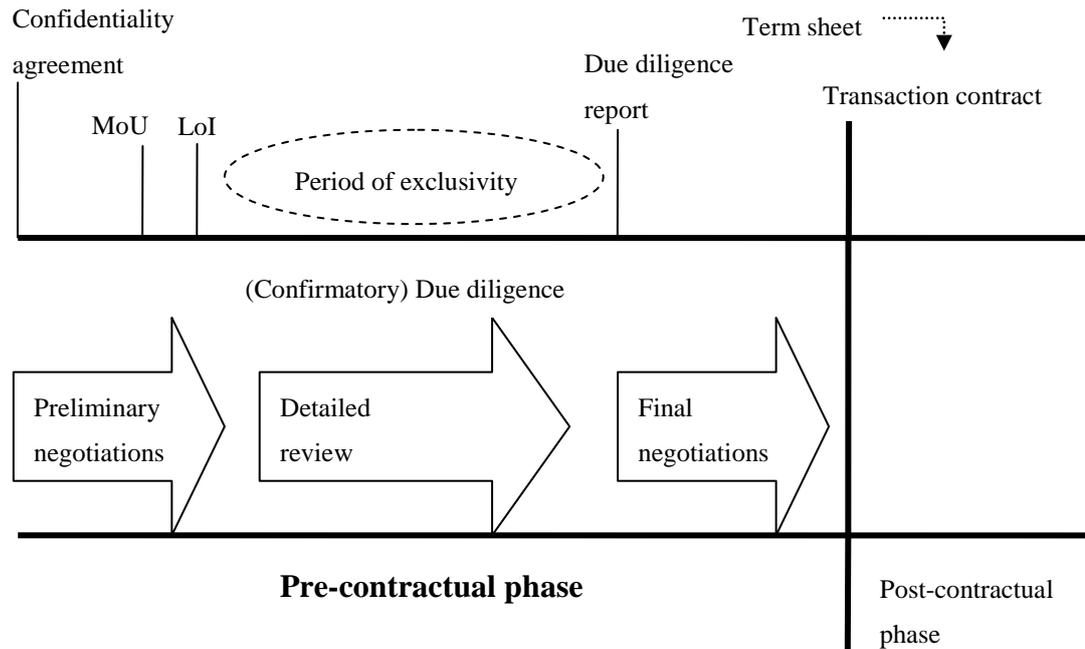


Figure 5 Pre-contractual phase of the acquisition process (adapted from Going West... 2009, 4; The phases of... 2009; Pack 2002, 154)

It can be seen in figure 5 that in general, these preliminary contracts contain the following documents: First of all, in order both to ensure confidentiality and to guarantee that the knowledge received is not used in disadvantage of the other party, a *confidentiality agreement*, also known as a non-disclosure agreement or a statement of non-disclosure, is signed. (Picot 2002b, 62–63.) The confidentiality agreement should be agreed as early as possible in order to protect confidential information, in particular, on the target. In addition, the non-disclosure of discussions is agreed upon in order to prevent the incident in which the public would be conscious of the possible deal prematurely. Typically the obligation of confidentiality covers all the information reported even though there might have been some discussions carried out already before the agreement. However, the protection offered by the confidentiality agreement should not be trusted too much. Accordingly, it is suggested that the most crucial and important information is not revealed until the transaction contract is signed or, at least, not until it is sure that the deal is going to be carried out. Nevertheless, the challenge is to determine the phase after which the acquirer cannot withdraw from the deal any longer. Moreover, in the confidentiality agreement there can also be decided that the acquirer will not persuade the target's employees. The challenge is to determine for how long this is forbidden if the negotiations break down. (Wilkinson 2007a, 178–180.)

Secondly, a *Letter of Intent*, LoI, is signed in order to state the intention of reaching a legal result, for example, the transfer of a company or a part of its business (Picot 2002b, 63). For the most part, it is after the preliminary negotiations when this

document is agreed upon (Blomquist et al. 1997, 54). According to Wilkinson (2007a, 180), the Letter of Intent defines the main terms of the transaction which is agreed upon 'in principle'. Moreover, both the timetable and the scope of due diligence, and the timetable of the acquisition process are settled in this document (Pack 2002, 159). Consequently, the Letter of Intent should be carried out before the due diligence process commences. However, Aiello and Watkins (2000, 102–103) point out that it is ill-advised to agree upon the price already at this stage simply because there is not enough information. On the contrary, it is crucial to pin down the central issues and to identify the 'must-haves'.

Because cross-border mergers and acquisitions involve several legal systems, there is no possibility of defining the Letter of Intent universally. In order to avoid possible misunderstandings, it is frequently stated separately in the document whether the statements are legally binding or not. Generally, the Letter of Intent does not yet put parties under a contractual obligation but the legal positions of the negotiating parties are noted. (Picot 2002b, 63–64.) Nevertheless, for example in the USA, the legal status of the Letter of Intent is determined by its content (Angwin 2007, 400). Wilkinson (2007a, 180) comments that this document does not prevent parties from changing their minds during the acquisition process but it does offer a moral obligation, at least to some extent. For example, there have been cases in which the acquirer only acts to be willing to acquire a company in order to reveal competitors' secrets (Angwin 2007, 400).

Thirdly, another frequently used preliminary contract is a *Memorandum of Understanding*, MoU (Picot 2002b, 64). There are misunderstandings concerning the content of the document. For instance, Wilkinson (2007a, 180) argues that the Letter of Intent and Memorandum of Understanding are similar to each other but Picot (2002b, 63–64) reports them separately. Similarly, Hollmén (2009) finds in his lecture that there is a difference between the Letter of Intent and the Memorandum of Understanding as the first one is by nature more binding already initially. Therefore, the Memorandum of Understanding is also described in figure 5 before the Letter of Intent. Nevertheless, the aim of Memorandum of Understanding is to guarantee that the main contract is completed. However, there is the same problem with the definition of this document than with the Letter of Intent – it is not possible to give one, universally valid definition. (Picot 2002b, 64.) As Hollmén (2009) points out, the practices, for example, in Finland are different from those of United Kingdom.

Fourthly, Wilkinson (2007a, 180–181) reports that, for example, break-up fees (discussed more in the chapter 3.3), and *the period of exclusivity* are agreed to be legally binding already in the Letter of Intent. The period of exclusivity refers to the phase during which the seller agrees not to negotiate with other acquirers. It is popular that the acquirer insists the period of exclusivity to be agreed upon because then they can

concentrate totally both on negotiations and on due diligence. This is the phase during which costs normally start to accumulate and the acquirer wants to hinder the seller's possibility of walking away from the deal. However, from the seller's point of view, it transfers the negotiation power to the acquirer and it can also dispel other potential acquirers. After the agreement upon the exclusivity period, the seller is not able to share information with other acquirers any longer. Moreover, if the seller commences to discuss with other potential acquirers after a while, these will notice that something went wrong because the initial acquirer walked away. In Western Europe, the exclusivity period is typically between four to six weeks, whereas, for instance, acquirers from the emerging markets typically expect a much longer period (Going West... 2009, 9). It is worth noting that consenting to the period of exclusivity does not necessarily lead to the closure of the deal.

After the preliminary contracts have been agreed upon, the focus can be moved both on due diligence and on formal sale documents (Wilkinson 2007a, 182). Blomquist et al. (1997, 54) point out that due diligence is carried out in different phases of the acquisition process and it must also be seen as a process. As it can be seen in figure 5, the process consists of preliminary negotiations, detailed review of the target, and final negotiations (a preliminary evaluation of the target has been carried out already at the target selection phase). Moreover, because due diligence can be executed in two phases, the word confirmatory is put in brackets in order to describe also this later stage of due diligence (see, for example, Roberts 2009, 179). The results of this audit are generally condensed in a *due diligence report* by legal and other professionals. The report is then handed in to the executives who are making the decisions. (Picot 2002b, 64–65.) Simultaneously with this due diligence report an executive summary is also given, which basically is a summary from the due diligence report (Blomquist et al. 1997, 42). Erkkilä (2001, 74) states that it is the acquisition team which makes a proposal to the management whether the acquisition process should be carried on or not. It is then the executives who make the final 'go-no-go' -decision, in other words, whether to withdraw from the negotiations or not.

The pre-acquisition phase is slightly different if the acquisition is executed as an auction process (discussed more in chapter 3.1). The auction process commences with the preparation of an *Information Memorandum*. The Information Memorandum is done by the seller in order to provide the most obvious and crucial information to acquirers who might be interested in acquiring the company. This document is generally then sent to potential acquirers simultaneously with the letter which describes the transaction process and generally contains the confidentiality agreement. In the letter there is also requested that the bidder¹⁸ makes the first non-binding offer. This offer is frequently

¹⁸ A bidder is understood to mean the same as an acquirer.

made in the form of the Letter of Intent. (Picot 2002a, 20–21.) Based on these offers the seller chooses the acquirers who are still in the competition and who will get an access to *the data room* (Blomquist et al. 2001, 14). The data room refers to the place where certain documents relating to the target and its business are available both for an inspection and for a limited due diligence. Before the access is granted to the data room, a certain kind of draft of the transaction agreement is made. Next, the acquirer must make a binding offer and the purchase price can be specified in the light of the new information. At this stage there can be agreed different kinds of penalties, warranties and down payments in the event of a negotiation breakdown. After this, the seller either chooses the acquirer and the negotiations can commence or the seller tries still to push up the price. (Picot 2002a, 21–22.)

Eventually, during the final negotiations, regardless of the method of the transaction, the structure of the deal, the final price, and other contract terms are negotiated (Blomquist et al. 1997, 54). A *term sheet* is an ever-changing document which is at the center of negotiations. All critical elements of the negotiated agreement are in this document. Broadly defined, the term sheet is the informal version of the final transaction agreement. (Boeh & Beamish 2007, 183.) *The transaction agreement*, that is to say the purchase and sale agreement depending on the party, can contain plenty of different kind of rights and obligations. For example, the contracts of cross-border mergers and acquisitions can differ from those of hostile takeovers, and the agreement of a share deal differs from those of an asset deal. Furthermore, because there is no one law system which should be obeyed in cross-border mergers and acquisitions, the know-how of carrying out agreements is in the heads of merger and acquisition experts. (Picot 2002b, 66–67.)

3 ACQUISITION NEGOTIATIONS

3.1 Concept of negotiations

In the business context parties negotiate because it is believed that in this way a better result is achieved than just by accepting the first alternative offered. It is worth noticing that a negotiation is a voluntary process and the parties can terminate the process whenever they choose to. (Ghauri 2003, 3.) This alternative to quit the process is closely linked with the concept of walking away. Negotiations are periods of time during which the issues uncovered in the due diligence process are given explanations, the price is agreed, and the potential deal breakers are in a favourable outcome overcome (Angwin 2007, 402). To conclude, the negotiation is a voluntary situation in which parties alter both their expectations and their objectives in order to achieve the necessary agreement (Ghauri 2003, 3). Accordingly, Pack (2002, 153) argues that the purpose of the pre-contractual negotiation phase is both to discover the objectives of the acquirer and seller, and to combine these in the best possible way.

Dupont (1991, 331) defines international business negotiations as the events in which the nationalities of the negotiation parties differ. International business negotiations are influenced by factors which are outside the negotiation process itself. For example, cultural differences at national, organizational, and individual level can have a considerable effect on negotiations. (Ghauri 2003, 4–5.) In addition, major differences in legal systems, for example, between the EU member countries are issues which must be adapted to (Beaufort & Lempereur 2003, 294). Accordingly, the transaction costs associated with international business negotiations are frequently disproportionate compared to the costs in domestic negotiations (Ghauri & Usunier 2003, 462). Nevertheless, Dupont (1991, 331) clarifies that larger complexity, geographical distance, and longer duration of negotiations can also meet the conditions of the domestic negotiations and, thus, it is exactly the institutional, legal and cultural differences which matter. However, even though these differences can hinder the preparation of negotiations, they can also provide opportunities in the form of new business ideas (Beaufort & Lempereur 2003, 294).

The process perspective can also be applied to the negotiation literature. Accordingly, Dupont and Faure (1991, 40) argue that negotiations, particularly international negotiations, are frequently seen to be composed of different stages. These are either organized into a well-structured pattern or they are overlapping and changing over time. Ghauri (2003, 8–13) distinguishes more clearly three phases within the

negotiation process: (1) pre-negotiation, (2) face-to-face negotiation and (3) post-negotiation stage. Figure 6 clarifies this negotiation process.

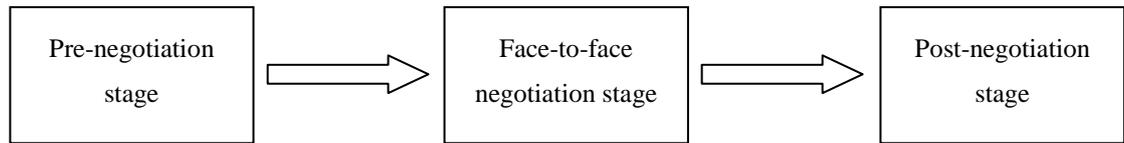


Figure 6 Negotiation process (adapted from Ghauri 2003, 8–13)

The pre-negotiation stage consists of information gathering and informal meetings in order to build the negotiation power. In addition, some tentative offers can already be made. Particularly in cross-border negotiations this pre-negotiation stage might be even more important than the latter stages because good social relationships can be a remarkable advantage later on in the process. If the value of the deal is a subjective matter, so is the negotiation process: parties enter *the face-to-face negotiation stage* both with different expectations for the outcome and with different perceptions of the process. The main point is both to explore the alternatives presented by the parties, to discover the differences in preferences, and to solve them. This results in *the post-negotiation stage* during which most of the conflicts are solved and parties are ready to sign the contract. (Ghauri 2003, 8–13.)

In comparison, Dupont and Faure (1991, 42–43) find that particularly in international negotiations it is important that the preliminary phase is separated from the formal negotiation situation. International negotiations are frequently preceded by informal preliminary contacts and both the pros and cons, and even the possibility of negotiating are investigated. This preliminary phase is grouped further into a formula phase during which the issues to be negotiated are selected and the broad principles are determined. During a detail phase these principles are then worked out. A formal negotiation situation refers to the face-to-face negotiations equally to Ghauri's view.¹⁹ It is worth noticing that the negotiation process can be terminated after every phase, and it is also possible that the parties re-enter the face-to-face negotiations because of the conflicting contract details (Ghauri 2003, 12). Similarly, Parvinen and Tikkanen (2007, 782) argue that, for instance, the financial evaluation and negotiation stage are frequently repeated during the pre-acquisition phase. Therefore, Ghauri and Usunier (2003, 477) support the viewpoint of Dupont and Faure (1991, 40) on the overlapping negotiation stages by pointing out that negotiations are more a continuum than a discontinuous activity. For example, even if the closure of the deal sets concrete timelines for the negotiations on

¹⁹ For more detailed descriptions of the negotiation process and its stages see, for example, Hendon et al. 1996.

the paper, it is not as clear in the real business world. Angwin (2007, 402) notes that most of the negotiation time is spent in verifying legal obligations, negotiating the price, clarifying accounting treatments, and discussing the treatment of the senior management. Moreover, only after when there is some kind of an agreement upon the issues of two firms' and management's teamwork, the attention can be turned more to price negotiations.

According to Arikan (2005, 182, 184), firms can be sold either by using *auctions* with bidding or by using straightforward *negotiations*. Aiello and Watkins (2000, 102) comment that an auction is a more structured process whereas a negotiation is less formal. The language of auctions is used to a large extent to illustrate the bidding process in mergers and acquisitions because companies strategically bid to acquire targets (Arikan 2005, 182, 184). As it was discussed in chapter 2.4, the auction process proceeds by different stages, and in every stage one or several acquirers are eliminated. The less there are acquirers and the closer the parties are to get an agreement, the more the acquirer gets information. Merger and acquisition auctions are special compared to normal auction situations because the identities of the acquisition parties are crucial. It is argued that this is one of the major reasons behind the negotiation failures and lengthened period of time in comparison to a normal auction situation. (Arikan 2005, 182, 184.)

Traditional negotiations are described as 'shake-hand' deals in which merging parties frequently get involved in the deal either with the assistance of merger and acquisition experts or with the assistance of upper level executives. On the contrary, in the auction process it is generally the investment and corporate finance experts who are in charge of the acquisition process. (Picot 2002a, 18–20.) In addition, the auction process is driven by the seller, and the acquirer may have to settle for less, for instance, when it comes to warranties (Wood & Stevenson 2007, 168). Furthermore, in the auction process the parties come into the negotiation phase and into the closing of the deal after a bidding competition and offering process (Picot 2002a, 18–20). It is only the bidding phase which separates these two transaction types, and a negotiation phase exists despite the method employed. Accordingly, the pitfalls of the negotiation phase exist in every acquisition.

3.2 Possible pitfalls in the negotiation phase

Both De Mattos et al. (2008, 249–250) and Reynolds et al. (2003, 237) identify five major factors which affect negotiations: (1) conditions of the negotiations, (2) negotiation situations, (3) negotiators' characteristics, (4) cultural differences, and (5) outcomes of negotiations. Therefore, the discussion of possible pitfalls during the

acquisition negotiations is based on this division. Chapter 3.2.1 discusses the issues of the conditions of negotiations focusing both on the nature of negotiations and on the motives of acquisitions. The second matter, the negotiation situation, is covered in chapter 3.2.2. This chapter discusses issues such as the momentum, information asymmetry, and softer aspects of the acquisitions. In chapter 3.2.3 both negotiators' characteristics and cultural differences are discussed simultaneously. The chapter emphasizes the challenge of the walk-away action, the composition of the acquisition team, and cultural differences both at organizational and geographical level. The last matter, the outcomes of negotiations, is overlooked because only the terminated acquisition processes are of interest.

3.2.1 Conditions of the negotiations

The negotiation phase is characterized by a high degree of uncertainty and mistrust. Both the interests of the acquisition parties and the nature of the negotiations can vary to a large extent (Pack 2002, 153). According to Saorín-Iborra (2008, 286–287), within the negotiation behaviour two categories can be distinguished according to the orientation and tactics used. *An integrative negotiation* consists of an honest, clear and open information exchange. The purpose is to find a mutual understanding. A *competitive negotiation* implies that the information is collected mainly for one's own purposes and, accordingly, some selected information may not be revealed at all to the other party. For example, the executives of the target company might reveal also negative aspects of the company, the issues which would be uncovered in any case, but some aspects are kept in secret in order to maximize the negotiating advantage (Angwin 2000, 16). However, it can be argued that all acquisition negotiations are like this at least to some extent – otherwise there would not be problems associated, for example, with *an information asymmetry*, the topic which has been paid attention to a considerable extent (see, for example, Parvinen & Tikkanen 2007; Qiu & Zhou 2006; Bates & Lemmon 2003). Information asymmetries are understood to mean the situations in which the parties have different amounts of information and of different quality (Parvinen & Tikkanen 2007, 770), and they are discussed further in chapter 3.2.2. Nevertheless, Hitt, Harrison, Ireland and Best (1998, 102) conclude that careful, skillful but frequently lengthy negotiations are the key to avoid some of the problems, for example, the possibility of paying the premium.

The objectives and strategic goals of the acquisition parties are factors which affect the conditions of the negotiations (De Mattos et al. 2008, 248). To this categorization can be included also motives of carrying out an acquisition. Bower (2006, 22) discovers that acquisitions are carried out mainly because of five reasons: (1) in order to deal with

overcapacity, (2) in order to reduce the number of competitors, (3) in order to expand to new market areas, (4) in order to acquire research and development, and (5) in order to enlarge industry boundaries. Moreover, in a study of Jagersma (2005, 17) it is indicated that the most important incentives for cross-border acquisitions are the exchange of capabilities, skills and experiences between companies. In other words, the companies are in the search of economies of skills.

The discussions on these motives are relevant for this research because initial motives can have an effect on the considerations of how reluctant the executives are to walk away from the deal. For instance, as Bower (2006, 21–23) argues, the acquisitions carried out because of the overcapacity on the markets tend to be one-time events which makes it even more difficult to reject the deal. Furthermore, as already discovered in chapter 2.3.2, Angwin (2007, 402) notes that ideally the target's stand-alone value and the purchase price should be as close to each other as possible. Nevertheless, the ability and willingness to offer more are dependent both on the importance of the target company and its management for the acquirer, on the target's management power and willingness to sell, and on the existence of other bidders. To conclude, the strategic importance of the target company matters when considering the rationality of the walk-away action.

The importance of the price and finance is broadly discussed and recognized in merger and acquisition literature (Very 2009), but Boeh and Beamish (2007, 101) report that the acquisition can go wrong even if the price paid is appropriate. For example, Erkkilä (2001, 15–16, 26) argues that if the target company's business is too different from that of acquirer's, the executives may have difficulties in understanding the logic of the acquired business. This view is supported by Ang et al. (2008, 30) as these scholars point out that in unrelated acquisitions acquirers pay higher premiums than in related acquisitions. It is the strategy which is the fulcrum of every acquisition. That is to say, potential targets are screened and the issues to be considered in due diligence are determined on the grounds of the strategy. The executives should have some kind of a picture on their mind about in what kind of business environment and in which markets the new company will operate in few years' time. This view should be realistic and feasible. (Erkkilä 2001, 26, 28.)

For the most part, according to Jagersma (2005, 17), a cross-border acquisition is most importantly a strategic decision instead of a financial decision. In addition, if the motive for the acquisition is to acquire knowledge, the acquirer must be confident that the combined skills, systems, knowledge, and competencies will create synergies. To sum up, if acquisition failures were discussed more publicly, it would be acknowledged that the problems with the strategic vision, the problems with an inappropriate target, and the problems with the deal structure are the factors underlying the acquisition

failures. (Epstein 2005, 38–39.) These are also the factors which in this research are interpreted to lead to the termination of the pre-acquisition phase.

3.2.2 *Negotiation situation*

Wood and Stevenson (2007, 164) point out that it is in favour of both acquisition parties to finalize the acquisition process as quickly as possible. Accordingly, Angwin (2000, 11) observes that *momentum*, or escalating momentum which is preferred by Jemison and Sitkin (1986, 151), arises both in terms of time and in terms of committed resources. Time pressure can be understood as a desire or a requirement to end the negotiation process as quickly as possible. In acquisition negotiations, time pressure is caused to a large extent both by the need for secrecy and by the perception of time availability. (Saorín-Iborra 2008, 285–290.) The committed resources, in turn, only keep increasing while the acquisition process proceeds.

According to Angwin (2000, 12–13), the momentum is characterized by reductionism, fragmentation and ambiguity²⁰. These three elements can be found both in the pre-acquisition phase and in the post-acquisition phase (Pablo et al. 1996, 734). *Reductionism* refers to the fact that the pre-acquisition phase frequently focuses on the financial statements and legal documents, and overlooks the ‘soft’ matters, such as cultural differences and environmental concerns. *Fragmentation* reflects the fact that external acquisition specialists are in head of the process, and that is why the employees of the acquiring company may get a fragmented view on the acquisition. (Angwin 2000, 12–13.) Nevertheless, because of the technical complexity of the acquisition process, external experts are required. *Ambiguity* is understood to mean the parties having different expectations concerning the negotiations, and because of these disagreements the bonds of trust may began to fall apart. (Jemison & Sitkin 1986, 148–149, 157.)

It is exactly the intensive personal involvement, time pressure and tensions which hinder the willingness of walking away from a deal (Angwin 2000, 11; Jemison & Sitkin 1986, 151). Therefore, the momentum is not actual deal breaker but it complicates the already difficult walk-away decision. Furthermore, Jemison and Sitkin (1986, 156) note that the momentum can be slowed down mainly by three factors: board approval, target resistance, and the chief executives officer’s prior experience. It is interesting to consider that these factors are also matters which can terminate the whole pre-acquisition phase. For instance, the board approval is required not only for the

²⁰ Jemison and Sitkin (1986, 148) refer to the same phenomena but they use the concept of ‘activity segmentation’ instead of the fragmentation, and the concept of ‘expectational ambiguity’ instead of the ambiguity. In order to guarantee the clarity, only the concepts preferred by Angwin (2000) are used henceforth.

commencement of the acquisition process but also for the breaking up of it. In addition, the seller may also withdraw from the process. Nevertheless, Haspeslagh and Jemison (1991, 64) indicate that these factors to terminate the process are weaker than the incentives to close the deal as quickly as possible.

Pablo et al. (1996, 733–736) view these three concepts more through a risk perspective. These scholars point out that in addition to the understanding of the momentum as a desire to complete or cancel the deal as quickly as possible, it can also be interpreted to mean that the process should be longer resulting from the riskiness of the transaction. In other words, if a risk averse person acts as a decision-maker, the pre-acquisition phase should take longer time because he or she wants to assess and reduce the risk as much as possible. On the contrary, a risk seeker is not worried about the risks and, thus, the pre-acquisition phase should be shorter. Furthermore, the risk averse people are willing to engage more people into the process mainly because of two reasons: Firstly, if there are more people involved, the responsibility of a failure or poor outcome is more difficult to address to one specific person. Secondly, the more there are people, the less likely the retribution is. This view is closely linked with Angwin's (2000, 12) views on the walk-away decisions' positive and negative effects on a manager's reputation (discussed more in chapter 3.2.3). In addition, Pablo et al. (1996, 723, 737) comment that the risk averse decision-makers might postpone risky decisions of the pre-acquisition phase to such an extent that, for example, the negotiations break down. To conclude, the decision-maker's risk perceptions affect, among other things, the characteristics of the evaluation and negotiations during the pre-acquisition phase.

In a study of Parvinen and Tikkanen (2007, 759, 768–770) it is argued that so called incentive asymmetries are the reasons both for the prolonged pre-acquisition phase, for biased financial evaluations, and for biased price escalations. Incentive asymmetries are understood to refer to the conflicting interests of the acquisition parties regarding the transaction, and it is closely linked with the concept of information asymmetries. The main point of these scholars is that incentive asymmetries are a reason for the commencement of the acquisition processes which would not be started without this uneven information and which should not be started at all. Accordingly, these asymmetries can also act as deal breakers. Furthermore, because of these information asymmetries executives may decide to engage in negotiations with distorted views (Parvinen & Tikkanen 2007, 773). As a result, it could be concluded that Parvinen and Tikkanen see the incentive asymmetries as a certain kind of an umbrella concept for the problems during the pre-acquisition phase. That is to say, other challenges and possible reasons for the termination of the pre-acquisition phase are derived from these asymmetries in a way or another.

In due diligence phase one of the most challenging matters can be to gain the access to information. However, all information which is required is not factual. For example,

it is important to know which matters concern the employees of the target company, what kind of values they have, what kind of conflicts can be anticipated and so on. Even rumors can be worth noticing. This softer knowledge is important because there are cases which have failed, for instance, because the chemistry between the executives has not worked. These soft issues have also an effect on the final price. For example, the more there are cultural differences noticed, the more there will be difficulties and, thus, the more expensive the integration stage. Nevertheless, walking away from the deal because of these soft issues is even harder compared to the situation when there are hard facts to support the decision. (Erkkilä 2001, 69–74.) Fang et al. (2004, 591–592) give a rare example of this kind of terminated negotiation process. These scholars comment that Telia-Telenor merger was broken down mainly because of three ‘softer’ issues: Firstly, there was a lack of trust between the negotiation parties. Secondly, both the potential difficulties and cultural differences were underestimated. Thirdly, the impact of history, for example, both the nationalistic sentiments and the feelings were not taken into consideration. Consequently, it can be argued that certain kinds of human and personal feelings may have a substantial role in the decision whether to walk away or not. Thus, Fang et al. (2004, 592) discover that the manager’s ideas, emotions, diplomatic capacities, and strategic visions are central for the success of cross-border mergers and acquisitions.

Boeh and Beamish (2007, 179) comment that many deals terminate during the negotiation process because the parties are not able to agree on certain terms and conditions. For example, there may be disagreements over human resource issues, such as the composition of the management team and board, option and pay packages for the employees, pension system and so on. Nevertheless, in a study of Jagersma (2005, 22) it is expressed that the existing management of the target company is usually always maintained as the same. An exception is the situation in which the management is accountable for extremely bad performance, particularly in the event of the financial performance. While many of the essentials of the negotiations are difficult to negotiate, there are also issues which bring the negotiations closer to reality. For instance, both the name of the new company and the location of the headquarters are this kind of visible decisions. (Boeh & Beamish 2007, 179.)

3.2.3 *Negotiators' characteristics and cultural differences*

*Doing deals is exciting. Making one's company bigger is thrilling. [...] When the investment banker calls with a prospect, the executive bites. And having eaten once and enjoyed it, the executive will bite again.*²¹

When talking of negotiation pitfalls, the negotiator's characteristics and cultural differences cannot be overlooked. To begin with, Angwin (2000, 12) argues that the walk-away decision can have an effect on the managerial reputation – if an executive is able to finalize the acquisition, it is frequently associated with the positive leadership whereas a failure in the completion of the acquisition deal is seen as negative. This statement not only supports the difficulty of walking away but also suggests that it is easier to stay determined and not to change the mind during the acquisition process (see, for example, Pablo et al. 1996, 733; Jemison & Sitkin 1986, 155). This is also discussed in a study of executives' and students' commitment towards the initial decisions by Bogan and Just (2009, 938, 942). The results show that the executives are less likely to change their minds than the students after reviewing new information. In addition, the executives review fewer pages than the non-executive students, and these two groups view information differently. For example, only less than 50 percent of the executives viewed the integration cost pages presented to them, and the rest of them made their decisions without even looking at those pages. Same kind of evidence of over-commitment is also provided by Haunschild, Davis-Blake and Fichman (1994, 538). Accordingly, Erkkilä (2001, 74) draws attention to the fact that only experienced acquirers are able to walk away because they are not that sentimental towards the deal.

The acquisition process should be characterized by clear decision-making roles and responsibilities in order to guarantee that there is someone whose decisions matter in the final instance (Cullinan et al. 2003, 182–183). That is to say, the emphasis is, on the one hand, on the leader of the team and, on the other hand, on the composition of the team itself. Firstly, according to Wood and Stevenson (2007, 165), it is common that there are misunderstandings between the parties concerning the issues both on the content of the process and on its length and complexity. This is the cause behind the recommendation that there should be appointed a chief decision-maker. As a result, Jemison and Sitkin (1986, 149) argue that it is generally the senior executives who symbolize the continuity between the acquisition phases and, thus, prevent fragmentation (see the chapter 3.2.2). Clearly defined responsibilities facilitate also in the situation in which it is necessary to consider whether to walk away or not (Cullinan et al. 2003, 182).

²¹ Bower (2006, 30)

Secondly, almost all successful deal-makers devote to the shaping of acquisition teams. These acquisition teams build up experience by getting involved in every acquisition within the company and, thus, it is relatively easy for the company to act proactively in the case of an appropriate target on sight. (Mergers & acquisitions... 2006, 7; Cullinan et al. 2003, 181–182.) Nevertheless, Haspeslagh and Jemison (1991, 59) discover that keeping these merger and acquisition experts as permanent employees is too expensive for most companies. Furthermore, Reynolds et al. (2003, 236) express an opinion according to which carrying out cross-border negotiations requires even more capabilities from the negotiators than the negotiations carried out at the native country. As a consequence, the best results are achieved when the team is formed from the people not only from the financial positions but also from the technical and operational levels without forgetting the strategic mindset (Marks & Mirvis 2001, 81–83). Furthermore, it is argued that if the primary negotiators have enough experience in cross-border acquisitions, the interference of the third parties in cross-cultural acquisition negotiations can be decreased (Saorín-Iborra 2008, 305–306). Ghauri and Usunier (2003, 478) express a similar view by stating that the third parties should be excluded from the initial negotiations because in some cultures the presence of, for example, lawyers can be interpreted as a sign of mistrust. This statement is controversial at least to some extent because the formality of the agreements is frequently seen as a key issue particularly in cross-border negotiations (see, for example, chapter 2.4).

Sebenius (1998, 27) states that many companies negotiate cross-border transactions on a regular basis. Therefore, it is likely that the acquirers' skills as dealmakers are one of the explaining factors for the acquisition successes and failures. Generally all acquirers have good timing ability, bargain ability to some extent, and varying amount of negotiation skills. Timing ability refers to the fact that when the acquirer pays the deal with stocks, it is done at appropriate time considering the price of the stock. Thus, this is not relevant for the acquirers who pay with cash. Furthermore, even though the hiring of external advisors is in general advisable, it is reported that even the advisors' deal-making capabilities should be regarded with suspicion. (Ang et al. 2008, 7.) Parvinen and Tikkanen (2007, 772) draw attention to this same fact by noting that the external advisors, such as investment bankers, have superior knowledge resulting in the information asymmetry (discussed in chapters 3.2.1 and 3.2.2), which they may take advantage of by making the numbers look favourable. In addition, even though external advisors have expertise in negotiations they also have no incentives to let the negotiations break down (Welch 2009, 856). On the contrary, both Jemison and Sitkin (1986, 155) and Saorín-Iborra (2008, 291) draw attention to the fact that the investment banks receive their rewards on the transaction basis and, accordingly, they want to

finish the deal quickly in order to transfer to the next deal. Therefore, they are less willing to walk away from the deal than the acquirer, the principal (Welch 2009, 856).

In general, cultural differences as a cause of acquisition failures can be understood to include several issues. For example, Erkkilä (2001, 37, 44) reveals that the most important causes behind the acquisition failures are differences both in values, in corporate cultures²², and in management methods. Angwin (2000, 157–159), in turn, discusses the mergers of non-for-profit organizations and the critical issues during these negotiations. Some of these issues are applicable to more general description of merger and acquisition negotiations. Firstly, differences in corporate culture may hinder negotiations. Secondly, the relative size of the companies can have an effect. Thirdly, leadership styles and the management structure can evoke severe conversations. For example, the decisions both on the people who will receive the key posts and on what will happen to the remaining employees can be critical questions. Consequently, Aiello and Watkins (2000, 103) point out that it is advisable to explain the future career opportunities within the new organization to the target management. In addition, Erkkilä (2001, 37) argues that losing the key persons is one of the major risks in acquisitions. Fourthly, the location of, for example, the headquarters is frequently an important question (Angwin 2000, 157–159). In a study of Very & Schweiger (2001, 20) similar cultural challenges are studied but the focus is more on the pre-negotiation stage; the knowledge both of how to negotiate and of how to establish the first contact with the foreign target are mentioned to be problematic.

In a study of Angwin (2001, 36–37, 50) it is stated that culture in general affects also due diligence, the exercise which is frequently argued to be objective. For example, culture has an effect both on the issues which are emphasized in due diligence, on the value what is looked after in due diligence, and on the types of advisors who are chosen to assist in the pre-acquisition phase. Nevertheless, all countries were unanimous that the most important task of due diligence is to ensure that there are no skeletons in the target company. Erkkilä (2001, 38) observes that the opinions on the significance of the geographical distance to acquisition failures vary. There are opinions according to which the risk is higher in unknown market areas. There are also opinions according to which this risk exists but it is insignificant because the acquirer is better prepared for the cross-border deal than for the domestic deal. However, the presumption of similar near-by market areas and, thus, not getting oneself familiarized with the target country almost always leads to bad results. Accordingly, cultural differences offer a far-reaching explanation for unsuccessful mergers and acquisitions. Moreover, Dupont (1991, 333)

²² Organization or corporate culture is a group's, for example, a team or a whole company, way of acting which is either mutually agreed upon or unconsciously born, and which controls behaviour (Erkkilä 2001, 45).

observes the same phenomenon of diverse views on cultural differences. Thus, Vuorenmaa (2006, 90) concludes that culture is a crucial factor in the acquisition process but its importance as an essential contributor is frequently overstated. This scholar suggests that cultural problems are an easy explanation for all problems occurred during the process and other explanations are not even searched for by the researchers.

3.3 Preparing for deal breakers

Picot (2002a, 22) notes that in addition to the challenge of negotiating the purchase price, the agreement upon contractual warranties is another concern during the negotiations. According to Pack (2002, 154), the acquirer is unable to minimize possible risks associated with the acquisition process because of the lack of relevant information. Furthermore, even though due diligence aims at an accurate snapshot of the target company, the time and money invested in it are always limited (Angwin 2001, 36). Consequently, in order to reduce some of these remaining risks, companies can include different kinds of warranties in their contracts (Picot 2002b, 62). According to Wood and Stevenson (2007, 176), this is the only way in which it is possible to anticipate the issues which can jeopardize the whole transaction. These possible warranties, guarantees and representations define both the concrete terms for the consequence of the liability, and the scope or the limitation of this liability in the transaction agreement. For example, in this way the seller can convince the acquirer that the company's production facilities are in a condition to produce a required amount of products on a certain due date. (Picot 2002b, 62.)

The acquirer may insist that a *break-up fee* (also known as break fee, termination fee) is agreed upon already in the Letter of Intent. The acquirer ensures that if the seller walks away from the deal or if due diligence reveals something that does not meet the acquirer's wishes, the seller must pay the break-up fee in order to cover the costs incurred for the acquirer. (Wilkinson 2007a, 181–182.) Naturally, the seller may insist the break-up fee from the acquirer as well. Nevertheless, in practice the usage of break-up fees is challenging: neither the seller nor the acquirer wants to be tied to the party who can bring the acquisition process to an end for a specious reason. Therefore the break-up fees are not widely used in mergers and acquisitions concerning small companies. (Wilkinson 2007a, 181–182.) In spite of this, Bates and Lemmon (2003, 470, 502) argue that a growing proportion of the acquisition agreements include a provision of the termination fee nowadays. However, these scholars draw attention to the fact that the termination fee provisions submitted particularly by the target company are used more frequently in complex deals which involve a considerable degree of

information asymmetry. Furthermore, Officer (2003, 458) indicates that the sizes of the acquisition parties matter also: if the target or the acquirer has a high market capitalization, it is more likely that the contract contains the termination fee.

Within the termination clauses two aspects may be distinguished depending on who is the payer in the case of a breakdown. On the one hand, the term *target termination fee* is used if the target company's actions are the cause of deterring the acquisition process and, thus, the target has to pay the compensation for the bidder (Officer 2003, 436). Bates and Lemmon (2003, 470, 475, 486–502) discover that the principle behind the target termination fee is that these provisions compensate the bidders both for the costs incurred from the negotiations and for the information asymmetries. Accordingly, this both improves the incentives of bidding and reinforces the disclosure of private information. This is something that is required because the announcement of the bid provides information on the valuation of the target company to third parties and, thus, the third parties can submit a bid which is higher than the prior bid. Nevertheless, there is no consensus on the effects of the termination fees on higher-valuing bidders: Officer (2003, 431) reports that there can be found only weak evidence to support the statement that the termination fees prevent competing bids. In addition, Dolbeck (2006, 1) states that the main purpose of the termination fee is not even to be that high that it would deter the considerations of other bids. At the same time, Leshem (2006, 3, 31) insists that the termination fee provisions decrease potential competition.

On the other hand, target companies favour termination fee provisions in order to lock in friendly bidders (Bates & Lemmon 2003, 486–502). The clause which obliges the bidder to pay the compensation for the seller is referred as *a bidder termination fee* (Officer 2003, 436). In other words, the bidder termination fee gives the acquirer the right to walk away from the deal by paying the agreed sum (Bernstein 2008, 40–41). According to Bates and Lemmon (2003, 469, 471), it is the target companies which grant termination fee provisions more than the acquirers even though they do it as well. Bidder fees are used particularly in deals which are characterized by high costs with an increased risk for the negotiation and bid failure. Furthermore, the target and bidder termination fees are also linked with each other as it is more than twice as likely that there will be a target termination fee if there is also a bidder termination fee in the contract (Officer 2003, 458). This reinforces the statement that the acquisition contracts are reciprocal agreements.

According to Bernstein (2008, 40–41), termination fees are more important in the situations in which there is only one potential acquirer – if the transaction is conducted through an auction process, there is usually no problem for the acquirer to guarantee that the price is the highest available. The usage of warranties is extremely important if due diligence phase is carried out only after the finalization of the transaction agreement. As a rule, the less there is information and data available for the buyer, the

more there will be guarantees, warranties, and liabilities in the contract. (Picot 2002b, 65.) Nevertheless, Angwin (2000, 17) reports that warranties are used to a large extent because the deal-makers are in a lack of time and resources in order to be able to carry out due diligence precisely enough.

Furthermore, Wilkinson (2007b, 188–189) notes that the acquirer's price offer is based on certain assumptions. However, the target is the only one who knows whether these assumptions are right or wrong, and the acquirer is willing to pay only for the right assumptions. If any of these is found to be untrue, the acquirer has a financial remedy against the seller, and it will be taken into account in the price that the target is not worth of as much as it was expected. If the seller is not willing to give this warranty, then the acquirer calculates a new price which includes this increased risk of the deal. The warranties can cover issues relating, for instance, to accuracy of financial information, to intellectual property, to employment and pension arrangements, to ownership of assets and so on. Nevertheless, Angwin (2000, 17) comments that the warranties may offer protection at the time of deal-making, but they are not a guarantee of the success in the future. Furthermore, in order the warranties to be valuable, the acquirer must observe if the possible risks actually occur, and as the requirement arises, insist the claims from the seller (Erkkilä 2001, 67).

Bernstein (2008, 40–41) reveals that the break-up provisions are an important method of terminating the acquisition process, for example, either if the financing of the transaction becomes too difficult, or if the price agreed upon is considered to be too high. This has been witnessed particularly in the United States as a consequence of the global credit crisis. Accordingly, it is suggested that the termination fees assist in walk-away attempts. Nevertheless, Bates and Lemmon (2003, 469) conclude that the termination fees can be regarded more as a contracting device than a method of discouraging competitive bidding. In other words, the termination fees can also hinder the breaking up. Blomquist et al. (1997, 29) state that the level to what extent a company can hedge itself against risks with the contract terms and warranties is highly dependent on the skills and experiences of the external advisors. Parvinen and Tikkanen (2007, 774) express a supporting view by stating that lawyers possess superior knowledge underlying the technicalities and details of the contract-writing phase. Furthermore, both the economic content of the termination fees (see, for example, Officer 2003, 435) and the conditions of their payment (see, for example, Dolbeck 2006, 2) can vary. Moreover, there are other forms both of the termination provisions, such as stock lockups²³, and warranties, such as retention periods²⁴. The literature of

²³ A stock lockup is understood to mean that the acquirer is granted a call option which gives it a right of buying a precise number of target shares at a predetermined price (Leshem 2006, 1).

termination provisions is more concentrated on the termination fees (see, for example, Leshem 2006; Bates & Lemmon 2003) and because the purpose of this study is not to provide an inclusive list of termination provisions and warranties, and their characteristics, these above mentioned matters are not discussed further in this study.

In addition to the legal tools, there are also issues for which it is impossible to be prepared by legal terms, for example, cultural differences. Ghauri and Usunier (2003, 462–463) point out that there is no point to commence the negotiations if the basic interests, objectives, and behavioural norms of the partner's culture are not scrutinized beforehand. Consequently, Hendon et al. (1996, 90–91) comment that the planning is the most significant single factor determining the success or failure of the negotiations. Accordingly, the preparation in advance can help in proceedings of the negotiations (Hitt & Pisano 2004, 52). For example, Marks and Mirvis (2001, 81) point out that good negotiators have a clear definition of synergies sought, and those are tested before negotiations commence and the momentum starts to build. Nevertheless, it is worth noticing that in this study the termination of the negotiations can be understood to mean success.

3.4 Synthesis

Ghauri and Usunier (2003, 468–469) point out that walk-away possibilities may be unclear in the commencement of the acquisition process. Nevertheless, despite the beneficial circumstances on the paper, there might be a mismatch between the acquisition parties during the negotiations and, consequently, a party or both parties are not willing to continue the process further. Accordingly, a negotiation party must determine upfront what the maximum which is wished to be achieved is and what the minimum which is prepared to be still accepted is. Figure 7 describes the options of walk-away actions in three different situations.

²⁴ A retention period is understood to mean that a certain amount of the price is retained on the completion of the deal in order to give the acquirer enough time to assess whether the warranties are true or not. The period can be as long as six to eighteen months. (Wilkinson 2007b, 190.)

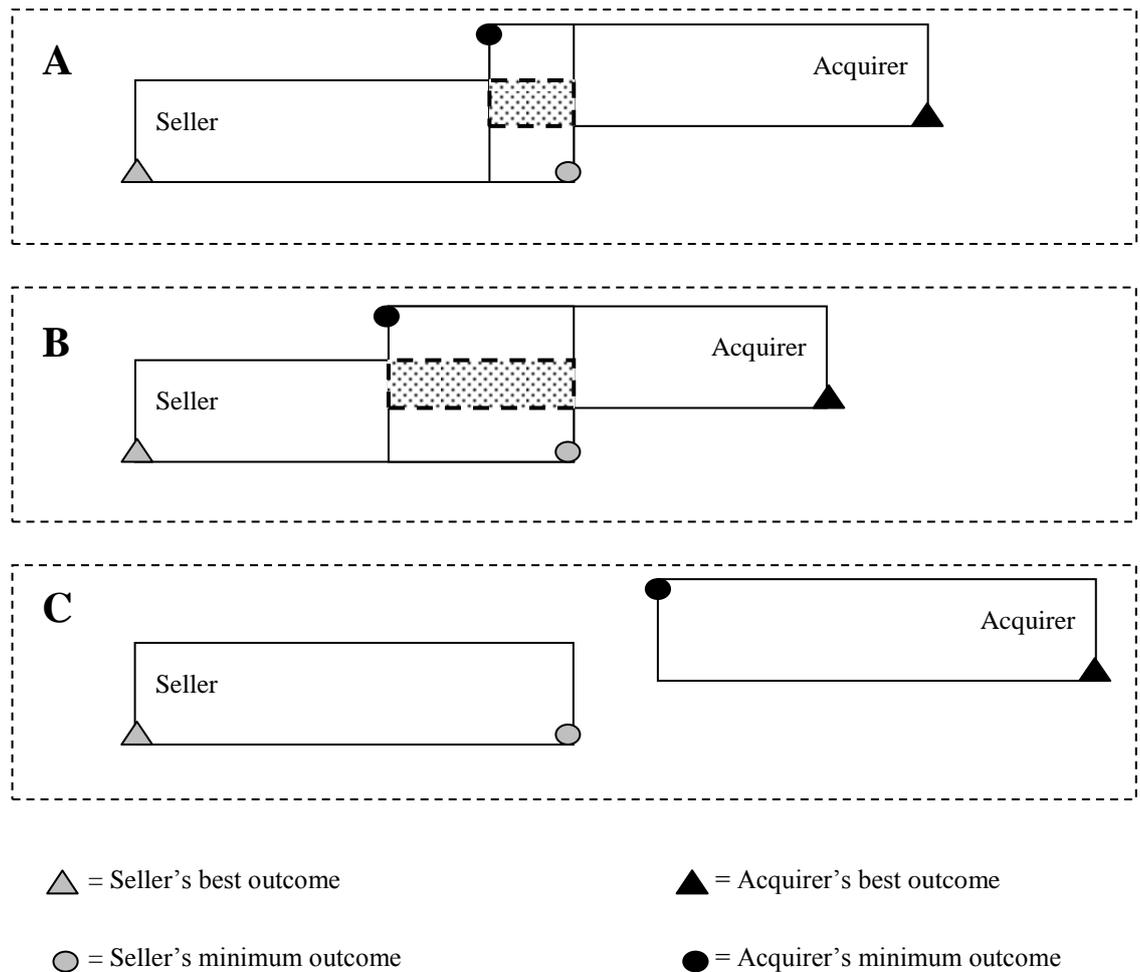


Figure 7 Negotiation parties' minimum and maximum outcomes (adapted from Ghauri & Usunier 2003, 469)

In figure 7, the situation A shows that there is a relatively small overlap between the minimum levels set by the acquirer and the seller. This may indicate that the parties are unwilling to cave in to other party's requirements. The situation B is in this respect more favourable because the overlap is larger, and the negotiations should definitely be continued. In the situation C there is no overlap which may be a reason both underlying the termination of the negotiations and behind the decision of not wasting any more resources in order to find an agreement. (Ghauri & Usunier 2003, 468.) Thus, it can be understood that in situation C, the walk-away decision should be easier than, for example, in situation A. Nevertheless, walking away from the deal is always extremely difficult. An acquirer invests a large amount of money, time, and resources in the acquisition process, and the public expects that the company's market value keeps increasing. Accordingly, the willingness to acquire is substantial. (Erkkilä 2001, 74.) Nevertheless, Ghauri and Usunier (2003, 477–478) state that the image of 'a deal closed is better than none' can be dangerous. Thus, figure 8 provides a synthesis of the pre-acquisition phase, deal breakers, and walk-away possibilities.

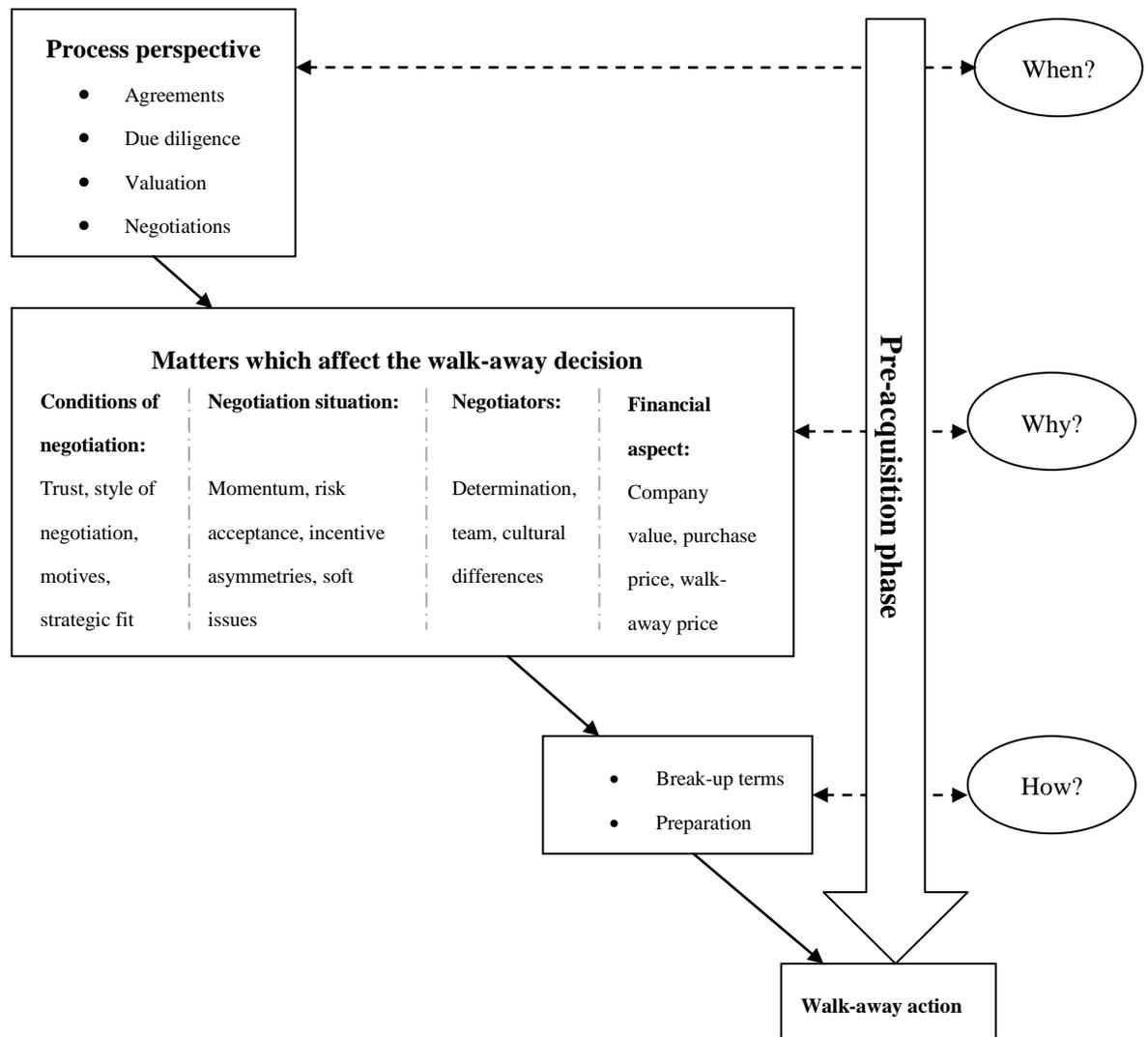


Figure 8 Pre-acquisition phase, deal breakers, and walk-away possibilities

The process perspective of the pre-acquisition phase is described in the upper part of figure 8. There are four main periods within the pre-acquisition phase, namely the agreements upon contracts, due diligence, valuation, and negotiations. These are also periods during which the impetus to the decision of walking away from the pre-acquisition phase can arise. Therefore, this aspect covers the first sub-objective of the study as it can be seen in the right side of the figure. The matters underlying the walk-away decision are summarized in the second box, and they are categorized according the chapters of the theoretical framework, namely conditions of negotiations, negotiation situation, negotiators, and financial aspect. As discussed in the previous chapters, the surprising results of due diligence and the disagreement over the price are not only factors which can cause the termination of the pre-acquisition phase. For example, according to Ghauri and Usunier (2003, 469), there are many reasons for the termination of the deal but these may be related, for instance, to:

- The initial definite premises have changed (for instance, an increase in price).

- Key people have changed their employer.
- Partners have discovered that the organizations will not fit together even though the deal itself on the paper seems perfect.

Furthermore, deals are terminated because of the reliability either of information or of people, or when there is too conflicting viewpoints concerning either the price or the terms of the contract (Very & Schweiger 2001, 21). A fragmented decision-making, momentum, ambiguous expectations, and multiple motives are also crucial factors in acquisition failures (Haspeslagh & Jemison 1991, 69). Moreover, in a study carried out by PricewaterhouseCoopers (Going West... 2009, 3), cultural issues are notified to be the most significant obstacles to cross-border acquisitions. According to Angwin (2001, 55), cultural differences exist particularly both in the way in which companies perceive the value in due diligence and in the way in which they view the pre-acquisition phase. The willingness of walking away is also determined to some extent by the negotiators' risk acceptance and determination. Thus, the theoretical basis for the second sub-objective of the study is multifaceted.

The third sub-objective of the study, namely the matters which are used in order to prepare for possible deal breakers, are described in the lower corner of the figure. In this category can be included different kinds of break-up terms and warranties, and the preparation in advance for the cross-cultural negotiations. Accordingly, these three above mentioned aspects result in a possible walk-away action. In conclusion, as Ghauri and Usunier (2003, 469) conclude: "strategy is a lot about what one chooses not to do".

4 CONDUCTING THE RESEARCH

4.1 Research strategy

This research is utilizing *qualitative research methods* because the purpose is to understand the termination of the pre-acquisition phase and factors underlying this action. Denzin and Lincoln (1998, 5–8) state that qualitative researchers aim exactly at understanding both of the construction of reality, of relationships we have with it, and of its situational constrains. Qualitative research methods are utilized in many paradigms, from cultural studies to feminism, but it has no theory of its own, and multiple methodologies and research practices are taken advantage of. This has resulted in the criticism towards qualitative research because it can be regarded to be unscientific, too exploratory or too personal. Nevertheless, in this study personal experiences and views are required tools in order to be able to understand the settings of the walk-away actions.

Ghuri and Grønhaug (2005, 111) comment that qualitative and quantitative research methods are applicable at different stages of the research. It can be argued that generally the research within the merger and acquisition field is at the third level – the subject is not a new phenomenon but there is still a lack of exact ‘walk-away theory’ (see also chapters 1.2 and 1.3). Moreover, in general both qualitative research methods (see, for example, De Mattos et al. 2008; Sebenius 1998) and quantitative research methods are used (see, for example, Bates & Lemmon 2003; Officer 2003). These different stages, however, only prove that reality can be studied from many points of view. Furthermore, in order to be able to carry out quantitative research, a researcher should have an access at least to dozens of acquirers. This, in turn, would require an access either to a list or to a database in which there would be discovered terminated mergers and acquisitions. The non-existence of this kind of list is due to the fact that the information on broken down acquisitions is generally possessed only by the acquisition parties themselves. Moreover, it is impractical to carry out quantitative research if it brings no additional value for the solution of the research problem. Consequently, this research is not carried out in order to make comparisons or generalizations in the sense that it could be said, for example, that disagreements over pension arrangements always result in the termination of the pre-acquisition phase.

Ghuri and Grønhaug (2005, 56) define research design as the plan which assists in relating the research problem with the empirical research. That is to say, the research design gives a framework both for the gathering of the data and for its analysis. This research is regarded as *descriptive research* because the research provides a description

of the walk-away action, and it was possible to define the purpose of the study in detail already at the beginning of the research process (Ghuri & Grønhaug 2005, 58–60; Berg 2004, 256–257). Nevertheless, the choice of descriptive research design is subject to constraints (Ghuri & Grønhaug 2005, 56), such as, time constraints set by the researcher herself, limited money available, and limited experience of the researcher. In consequence, all these elements impact on the scope of the research.

4.2 Expert interviews as a data collection method

In this research, the data collection is based on expert interviews even though Eriksson and Kovalainen (2008, 77–78) argue that the empirical data can be collected from various sources. The expert interviews were chosen as the data-gathering technique due to several factors: First of all, there are no written documents on the terminated acquisitions and deal breakers, or at least, they are publicly unavailable. Therefore, the usage of existing documents as a primary data source is impossible. Secondly, the walk-away action is difficult to observe because it always happens as some kind of a surprise – naturally the ultimate aim is to complete the acquisition and avoid the deal breakers. Accordingly, the walk-away actions are difficult to understand outside their natural sceneries and without the individuals who either have been or are at the moment a part of these sceneries. Thirdly, it is believed that it is the merger and acquisition experts who have unique knowledge on the terminated acquisitions, and like Hesse-Biber and Leavy (2006, 119) note, this knowledge is accessible through verbal connection. Thus, the experts assist in the transformation of practical and complex business issues into a more understandable and descriptive format.

A researcher must decide how broad area of reality is covered in the research (Berg 2004, 252). In this study, the decision on the appropriate number of expert interviews is based on the saturation point. The saturation point is understood to mean the point after which the researcher feels that there is nothing new found in the setting any longer without jeopardizing the research perspective (Hesse-Biber & Leavy 2006, 255, 272). Thus, it is believed that increasing the number of expert interviews from five without the change in the purpose of the research or without further limitations in the scope of the research, would bring no extensive additional value. In addition, the small sample size is acceptable and even desirable because the purpose of the study is not to make generalizations upon how many companies have walked away from the pre-acquisition phase, but to understand how companies have experienced this action and why they have done it. In other words, the purpose is to describe the meanings which merger and acquisition specialists attribute to this social situation.

4.2.1 Selection of experts

When the search of possible interview candidates was commenced, it was believed that it may be easier to contact large, international companies and their experts simply because larger companies usually have resources and capabilities to act as acquirers on a regular basis. Moreover, in order for the experts to be willing to discuss broken down acquisitions, they would have to have, on the one hand, experience of many years' standing on mergers and acquisitions and, on the other hand, experience on successful acquisitions in addition to unsuccessful ones. Therefore, it was believed that the experts probably work for large, international companies. In addition, according to Odendahl and Shaw (2002, 303), the existence of experts²⁵ can be verified with rankings and numerical indexes. Consequently, the number of mergers and acquisitions carried out by a company was checked from the website of Talouselämä (Yrityskaupat) before sending a request for an interview. Obviously it does not mean that the same person has always been carrying out the acquisitions within the company but the website gave a direction for the researcher. Accordingly, target population, its accessibility, and type of an organization were considered closely as Ghauri (2004, 112–113) suggests. Table 2 summarizes the expert interviews carried out in this research.

Table 2 Expert interviews carried out

Expert	Company	Responsibilities of the expert	Date	Duration
Mr Tom Nikander	Tieto Corporation	Senior Vice President, Corporate Business Development	20.11.2009	55 min
Mr Jukka Kaitaranta	Raisio Plc	Former Director, Business Development ²⁶	26.11.2009	78 min
Mr Mikael Österlund	PwC	Partner, Transaction Services	9.2.2010	41 min
Mr Michael Hardy	PwC	Partner, Transaction Services	11.2.2010	52 min
Mr Matias Lindholm	PwC	Partner, Corporate Finance	3.3.2010	38 min

As it can be seen from table 2, five expert interviews were carried out: Mr Nikander is the Senior Vice President of Corporate Business Development of Tieto Corporation, and he has over 10 years of experience on mergers and acquisitions. Tieto is an IT

²⁵ Odendahl and Shaw (2002, 299) prefer the term 'elite'. Elites are individuals who have more knowledge, money, status, power, and privileges than other individuals within the population have. Because the interviewees' positions within the organizations are high, it can be understood that they are elites regarding the level of knowledge and power. However, in order to guarantee the conformity of the study, only the term 'expert' is used.

²⁶ Currently Principal Lecturer of Turku University of Applied Sciences.

service company which main market areas are Northern Europe, Germany and Russia. It has strengthened its expertise in the chosen industries with several cross-border acquisitions within the last decade, and the growth strategy is supported with acquisitions in the future as well. (About Tieto 2010.) Mr Kaitaranta is the former Director of Business Development of Raisio Plc, and he was coordinating the acquisitions of the company during his career within the Group. Raisio operates in the food and feed industries, and its main markets are Finland, Sweden, the Baltic countries, Russia, Ukraine and Poland (Raisio Group 2010). Mr Österlund and Mr Hardy are both the Partners of Transaction Services of PricewaterhouseCoopers (PwC). Mr Österlund has approximately 15 years of experience and Mr Hardy approximately 10 years of experience in the field of mergers and acquisitions. Transaction Services provide advisory services by assisting companies both to carry out acquisitions and divestitures, and to access the global capital market (PwC Transaction Services 2010). Mr Lindholm is the Partner of Corporate Finance of PwC, and he has approximately 15 years of experience in mergers and acquisitions. Corporate Finance provides advisory services relating to issues of corporate finance and valuations (PwC Industry Expertise). Consequently, the above mentioned experts have several years' experience in the field of domestic and cross-border mergers and acquisitions. Furthermore, the emphasis is on every expert's experiences and thoughts, not on the companies which they have worked for or are at the moment working for. As a result, the companies were introduced extremely briefly.

The experts were chosen by using *a convenience sample*. The convenience sample is understood to mean that the sampling follows no predetermined plan. Instead, a researcher faces circumstances which provide possibilities, for example, of pooling the participants for the research. (Hesse-Biber & Leavy 2006, 71.) There were several favourable circumstances which assisted in the access to interviews: First of all, pre-existing contacts with some of the companies facilitated the access to them. Secondly, the assistance of Mélanie Raukko, researcher and project coordinator at Turku School of Economics, with regards to the interview contacts was extremely important. Thirdly, a trainee position at the time of the research within one of the companies enabled the researcher to make new contacts. Fourthly, careful negotiations and persistence were also central. In conclusion, eight interview requests were sent by email of which five were positive and the experts agreed to the requests. One did not answer at all, one said that she has no experience on terminated acquisitions, and with one there were collisions of schedules. Moreover, the expert who did not answer at first was not contacted again afterwards because of the achieved saturation point (discussed in chapter 4.2). Accordingly, getting the access to experts required ingenuity, social skills,

contacts, circumstances, and careful negotiations (Odendahl & Shaw 2002, 305). In addition, two of the interview requests were sent by using *a snowball technique*²⁷. This was done because the researcher had no direct contact information of a merger and acquisition expert within the companies. Within the both cases, the right person was finally found.

4.2.2 Conducting the expert interviews

The interview situations were based on a semi-structured question framework (see appendix 1). That is to say, the outline of the topics and issues to be discussed as well as the most important questions were planned in advance (Eriksson & Kovalainen 2008, 82). The main topics and issues chosen were based on the theoretical framework: The background questions were related to the interviewees' positions, roles, and careers. The questions relating to the pre-acquisition phase and acquisition negotiations covered the discussions both on the process aspect and on the possible deal breakers. The last section, the questions relating to the walk-away action, was focused on the walk-away decision-making and on summarizing the earlier sections.

All interview questions were open-ended. According to Eriksson and Kovalainen (2008, 82), this type of interview is especially useful for an intensive and broad analysis which aims at an understanding of a participant's point of view. The interviews which would be open and narrative in nature were required because the hints of interviewees' attitudes towards the termination of the pre-acquisition phase would be of value for the analysis, and these were thus hoped to be discovered. For this reason and because of the sensitivity of the subject, it was assumed that the interviewees may reveal more if they were given an opportunity to answer voluntary and freely to the questions. Moreover, in order to get a comprehensive view on the matter, the focus of the questions was not on any specific acquisition. Therefore, the interviews included common questions, but still each interview was unique, forming a unique 'puzzle piece' as Wilkinson and Young (2004, 208–209) state.

The semi-structured nature of the questions was due to the fact that it is extremely difficult to form structured questions which would account all the possible answer alternatives about the pre-acquisition phase and deal breakers. In addition, it was wanted to guarantee that the question ordering and the wording of questions can be modified during the process. This was proved to be a good decision because the experts' answers generally covered several subjects simultaneously. It also assisted in deleting or adding

²⁷ The snowball technique is a method of non-probability sampling in which the sample is built with the assistance of informants (Blaxter, Hughes & Tight 2006, 163).

questions between the interviews. This possibility of modifying the questions was necessary because the interviews took place during a long time period. That is to say, the first interviews were carried out in November 2009 and the last ones in March 2010 (see table 2). Thus, a selection of questions was added after the first two interviews in order to guarantee that the purpose of the research would be met. In addition, the interview situation with the corporate finance expert was focused on the pre-acquisition phase, walk-away price and valuation, and the questions of acquisition negotiations were overlooked. This was because acquisition negotiations were discussed widely with other interviewees, and it was believed that the expert would be able to offer more views in particular to the other themes. As a result, this interview was also slightly shorter than other interviews (see table 2).

Hirsjärvi and Hurme (2008, 34) state, however, that there is a risk of source of error both because the questions were sometimes differed from those of written in the question framework mainly in the form of wordings, and because sometimes the explanations given by the researcher could drive the interviewee to give desirable answers regarding the study. However, in this study the explanations given were seen more as necessary rather than problematic: Possible confusions about some terms were pre-empted by explaining, for example, what is the scope of the research within the acquisition process. In addition, after finding out that the term 'walk-away price' was not immediately familiar to some of the interviewees, in subsequent interviews the term was automatically explained. However, there were some differences between the experts because at least one of them had been a researcher in the past and he was, thus, familiar with the academic concepts to a large extent.

Before carrying out the interviews, the interviewer familiarized herself with the companies' acquisition history, and the interview framework was modified if needed. It was also decided in advance which questions could be overlooked if there were problems with the sufficiency of time. All interviews were carried out face to face in each company's facilities. In some occasions this required that the researcher travelled to Helsinki but all other arrangements considering the venue were arranged by the other party. The interviews were carried out either in an interviewee's office or at a separate conference room. In addition, the interviewer was always able to sit close or opposite the interviewee. The door was always closed and there were no other persons involved in the interviews. Nevertheless, there were a small number of interruptions which were mainly due to telephones. After these interruptions the discussions continued without that the researcher had to remind what the topic was. Therefore, the interruptions were not seen as problematic.

The interviews were recorded with the consents of the interviewees. Four of the interviews were carried out in Finnish and one of them in English because of the different nationality of the interviewee. Therefore, the common language enabled the

effective communication and analysis. The researcher said very few words during the interviews except both showing her engagement through gestures and asking few clarifying questions. This was quite a good tactic because most of the interviewees gave examples on their own initiative, and they spoke quite freely about terminated acquisitions. If there was something that they did not want to be revealed in the research, it was always said separately. Furthermore, it was also agreed with all interviewees that they will remain anonymous while analyzing the results even though their names could be revealed while introducing the methodology of the research. Accordingly, both the preparation relating to logistics and physical context of the venue, and mental preparation were considered carefully as Wilkinson and Young (2004, 209) suggest.

Nevertheless, there were also challenges with the expert interviews as Hirsjärvi and Hurme (2008, 34) state. For instance, the search of the appropriate interviewees and getting in contact with them took several weeks. It was also challenging, in one case even impossible, to schedule the meetings because of the tight schedules of the interviewees, and the interviews had to be rescheduled several times. Furthermore, the interviews themselves as well as their transcribing required time to a large extent, and the interviews carried out in Helsinki caused also some costs.

4.3 Data analysis

According to Hirsjärvi, Remes and Sajavaara (2009, 221), the analysis, interpretation and conclusions are the most important phases of a study. Accordingly, the analysis was a non-stop work during the thesis process: because the interviews took place at very different times, the preliminary analyses, such as transcriptions and writing down the main points of each interview, were done immediately after each interview. Also the observations made, such as the nature of the interview atmosphere, interruptions, and the way of telling examples, were noted down immediately after the interviews. In addition, a couple of charts and pictures which were shown during the interviews but which were not given to the researcher were drawn to the notes when they were still remembered. Therefore, the analysis process was commenced long before the commencement of the actual writing of the findings. This method of long analysis process is supported by several scholars (see, for example, Hesse-Biber & Leavy 2006, 142; Hirsjärvi et al. 2009, 223; Wilkinson & Young 2004, 221).

The analysis was continued by going through the transcribed interviews in case of missing information as Hirsjärvi et al. (2009, 221–222) suggest. The only matter which was inquired afterwards by email was the clarification on an expert's former responsibilities and the former title. Thus, the missing information was completed if it

was seen necessary. Eskola and Suoranta (1998, 161–162) state that there are several analyzing methods and they categorize them into six different methods: quantification, organization by themes, classification by types, classification by the content, analyzing the discourse, and analyzing the conversation. However, frequently several methods are employed and other kinds of categorizations can also be seen (see, for example, Hirsjärvi & Hurme 2008, Blaxter et al. 2006; 152–154; Ghauri & Grønhaug 2005, 207–212). Accordingly, in this study, organization by themes and classification by types were used. *Organization by themes* rests on the fact that there can be discovered themes which answer to research questions (Eskola & Suoranta 1998, 175–176). Therefore, it was decided upfront how the chapter considering the main findings was going to be constructed. The transcriptions were then systematized according to this grouping with the assistance of different fonts and colours. Moreover, it was written down to the side of the text which matter was discussed in each paragraph. For instance, the discussions on deal breakers were symbolized with ‘DB’ whereas the discussions on the challenge of the walk-away action were symbolized with ‘WW’.

Furthermore, it was also written down as marginal notes whether the statement in question was also noted in some other interview, and whether these statements were coincident with each other. This can be understood as the method of *classification by types*. This method requires that the data is first organized, for example, with the assistance of themes. (Eskola & Suoranta 1998, 182.) Therefore, the statements were easier to compare with each other when they were first marked with the above mentioned combination of letters. At this stage it was also noticed that the differences between the interviewees’ backgrounds gave variety to the research because the consultants and corporate experts²⁸ become involved in the pre-acquisition phase at different stages and, thus, their roles in the pre-acquisition phase vary (differences are discussed further in chapter 5.1.1). The organization by themes and classification by types were quite simple to carry out as the main points of each interview were easily recognized. Eskola and Suoranta (1998, 179) conclude that theme categories are a good method of analysis method when the research questions are very practical. In that case, it is easy to extract relevant data from the narrative. Accordingly, it was noticed that these methods were useful as they left space also for new themes to occur and the analysis was not limited to pre-determined codes. As a result, for example, the findings on complete and adaptable deal breakers were discovered.

It is worth noting that the analysis is a result of subjective choices. Blaxter et al. (2006, 202–204) state that the researcher always chooses which items are emphasized

²⁸ The concept ‘corporate experts’ are employed when referring to the interviewees who are not acting as consultants. On the contrary, ‘consultants’ are the interviewees who actually work in the consulting business.

and discussed, and which are used to illustrate the arguments. This selection process was extremely important because the interviews gave much information, for example, both on the acquisition process in general and on the acquisitions of family-owned companies, but this data was not relevant according to the purpose and scope of the research. Therefore, more information was gained than finally reported.

4.4 Evaluation of the study

The most appropriate evaluation criteria for qualitative research are under the debate (see, for example, Eriksson & Kovalainen 2008; Tynjälä 1991; Lincoln & Guba 1985) and there is no consensus on what is the best way to ensure the trustworthiness of a study. However, this can be argued to describe both the subjective nature of qualitative research and the way of seeing the reality as consisting of various interpretations. According to Lincoln and Guba (1985, 300), within the evaluation of a study's trustworthiness four elements may be distinguished: credibility, transferability, dependability, and confirmability. All these concepts are discussed below.

Credibility refers to the fact that a study is conducted in a way which enhances the results' probability of credibility and that the study describes reality as it really is. However, it can be stated that the perfect description of reality cannot even be achieved because reality is subject to various mental constructions. Nevertheless, there are several ways to increase it. (Lincoln & Guba 1985, 294–296.) Firstly, the expert interviews were long enough in order to give a large amount of data to be managed and analyzed. They were also carried out during several months which enabled that there was time for the analysis between the interviews, and the question framework could be modified in order to finally meet the purpose of the research. The interviewees received a detailed description of the research subject when they were asked to participate in the study in order to guarantee that the time reserved for the interview time could be exploited as well as possible. Therefore, the vast knowledge on the interviewees' experiences on the pre-acquisition phase and deal breakers was achieved. Moreover, the experts had several years' experience on mergers and acquisitions, and all of them had also seen walk-away actions. Thus, it can be understood that the experts were appropriate interviewees.

Secondly, in most occasions triangulation can be used to improve the credibility of a study (Tynjälä 1991, 392–393) but in this study the usage of different sources and methods was limited except the review of company information prior to the interviews (see chapter 4.2.1). However, as discussed in chapter 4.2, the usage of other data collection methods was impossible because of the nature of the research's purpose, and taking advantage of many researchers was not even considered at this point. Thirdly, the

operationalization chart (see chapter 1.3) was used in order to assure the congruence between the purpose of the study, the theoretical framework, and the interview questions. This confirmed that all the aspects of the study proceeded to same direction all the time.

Fourthly, ‘member checking’ could be done in order to enhance the credibility of the study. Member checking is understood to mean that the parties from whom the data is collected also check the correctness of it (Lincoln & Guba 1985, 314). However, because the analysis was not emphasized either on accurate figures or on company names expressed during the interviews, this was not seen as necessary. Moreover, when considering the challenges of finding time for carrying out the interviews, the request of whether participants would check the transcribed interviews would have been fruitless. None of the participants asked for member checking but they did ask for a copy of the completed research. Therefore, the participants’ evaluation about the correctness of conclusions will be received only afterwards. Finally, the intelligibility of terms and concepts was also considered as Tynjälä (1991, 393) suggests. The terms used in the academic literature were understood and known by the participants with the exception of few details (discussed further in chapter 4.2.2). Moreover, the interviews were carried out at the mutual native language whenever possible, they were recorded, and the transcriptions and notes were read several times in order both to improve the truthfulness of the data and to improve the credibility of the study.

Transferability differs from other evaluation elements because it is the duty of a researcher to offer only the tools for a reader to evaluate whether the findings are usable and applicable to other contexts (Lincoln & Guba 1985, 297, 316). On the one hand, the foundations for the evaluation of transferability are laid in chapter 4.2.1 in which the criteria for the selection and the descriptions of the experts are explained. However, the study is not about the companies themselves, and only the facts which were seen to be of value when evaluating the criteria for selecting the experts are presented. The experts and their companies are introduced by names in order to improve the evaluation, but because of the wish of the experts, they remain anonymous while discussing the findings. In addition, mergers and acquisitions are not named separately within the report, even if they had been briefly mentioned during the interviews. On the other hand, the settings of the evaluation of transferability are discussed in chapter 1.3 in which the scope of the research is explained in detail.

It can be argued that the experts’ opinions and experiences are similar to those of other acquisition experts to some extent. For example, the non-existence of strategic fit is probably a deal breaker regardless of the industry and the decision of walking away from the deal is most likely always a result of the lengthy considerations. Nevertheless, there must be shown criticality when transferring results to other contexts because, for example, the size of a company, the ability to gain finance, and the role of the board in

the walk-away decision-making affect certainly the willingness and the ability to take risks. The limitations of the research are discussed further in chapter 6.3. Furthermore, the findings of the interviews are considered in conjunction with the existing theoretical framework (see also figure 9) in order to increase transferability.

Lincoln and Guba (1985, 318) argue that the evaluation of *dependability* can be described metaphorically as an audit which consists of an examination both of the process and of the product. Tynjälä (1991, 391) specifies that the evaluation of the process refers to the evaluation of the research situation including, for example, considerations both about the researcher, about the surroundings of the research and about the research subject itself. Dependability was enhanced by open atmosphere and trust, which resulted in the situation in which a large amount of examples were given. This was partly due to the researcher's role as a trainee within one of the companies. Nevertheless, according to Lincoln and Guba (1985, 302), this leads to the situation in which a researcher needs to show judgement because of possessed values and constructions which may easily distort the analysis and conclusions. However, this was not seen as problematic because the employer-trainee relationship continued only two months, which does not yet jeopardize the researcher's objectivity. Moreover, the experience of being more an insider than an outsider facilitated the contact to this particular company. Furthermore, Odendahl and Shaw (2002, 313) draw attention to the fact that separating the person being interviewed from the institution in which he or she works is also challenging, in particular with the experts. However, this was minimized by forming the interview questions, for example, as follows: 'In Your experience, what is most challenging during the negotiations?' or 'How would You describe the pre-acquisition process?'. This also emphasized the aspect that it is the experts themselves which are of interest, not the companies.

The examples were of great importance and assistance while analyzing the results. Nevertheless, the interviewees' style of telling about their experiences varied to a considerable extent, and some of them were more descriptive than others. However, the research topic was experienced as sensitive at least to some extent because the participants were clearly careful about not to reveal too many company names, years or locations, but this was an issue which was predicted already at the beginning of the study. Furthermore, interruptions during the interviews are one matter which may hinder dependability but in this study, the interruptions were not seen as problematic (discussed further in chapter 4.2.2).

The examination of the product, in other words *confirmability*, refers more to the evaluation to what extent findings, results, and recommendations are based on the data (Lincoln & Guba 1985, 318). According to Eriksson and Kovalainen (2008, 294), confirmability represents the linkages between the findings and subjective interpretations. First of all, the study was done in an extremely organized manner and

all the sources were documented with the assistance of Microsoft Excel. Secondly, confirmability was improved by telling openly how the study was conducted and the researcher's relationship with one of the companies was fully described. Thirdly, by using the recorder, taking written notes, transcribing the interviews, and reading them several times assured that the analysis is based on what was actually said and not on imagination, on earlier beliefs or on experiences as a trainee. Nevertheless, because the interviewees are presented anonymously when analyzing the results, it complicates the conduction of a similar research in order to evaluate confirmability.

5 STEPS TOWARDS THE WALK-AWAY ACTION

5.1 Timing of the walk-away action and acquisition negotiations²⁹

This chapter discusses the general findings concerning the pre-acquisition phase and the acquisition negotiations. That is to say, chapter 5.1.1 focuses on the interviewees' descriptions on the pre-acquisition phase in general. The role of preliminary contracts, the timing of due diligence, and the phases during which the pre-acquisition phase is likely to be terminated are discussed. Chapter 5.1.2, in turn, puts more emphasis on the acquisition negotiations: the playing field of negotiations is introduced and the importance of negotiators' skills and capabilities for the acquisition negotiations as well as the non-existence of clear negotiation phases are discussed.

5.1.1 *Pre-acquisition phase and non-binding preliminary contracts*

It can be argued that the scope of this research (see chapter 1.3) was limited in a way which has no unanimous theoretical background. In other words, the understanding of the pre-acquisition phase is a subjective matter, and similarly the interviewees described the process differently despite the fact that the scope was explained to them in advance. For instance, three out of four respondents commenced the description of the pre-acquisition phase from 'a long list' – the phase in which there are still a number of target candidates and they are not yet whittled down only to the most promising ones. Nevertheless, this supports the views of Marks and Mirvis (2001) on the ambiguity of the acquisition process. Furthermore, the elaborateness of the descriptions varied to a considerable extent as some of those were more detailed, including for example the duration of different phases, and some of those covered only the major lines of the pre-acquisition phase. The following citations demonstrate the range of descriptions of due diligence process by two interviewees.

This would be like, you could call this 'phase one due diligence'. They get the Information Memorandum. They get access maybe to the vendor due diligence report³⁰, or actually probably not. Probably they get the IM

²⁹ If not otherwise stated, the findings and discussions are based on the expert interviews carried out.

³⁰ Vendor due diligence is an independent due diligence research carried out from the target company at the expense of the seller (Blomquist et al. 2001, 20).

and then they get access to some other limited information, maybe to management presentations.

[...], then all these due diligences are done.

However, the descriptions between the consultants and the corporate experts did not vary to a considerable extent. Moreover, in general there were few aspects which were discovered to differ between these two parties: Firstly, the consultants emphasized more the general economic situation than the corporate experts. Secondly, the consultants also paid more attention to the categorization of acquirers into corporate acquirers and private equity investors. Thirdly, the consultants usually participate in the deal at the later stage of the process and, thus, their views on the first stages of the pre-acquisition phase were not as detailed as the descriptions provided by the corporate experts. The differences might be due to the fact that consultants' assignments are to a large extent dependent both on the general economic environment and on the nature of the customer. These differences are not in major role while discussing on the findings because it is believed that mentioning them always separately would bring no additional value for the research.

An interviewee showed a detailed process description which contained all the elements taking place during the pre-acquisition phase, and which was build according to the respondent's own experiences within the company. This description followed the description in figure 5 (see chapter 2.4) to a large extent. The main difference was that negotiations were described to be carried out only after due diligence phase instead of negotiating throughout the process. However, this might be a matter which is more due to the technical way of presenting it because in order to carry out due diligence a certain kind of contact is required in any case. Contrary to this description and despite the substantial emphasis on the process perspective in general (see chapter 2.2), another participant stated:

We took the method that we do not have a detailed process description on the acquisition process because... Well, let's say, with colleagues we have found that it would bring more harm than good with it [...]. In addition, there is not even one uniform description of the acquisition process.

Some of the interviewees described due diligence as a two-phase process whereas some of them referred to it more as a general concept taking place somewhere between the preliminary contracts and the final agreement as Blomquist et al. (1997) also states. Nevertheless, none of the participants did suggest that due diligence could be done as a post-acquisition audit (see Picot 2002b). On the contrary, it was emphasized by two participants that the final decisions and conclusions cannot be made before due

diligence is completed and its results can also be considered, or at least they should not be done that early. As it was demonstrated by one respondent:

We are quite rigorous that before making the final offer, it is required that we have been able to do an extensive due diligence.

Furthermore, only one of the interviewees mentioned the valuation and determination of the purchase price as a separate part of the pre-acquisition phase which is carried out already before the preliminary contracts and due diligence. This is worth noticing because there was also an opinion according to which, in order to be able to price the target company, the acquirer must understand the synergies which are anticipated from the deal and, thus, in order to understand possible synergies, due diligence must be carried out. Therefore, according to this latter opinion, the valuation could not be carried out before due diligence.

All participants agreed that preliminary contracts are used when entering into the acquisition process, but like Picot (2002b) notes, the contract terms and the content of the agreements are subject to companies' own interpretations. Therefore, the terms LoI and MoU (see chapter 2.4) were both used, and there was no clear distinction provided for them by the interviewees. Nevertheless, all agreed that a certain kind of a confidentiality agreement is signed, but at most occasions its scope is extremely limited covering basically only the non-disclosure of information and sometimes also the exclusivity period. Furthermore, there was also a consensus that preliminary agreements are always understood as non-binding in nature without even moral obligations (see Wilkinson 2007a). As an interviewee stated:

They [preliminary contracts] are often that kind of in nature that you are always able to get rid of them though. [...] it is more a declaration of intent.

The respondents drew attention to the fact that preliminary agreements form a framework for the negotiations in which there is described, for example, what is important for both of the parties. In addition, a selection of main terms and a broad price indicator can also be agreed in the preliminary contracts. The seller might require that this kind of a rough term sheet is already agreed at this stage in order that they would grant an access to due diligence for the acquirer. This relates closely to the description of an ever-changing term sheet provided by Boeh and Beamish (2007). Nevertheless, an interviewee pointed out that the LoI and MoU are seen in corporate-to-corporate transactions whereas in structured auction processes, there might be a process letter provided by the financial advisors running the sale for the company. Thus, it can be understood that the type of the pre-acquisition process affects the agreements made as discussed in chapter 2.4. All in all, the documents which oblige acquirers to make a deal at certain terms are avoided at the pre-acquisition phase. As it was demonstrated by an interviewee:

We will never write an agreement which would at that time bind us to the execution of the deal for good. Some might do it, but we are really strict about it.

This also supports the above mentioned view that because the final decisions can be made only after due diligence, the acquirer should retain the right to do changes to preliminary contracts. One of the participants made it clear that this can be understood as a pitfall during the pre-acquisition phase.

From my point of view, it is one mistake which is made in processes by some parties that they will accept that DD [due diligence] only gives a right not to sign but not a right to push changes to the draft contract. And that is a matter which you should not resort to.

Angwin (2000) expresses an opinion that it may result in problems if the integration of two companies is not analyzed early enough (see chapter 2.2). Relating to this, it was interesting to notice that the integration planning was also briefly discussed by some of the participants. It was noted by one of the interviewees that the integration planning occurs frequently between the signing and the closing of the deal, which basically indicates that it falls out of the scope of this research. Nevertheless, it was admitted by the same interviewee that in order to be able to evaluate possible synergies, the integration planning has to be done earlier. Moreover, another interviewee noted that acquiring a company and leaving it as it is without making any changes or restructurings, is not sensible for a developing business unit because then the acquirer would act only as a banker. Therefore, considering the integration already at the pre-acquisition phase can also be understood to give the acquisition its legitimacy, and it may thus become a cause behind the termination of the pre-acquisition phase.

Within the phases during which the pre-acquisition phase is most likely to be terminated, three different elements could be distinguished: (1) during due diligence, (2) during the final negotiations, and (3) between the signing and closure of a deal. First of all, the importance of due diligence as the phase during which the possible surprises are discovered was noticed by all of the interviewees. For instance, if due diligence is carried out as a two-phase process, it might be that after pre-due diligence the acquirer does not make even an initial offer, or after the actual due diligence the acquirer does not make a binding offer. Secondly, the disagreements over the final terms in the transaction contract can result in the termination of the pre-acquisition phase. As respondents revealed:

Sometimes there are disagreements over the final terms of the contract. That is to say, the matter which we are requiring, [...], and the counterparty just doesn't capitulate to it. And in particular with international projects especially in certain countries there are big issues.

On Tuesday morning the negotiations were started at an office in Riga. [...] And, to tell you the truth, I didn't leave that negotiation room earlier than on Thursday at 1 p.m. And then, we shook hands and stated that it was nice but this negotiation is now over, and we will pack our stuff and go home, and you will continue your business as usual.

In addition to the situations described above, the first two phases and deal breakers occurring during them are discussed further in chapters 5.2.1 and 5.2.2. The third point, the walk-away action taking place between the signing and the closure of the deal, is overlooked because it falls outside the scope of this research.

5.1.2 *Playing field of the acquisition negotiations*³¹

Even if the pre-acquisition phase was quite easily described as consisting of different phases, the same could not be seen while discussing acquisition negotiations. In other words, the interviewees did not refer to different negotiation stages which are presented in chapter 3.1. Nevertheless, it was pointed out by an interviewee that the same basic principles can be found in every negotiation, but the matters which are emphasized the most in each case can vary. For instance, the one may prefer that the issues are handled systemically from top to down whereas for the other it is more important that every single detail is agreed upon. The findings of re-entering the negotiation stage several times confirmed the statements in the theoretical framework (see, for example, Parvinen & Tikkanen 2007; Ghauri 2003). In conclusion, it can be argued that the process perspective is more applicable in the descriptions of the pre-acquisition phase in general than in the descriptions of the acquisition negotiations. Therefore, the views of Dupont and Faure (1991) on the negotiation continuum gained support.

The aspect which was emphasized by certain interviewees was that the success of negotiations is to a large extent dependent on the capabilities and skills of the negotiation parties. This means that the acquirer must be aware both of its own limits and possibilities and also of the seller's ones. This was demonstrated as a playing field of negotiations such as in table 3.

³¹ While discussing the findings regarding the acquisition negotiations, it must be noted that the consultants are not typically involved in those and, thus, their views may not be based on their own experiences to the same extent than with the corporate experts.

Table 3 Playing field of negotiations (adapted from an interview)

Element	Favourable level	Acceptable level	Fall back level
X			
X		← Y	
X			
X		Y →	

In table 3, on the left side there are listed the elements which are the most important for the acquirer as well as for the counterparty. For instance, an element could be the finance side of the acquisition. While determining these elements, the most favourable level for each of them will also be found out. For example, the acquirer determines that the most positive scenario would be if the purchase price was EUR 5 million. On the right-side of the table, the fall back level is understood to mean the level under which that certain element cannot go or otherwise it becomes a deal breaker. In the middle, there is the area which is acceptable in the terms of each element. The main idea behind this playing field is that after the acquirer has learned what is the most crucial for the counterparty, the acquirer will be able to bend with its own requirements and, thus, win some elements which are crucial for it. As the interviewee explained this playing field:

And you will play in this whole field. [...] That is to say, you will play it across the field. So, if you are able to draw some elements to this corner [to the left], it can be that you are able to live with it although the finance side [or some other element] transfers little bit to that corner [to the right].

The arrows in table 3 point out the transfers, in other words, the game movements demonstrated in the quotation above. According to the interviewee, this playing field and the rules of how to play it form the framework for the negotiations no matter what kind of a negotiation it is. Therefore, this playing field of negotiations can also be adapted to other negotiation situations. It can also be understood that this playing field of negotiations clarifies the same matters than the seller's and acquirer's minimum and maximum outcomes described in figure 7. Moreover, it can be argued that in order to be able to play this, a negotiator must have experience. Therefore, this is a matter which cannot be mastered by a person at the beginning of his or her career. Furthermore, while discussing the most challenging aspects in the negotiations, it was mentioned that it may be problematic to decide which matters can be revealed to a counterparty and which matters should be kept as a secret. As it was noted by a respondent:

[...], the tricky thing is to, you know, what you choose to put on the table and what you don't.

Therefore, it can be argued that acquisition negotiations represent the competitive negotiation style (see Saorín-Iborra 2008). Nevertheless, this can also be understood as a matter which is dependent on the negotiator's skills and, thus, it supports the above mentioned statement on the importance of negotiator's skills, which is in line with the opinions of Sebenius (1998).

In addition to negotiators' skills and capabilities, the negotiation tactics were also discussed both by the consultants and the corporate experts. There seemed to be some kind of a consensus that the capability to get the seller to accept the price offer is affected by the negotiation tactics to some extent. For instance, as a respondent pointed out:

This is little bit about tactics. Someone wants to go in with extremely low [price offer] and try to lower it further. Someone might think that it is more favourable to go in with a high price and, thus, ensure the negotiation seat, and only then start to negotiate the lower price.

The other respondent revealed that the most favourable scenario is if the acquirer is able to enter into the acquisition negotiations without telling the seller how much they are prepared to pay for the company. In conclusion, it was pointed out quite clearly that all kinds of so called 'take-it-or-leave-it packages' prepared by the seller do not meet the requirements of the acquirer. This was mentioned to be the case in particular (1) with auction situations, and (2) a few years ago when there was a merger and acquisition boom and the markets were dominated by the sellers. Particularly this was experienced as problematic by one of the corporate experts because according to him, the draft contract is in these cases simply ineligible. In addition, after the acquirer recommends some changes to this draft contract, they will soon notice that they are negotiating only by themselves and the seller has walked away. Therefore, the significance of negotiations as a cause of acquisition successes and failures is notable in particular if it is considered that there are no 'turnkey acquisitions'.

The aspect which was coincident with the statements in the theoretical framework was the views on fragmentation (see Angwin 2000). It was noted that the risk of misunderstandings exists because people are responsible for different tasks at different times of the pre-acquisition phase. A participant provided an example that there are always people who are not aware of all aspects of the deal and, thus, while negotiating it must be noted that there will not be any unintentional misunderstandings because of this. Another interviewee pointed out:

[...] the insider ring of people within the business that are involved at that stage is so small that everything is kept at relatively high level.

Therefore, the synergy expectations which this insider ring is anticipating and hoping for might be different from those of which are revealed during due diligence and which are actually achievable. As also stated in the theoretical framework (see chapter 3.2.2),

it was pointed out that fragmentation is no deal breaker as such but it may result in wrong value expectations which, in turn, may have an effect on the termination of the pre-acquisition phase (the findings on deal breakers are discussed further in chapters 5.2.1 and 5.2.2).

The formation of the acquisition team was also paid attention to. As one interviewee stated:

So, it is the question of whether matters can be discussed with their own names and whether the parties understand the matters right. If a layman does, or acts, as another party and in the other side there is a lawyer, they will speak different language.

It is interesting to notice that the above mentioned example was said when the interview situation considered cultural differences. However, it was immediately admitted by the interviewee that this cannot be understood as a cultural difference. This, in turn, provides dissenting opinions regarding Vuorenmaa's (2006) statement on cultural differences as an easy explanation for all problems because the example clearly showed that the difference between cultural and other factors was acknowledged. Another interviewee provided a solution for this above mentioned challenge as he noted that negotiations are frequently divided in a way that first it is the duty of principals to agree on main points and only after that it is the duty of lawyers to talk through the paragraphs of a law and decide the wordings. Therefore, as it is also concluded by Marks and Mirvis (2001), it was pointed out that the negotiation team should be as extensive and proficient as possible. Furthermore, it was argued that it is important that the negotiators negotiate deals as representatives of the acquirer, not as personal acquirers. If this would be the case all the time, the concerns over the soft issues, such as the chemistry between the parties, would be unnecessary (see Erkkilä 2001).

5.2 Deal breakers during the pre-acquisition phase

The following two chapters discuss the reasons behind the termination of the pre-acquisition phase in general. Chapter 5.2.1 focuses, on the one hand, on the aspects which are revealed automatically and, on the other, on the possible surprises during the due diligence research. The chapter commences with the discussion on the aspects which were emphasized and mentioned by all of the respondents, and at the end of the chapter, the factors which were noted only briefly are described. Chapter 5.2.2 is more concerned with the financial aspect as a contributor to the termination of the pre-acquisition phase. Moreover, the usability and meaningfulness of the walk-away price is also considered.

5.2.1 *Surprises and realities uncovered during due diligence*

The role of due diligence in order to find the skeletons relating to the target company was noticed to be significant by all of the respondents. This shows that the findings are consistent with the statements of Carbonara and Rosa (2009) on the recognized role of due diligence. The following examples were indicated by respondents.

Well, as a result of due diligence, it's... There is therefore more information gained, more understanding about the business being acquired.

And then there are of course pure due diligence findings which indicate that our fundamental axiom for the whole project or the certain kind of hypothesis is found to be leaky.

There were interesting views on the possible surprises found during the pre-due diligence. According to a respondent, the pre-due diligence comprises mainly of the elements which are also stated in the theoretical framework (see chapter 2.3.1): First of all, market due diligence should not reveal any major skeletons because the analysis of the market position and the knowledge on the market in general should have been done already before entering into the acquisition process. This was supported by another respondent when stating that in particular in domestic transactions, the companies know each other quite well and total surprises are rare. However, it was admitted that acquisitions within the borders of Finland have also been rare within this company during the last ten years. Secondly, financial and legal due diligence may be overlapping, and they may, on the contrary to market due diligence, disclose surprises. Moreover, this is also the area in which cultural differences between western, developed countries and developing countries matter. An interviewee provided an example of challenges in Russia.

[...], the question of what are the company's real rights for example to assets which are included in the balance sheet [...] is problematic.

For instance, the issues concerning the property of land and tax liabilities are observed to be challenging in Russia. Thirdly, there were some differing opinions regarding the issues exposed in human resource due diligence. On the one hand, it was commented that the key persons who are required to transfer to the new company generally are not the cause behind the termination of the pre-acquisition phase because these matters can be settled in a way or another. On the other hand, it was also expressed a view that the continuity of the old management, in particular if the company to be acquired operates in service business, is extremely important. Thus, if it is either impossible to organize the acquisition in that way or impossible to continue working with this old management, it can become a deal breaker. Fourthly, it was noted that

synergy due diligence is in a way simpler procedure because there either are synergies or then there are not. This is related to above mentioned issue whether it is sensible to acquire a company in which there is no overlapping and, thus, need for any restructurings (see chapter 5.1.1). However, it was commented that it is more probable that the synergies are overestimated than underestimated.

Accordingly, it can be regarded as a positive matter if the surprises are discovered already during the pre-due diligence because if they are exposed at the later stage, it may raise questions. It was demonstrated by a respondent:

But let's say, if they are discovered only at that point [actual due diligence], then it will hinder the whole process because the trust and credibility fade. [...]. So, if you bite bad egg once, you know that the rest is also bad.

Therefore, it can be understood that possible deal breakers should be uncovered as early as possible because there is a risk of lack of confidence which can quite easily result in the termination of the pre-acquisition phase. This issue was mentioned both by the consultants and the corporate experts as one of the major reasons for the terminations. It is interesting that theoretically the ultimate aim of due diligence is to challenge the mental idea which the target company has created from itself (see Cullinan et al. 2004), but when it actually proves to be unrealistic, it is a remarkable obstacle. If this given view on the target company is unreal in particular with the elements that are essential for the acquirer (see table 3), the process is likely to break down. Nevertheless, the change in the picture provided by the target company does not necessary mean that the information given was intentionally wrong, as it was pointed out by an interviewee:

It doesn't always mean that it would have been outright lying. On the contrary, it is often ignorance also. That is, it is extremely difficult for a manager to say that he doesn't know if I ask. And then he will probably answer like he thinks that I would like him to answer.

The ignorance on matters leads the discussion to information asymmetries (see chapter 3.2.2). It can be understood that differing views on the target company are basically due to information asymmetries. However, it was demonstrated that the magnitude of information asymmetries varies depending on the counterparties. On the one hand, with the companies which are listed on the stock exchange the information asymmetry is more insignificant due, for example, to the public information and the market value. However, with private companies this kind of information which could verify the observations is not publicly available. On the other hand, there are also differences between the acquirers: a private equity investor aims at growth potential and profits whereas an operational investor is more concerned with the business and synergies. Therefore, their knowledge base in order to evaluate, for instance, the

purchase price, differs and, thus, information asymmetries exist. Consequently, as it is suggested in chapter 3.2.2, information symmetries are not deal breakers by themselves but they easily result in the situation which becomes concrete in the form of termination of the process. For instance, because of information asymmetries the acquirer finds out that the seller has not told a crucial factor and as a result, the acquirer loses the trust on the seller and the process breaks down.

The findings indicate that the access to information was not experienced as problematic or as a separate cause behind the termination of the pre-acquisition phase, which is in contrast to the statements in the theoretical framework (see chapter 2.3.1). The respondents emphasized more that the information is frequently received bit by bit during the acquisition process. In particular this was pointed out to occur with auction processes which were described quite similarly than in chapter 2.4. Nevertheless, the access to matters such as key contracts, margins by customers, and sales by customers is frequently restricted. It was no surprise that the above mentioned aspects were noted by a consultant because companies frequently hire external advisors to carry out particularly financial due diligence and, thus, it is the consultants who struggle with the financial figures like above. Moreover, according to a respondent, companies already even know to expect that the access to information will always be limited.

The views on cultural differences and their impact on the termination were conflicting. First of all, some interviewees argued that cultural differences have a significant effect on the termination of the pre-acquisition phase due to the fact that the acquirer might not be able to understand and interpret the messages of a foreign party correctly. As a respondent concluded:

You have no, you don't know how far you can push, you don't know whether you got their walk-away point, you are not able to read their signals either.

However, it was stated as strength for Finns that they are quiet and calm, and silence was said to be a powerful tool during the negotiations. Perhaps it can also be understood that it is the quietness which is the reason behind the fact that Finns are difficult to read. Nevertheless, another interviewee saw this relating more to a negotiator's skills and capabilities, not as an issue deriving from different cultural backgrounds. Moreover, it was also pointed out by a respondent that with professional parties cultural differences should not be a problem.

Well, let's say, business is business and money talks. If you are dealing with high-powered parties, the cultural difference doesn't... It may impact on the process schedule but otherwise, from my point of view, it even can't be, it shouldn't be.

This might be explained by a fact that the corporate experts view the whole acquisition process consisting more of tactics and strategies whereas the consultants do

not have to be concerned with these matters to the same extent. In addition, cultural differences, for instance, between the new and old management have to be settled because of the importance of the continuity of the management. Accordingly, from this point of view, cultural differences offer a far-reaching explanation for the different outcomes of mergers and acquisitions exactly like Vuorenmaa (2006) suggests (see also chapter 5.1.2). Secondly, all respondents except for one consultant clarified that the eastern countries and Russia are frequently problematic. As it was demonstrated by an interviewee:

And a guy who is working in the acquisition transactions for an international company [...] stated me that he hasn't yet come across a company in Russia which would have been blameless.

Particularly tax optimization was mentioned by two respondents to cause concerns with Finnish companies because, as it was explained by a respondent:

It is always a difficult thing because everyone in a way understands that in that country you must act in a certain way. But as a Finnish public company you can't go along with it.

This statement of 'a natural way to act in Russia' was supported when it was argued that this tax optimization is quite easily discovered and, thus, it is rarely a secret. Accordingly, it is not experienced as illegal in the target country but it may be non-acceptable in the acquirer's home country. Moreover, the differences both in legal environment and in social order impact the scope of due diligence which is also noted by Blomquist et al. (1997). For example, it was demonstrated that in Russia it has been sometimes challenging to get the counterparty realize that the disclosure of information is the whole starting point for the execution of due diligence. Nevertheless, Erkkilä's (2001) views on diverse effects of geographical distance were supported because it was also noted that there might be differences between corporate cultures, which makes the concept of geographical distance irrelevant. Furthermore, it was quite natural that it was in particular Russia which was emphasized because both Tieto Corporation and Raisio have operations in Russia, and PwC has so called Russian Desk which is focused on deals involving Russia. Therefore, it may be a reason behind the fact that, for example, Asia was not mentioned during the interviews.

The aspect which was noticed by all of the respondents was the strategic importance of the acquisition. As an interviewee concluded:

[...] the strategic fit. That's the main question.

It was stated that the strategic fit is the bottom element to which other elements are compared and its significance was pointed out several times in each interview. For instance, the target company's product platform may be technically incompatible with the acquirer's own product offering. This example was provided by a consultant even though these kinds of deal breakers generally are uncovered before consultants are

hired. In addition, the most crucial elements in each acquisition which are also described in the playing field of negotiations (see table 3), must also be identified in relation to the company's strategy. Accordingly, there is always a strategic intent behind the transaction and companies are not acquired simply, for example, because they are cheap. Another aspect which was highlighted in the interviews was the importance of third parties. Third parties include, for example, the main customers and partners. As an interviewee demonstrated:

For us one essential or powerful contributor has been the target's strong grip with a main customer in which we are interested [...]. And if this customer doesn't approve that its contracts are transferred in a deal, then it usually means that the deal is called off.

Another example was that a company is planning to acquire a company in order to expand the presence within the market area. In order to be able to put the production in operation it needs electricity or natural gas or similar goods which are usually bought outside the company. Therefore, the acquirer requires that the volumes and prices for this good are acceptable. Accordingly, this comes back to the strategic meaningfulness because if they disappear, there is no rationale for the acquisition any longer. Therefore, these are difficult issues to be settled in the negotiations because, as it was pointed out in an interview, the seller attempts to prevent that the acquirer would be aware of these before the signing of the deal. As a result, some kind of a provision is agreed to the transaction contract. Nevertheless, it was argued that cases like this are rare and sometimes they are avoided by renegotiating the deal terms.

Other separate matters which were noted were, for instance, company's liabilities relating, for example, to pensions, properties, and environmental issues. In other words, in due diligence there might be found a loan which has a charge over property or land. The indemnities provided by the seller can also act as a cause of the termination. For instance, there might be a dispute over a patent or some other disagreement, and the possible compensations for the damages are massive. As it was illustrated by a respondent:

Let's say that the price might be a million or five millions but the potential compensations for the damages might be 50 millions.

If the seller does not answer for these damages, or answers too limitedly, the acquirer may not be able to take such a significant risk. This is also a matter in which private equity investors and operational investors differ: when private equity investors are exiting the company, they generally provide no indemnities. Moreover, the pre-acquisition phase may break down also because in auction processes, there is only one acquirer which can win. It was pointed out by a respondent that this deal breaker can be understood to derive also from the acquirer – at the event of the termination, the acquirer has decided to make an offer which is too low. One respondent also noted that

within the business deal (see chapter 2.1), the problem might arise in the form of determination of what is actually acquired. In other words, either there is a disagreement over what is included in the deal or then the seller is not able to carry out necessary ownership restructurings, which would enable the acquisition. Lastly, the accounting issues, such as the calculation of EBITDA³², revenue recognition³³, and the determination of the net working capital³⁴, they all have an effect on the view which the acquirer perceives on the target company. As it was concluded by an interviewee:

So, it's only once they have started to see that, they really start to understand the profitability of the business.

Therefore, this new view may differ to a large extent from the reported results or from the management accounts. This extremely detailed description on the accounting issues was provided by a consultant which clearly indicates the experience of many years among financial due diligences.

In conclusion, the matters which were mentioned as possible surprises during due diligence were not emphasized solely on financial issues as it is suggested by several scholars (see, for example Carbonara & Rosa 2009; Angwin 2001; Marks & Mirvis 2001). This may be due to the fact that it is the financial aspect which acts as a basis for other analysis, and on the grounds of financial figures it is possible to get an intimation of other issues. In addition, it was argued that deal breakers in cross-border deals are not that different compared to those of the domestic deals. As an interviewee demonstrated:

This is quite international this merger and acquisition market. The findings are both international and domestic.

Nevertheless, exceptions to this argument were the challenges experienced in Russia and the differences also in corporate cultures like mentioned already above. In addition, it was argued that naturally obtaining finance in cross-border deals might be more challenging, for example, because the debt might be required to be syndicated.

5.2.2 Target company's value and plausibility of the walk-away price

I have sometimes said that the price is never a deal breaker but that is little bit too firmly said.

As the citation above already to some extent indicates, there were two major points discovered during the discussions on the purchase price and on its significance as a deal

³² EBITDA refers to earnings before interests, taxes, depreciations, and amortizations (Welch 2009, G-5).

³³ Revenue recognition refers to the principle according to which revenues are recognized in accounting (Doupnik & Perera 2007, 151–153).

³⁴ Net working capital refers to current assets minus current liabilities. Frequently also called as working capital. (Welch 2009, G-10.)

breaker: First of all, the price can be included in the top three causes behind the termination of the pre-acquisition phase. Secondly, and despite the first point, the discussions on the price cannot be excluded from the discussions on the other contract terms. That is to say, the price cannot be determined without considering the other contract terms. However, there were slight differences between the interviewees which one of these aspects they emphasized more: Particularly one consultant focused increasingly on the challenge of determining the purchase price without putting the emphasis on the other contract terms. For example, the consultant described:

The next stumbling block is the determination of the price, the decision on the price.

On the contrary, a corporate expert demonstrated:

Well, I met a lawyer from London who then said me that don't argue over the price now, argue over the terms. [...] If you pay 100 million or 90 million, the difference might be less significant than if the contract terms are under control.

Nevertheless, it is worth noting that both aspects were noted by all of the respondents and, thus, too extensive generalizations between the consultants and the corporate experts are unworkable. Furthermore, it was pointed out that at the beginning of the acquisition process there is generally a quite large expectation gap in the terms of pricing between the acquirer and the seller, which is due to not knowing the company sufficiently. Moreover, the determination of the central concepts which are used while valuating the company, such as the working capital, is subject to different interpretations. This results naturally in different outcomes for the value of a company. Therefore, it can be argued that information asymmetries are a fundamental factor underlying also the challenges of the valuation. Accordingly, the outcome of the valuation phase is to a large extent dependent on the negotiations. For example, it can be agreed that the end price of the deal is dependent on the financial results of next two, three years. This is utilized in particular in the situations in which the acquirer's views on the price are lower than those of the seller's, but the parties do not want the price to become a deal breaker. It can also be that the price is tied to the key employees, and if they will leave the company during a certain period, the end price will change. Accordingly, as an interviewee concluded:

And, on the other hand, also the structuring of the deal, [...]. It has an effect.

Moreover, different kinds of co-operation agreements may assist in the price negotiations. That is to say, the price may be lower but because the acquirer has promised to continue to co-operate with the seller, the seller might feel that it is able to take advantage of future profits in the form of a favourable service contract. It can also be that the conclusion of a co-operation agreement is something that is required by the

acquirer. For instance, if the business acquired is located in the same area than the rest of the seller's facilities, it is practical that the acquirer attempts to agree with the seller over the waste water set-ups, and not to build its own systems. This matter is closely related to the idea of third parties as deal breakers (discussed in chapter 5.2.1). Considerations of the possibilities of co-operation agreements bring, however, a new factor to the determination of the purchase price and, thus, the whole evaluation becomes even more complicated. Moreover, the seller has a right to insist only cash as a method of payment, and in that case the co-operation agreements are unfeasible. Nevertheless, the acquirer might also agree on the higher price if it is as risk-free as possible. As a respondent explained:

The more the seller ensures that the company is in good condition and that it will be able to make profit, the higher the price can fairly be because then the acquirer receives in a way a guarantee [...], and it knows that if the product is not saleable, it will receive indemnities.

Another respondent discussed the risk perspective more in detail and argued that the main factor is whether the risk is quantifiable or whether it is not.

A lot of those things don't need to stop the deal if they can be priced into the deal. So, as long as you have a good picture of the risk and you are able to quantify the risk, then the buyer is able to price that into its purchase price or then seeking indemnity from the seller.

Naturally even the pricing of the risks can result in the price which just is unacceptable for the seller, or the seller cannot give indemnities (see also chapter 5.2.1). Furthermore, there were interesting differing opinions regarding whether there is a clear phase after which the price is determined. On the one hand, it was argued by one interviewee that the price is already decided to a large extent before due diligences are commenced. On the other hand, it was stated by another respondent that the price develops during the process. This same interviewee in question also provided a different view on the price determination:

And if the process proceeds in a way that when there is more information received and this information supports the initial impressions, then the effect of the price on the outcome is minimal.

Therefore, it can be understood that as long as the initial picture over the target company remains almost unchanged, the price is a minor deal breaker. However, if this picture changes and, as a result, the trust on the counterparty fades, the acquirer is not that flexible in terms of the pricing any longer. Accordingly, there are no fixed solutions in the determination of the purchase price. It might be that it is not only what happens at the moment of the transaction but also what happens during the next years which matters. Moreover, the sellers' preferences also vary because for private equity investors the price is generally more essential than for corporate sellers. Therefore, there

are several variable factors in each transaction, and it is not possible to compare two prices without being aware of these variable elements.

It is exactly this combination between the price element and other contract terms which hinders the plausibility of the walk-away price. It was argued by all of the interviewees that there is no concrete, absolute walk-away price. As an interviewee demonstrated:

The concept of the walk-away is not that plausible. Of course, you might have some kind of absolute point that 'more than that I won't pay'. These can be then related, for example, to key ratios.

Consequently, the walk-away price without any reservations or possible changes was argued to be impractical. This provides support for the non-existence of a detailed definition of the walk-away price (see chapter 2.3.2). Nevertheless, it was clarified that naturally there is a certain price range which is possible because obtaining finance may become a problem after the certain price level, and the payback times must be under control. Moreover, it was argued that in particular during the last two years, the acquirer's ability to obtain finance has caused acquisition processes to break down.

The walk-away price was noticed to be closely related with negotiation tactics and skills, as an interviewee demonstrated:

[...], of course, they always talk about making your boundaries clear. So, it's actually very good to understand what your walk-away price is and also what the seller's walk-away price is [...], and somewhere in the middle is the ring for the negotiations.

Accordingly, the playing field of negotiations (see table 3) is also related to the walk-away price – the financial aspect is one element within the playing field and, thus, the fall back level is determined also for this aspect. However, because the whole idea behind the playing field is that the acquirer must be able to bend with its requirements, the probability of walking into the walk-away point is smaller. Nevertheless, it was pointed out that the situation is different with auction situations than with bilateral negotiations: in auctions it is the bid which is basically determining whether the acquirer is still in on the competition, and the role of the walk-away price is then more significant. In spite of this, Cullinan et al. (2004) state that, if used properly, the walk-away price can be an effective tool in the management of the acquisition process. However, it can be understood now that the walk-away price is rather a point which is hoped to be avoided than a point which would be desired. Thus, it can be argued that it is not such a good management tool, or at least it is a different kind of a tool because its basic principle is based on the most negative scenario instead of the most desirable scenario.

The above mentioned view can be challenged by approaching the issue from another viewpoint. That is to say, the starting point could be to find the lowest possible price

instead of the highest one. This was discovered while discussing the challenges of the valuation. An interviewee stated:

Well, in a way it [the most challenging aspect] is to find the lowest possible price which the seller is still willing to consider.

In other words, perhaps the lowest possible price could act as the management tool during the pre-acquisition phase. It is worth noticing that the acquirer's lowest price equals to the seller's walk-away price. Moreover, this raises another challenge in the form of sufficient explanations. As it was noted by an interviewee, if the acquirer makes an offer which is known to be lower than the seller's expectation, the acquirer must have good reasons and explanations for making that kind of an offer.

5.3 Challenge of walking away

The study of Bain & Company (see chapter 2.3.2) discovers that the decision of walking away from a deal is an extremely difficult decision to execute. In particular this is the case if there are no facts to support the decision. As a respondent stated:

[...] maybe we ought to have terminated also some cases in which there was a slight doubt whether this is really what it seems like [...].

In most occasions, these are matters which cannot be attested during the pre-acquisition phase and, thus, they bring more human aspect and subjectivity into the decision-making. Nevertheless, it was also argued that if the issues are more factual in nature, they are always attempted to be settled with negotiations, and their transformation into deal breakers is tried to be avoided. In addition, as a respondent concluded:

I would say that more often they [terminations of the processes] are due to several small factors and perhaps the general feeling instead of that there is one specific thing in which you can point your finger at and state that this is the reason why this broke down.

Therefore, it can be argued that in order the acquirer to have 'the general feeling', it also has to have some experience both on mergers and acquisitions, and on negotiations. This supports the statement of Erkkilä (2001) that only the experienced acquirers are able to walk away. However, Erkkilä (2001) suggests that it is to a large extent due to the fact that these experts are not that sentimentally devoted to the deals. On the contrary, in the interviews it was discovered that the momentum (see chapter 3.2.2) frequently drives the process further, and also the managers and the acquisition teams might be too eager to make the deal. An interviewee descriptively explained:

This is something like, when speaking of a man and that they get an obsession to buy a new car during the spring time, and this is then almost hunted with a rifle.

Nevertheless, it was also stated that the momentum is a positive element which hinders the acquisition processes from fading; that is to say, the momentum ensures that, for instance, the decisions relating to the acquisition processes are made on time and the processes proceed continuously.

During the interviews, there was also expressed an opinion that if a professional acquisition team is in the head of the process, approximately half of all the cases should break down. This is quite a high percentage but when considering both ‘the termination percentages’ (presented at the end of this chapter) and the large number of all possible target companies which are scrutinized by bigger companies, it is reasonable. Furthermore, Angwin (2000) notes that the executed acquisitions are generally associated as positive in terms of the managerial reputation whereas a failure in the completion of the acquisition is associated as negative. However, according to the interviewees’ opinion, it can also be understood that the amount of the terminated acquisition processes shows professionalism and, thus, is a sign of good leadership.

In chapter 3.3, it is stated that different kinds of contractual warranties are utilized in order to minimize the risks associated with the pre-acquisition phase. However, there were discovered differing opinions during the interviews. First of all, it was argued that contractual warranties are used sometimes in order to compensate the time and resources invested in a case of a breakdown in the acquisition process. They might be utilized particularly if the seller is anxious to sell and the acquirer then promises to carry out a preliminary research. It was pointed out that the existence of break-up terms is to a large extent dependent on the determination of the preliminary agreements. For instance, if a break-up term is agreed to be included in the preliminary contract, the acquirer binds not only itself but also the seller to the deal more than it is necessary or wanted. Therefore, because the non-bonding nature of the preliminary contracts was emphasized (see chapter 5.1.1), the binding break-up terms are also avoided exactly as Wilkinson (2007a) argues. Nevertheless, as an interviewee stated:

Yes, may work sometimes. But it [the break-up term] can also be quite a bad solution. It may then in a sense result in fruitless disputes if the deal doesn’t come true.

Secondly, there were also opinions according to which the break-up terms are not utilized. It is worth mentioning that there was no clear distinction between the answers of the consultants and the corporate experts. In other words, some of the consultants had experience with the break-up terms and some had not, and likewise with the corporate experts. It was pointed out that the break-up terms were used several years ago because of their intention to show commitment from one party to another, but for some reason

they are not seen any longer. It is interesting that in this context the commitment of the seller was presented as a positive matter whereas it was argued above that the excessive binding of the seller is something that is avoided. The explanation for the non-usage of the break-up terms nowadays was that at the age of auction processes, they are impractical and they are not even expected by the parties. Thirdly, it was pointed out by an interviewee that the break-up terms do not prevent parties from walking away from the deal.

Seldom the break-up fee prevents... That is to say, if there is a deal breaker, it [the break-up fee] doesn't bind the acquiring parties that much.

In addition, if the break-up term is required by one party, it will be required also by the other party. Accordingly, it can be argued that these are situations which easily result in above mentioned disputes. In conclusion, the negotiations on the break-up terms were not discovered to be that problematic than Picot (2002a) argues them to be. In addition, in the theoretical framework it was discussed whether the break-up terms have an effect on the breakdown of the pre-acquisition phase (see Bernstein 2008; Bates & Lemmon 2003). According to the interviews, it seems that they have no major impact on the walk-away decision, because it was mentioned that they do not prevent the terminations, but it was not either mentioned that they would make the decision easier. Moreover, it can be understood that the usage of the break-up terms is a case-specific matter.

There was a strong consensus that the acquirers and the managers who execute acquisitions on a regular basis accept that there is always a risk of a process breakdown – it was argued that it is exactly the disclosure of risk factors which is the reason behind carrying out due diligences and not paying the money immediately. In addition, a respondent expressed an opinion that the starting point for the negotiations is that they are not binding and the parties are able to walk away whenever they like to as Ghauri (2003) states. Therefore, the possibility of walking away is an axiom. Nevertheless, it was also stated that sometimes the strategic rational of the deal is so significant, and if the pricing of the deal is already agreed upfront, due diligence can be seen as a ticking-the-box exercise which has no major impact on the deal. This supports further the argument that the strategic intent is the basic element of each transaction (see also chapter 5.2.1). However, the type of the acquirer matters also, as it was demonstrated by a respondent:

And for corporations which are not in the deal market, [...], which do deals once every three years and they put a lot of work into it and they are fully committed, it can be a shock to them if at the end of the day the deal doesn't go through.

The interviewees also agreed that the final decision to terminate the process is made by higher executives and the board but the opinions of the acquisition team and business leaders are also taken into consideration. This is, however, to a large extent dependent on the size of the deal. For instance, it was argued that with smaller cases the decision of terminating the acquisition process is routine and the board is only informed about the breakdown. Furthermore, it was expressed that, if the deal breaker is a due diligence finding, the basis for this higher executives' decision to terminate the process is always laid in the due diligence report or otherwise the team has not succeeded in its work. This is closely related with the above mentioned statement on professionalism. Nevertheless, it was also argued that the owner has always a right to terminate the acquisition process. In the theoretical framework (see, for example, Jemison & Sitkin 1986), it is suggested that the board approval may be a deal breaker. This is supported by the above mentioned statement because the board represents owners.

It was interesting to discover that all interviewees regarded their own role in the acquisition process as the most neutral one. As it was pointed out by respondents:

Sometimes it feels that we are the only ones who then warn whether there is any sense in this.

I have tried to hold on that always wake up the people that, wou wou wou, don't go according to that template straight away.

It was demonstrated that the role of a corporate expert is to hold factual perspective and sometimes this may result in disagreements with the operational management. Consultants, in turn, analyze companies within the limits of the assignments, and the discovered facts are the outcomes of their work. However, they give no recommendations and they do not interfere in the decision-making. Corporate experts may not be equally independent compared to consultants because they are in a way bound to corporate cultures and a company's way of carrying out acquisitions. Nevertheless, perhaps the views of both parties are justified because it is the duty of the interviewees to assure that all aspects are at least presented to the higher executives and to the board. However, it is worth noting that both the consultants and the acquisition team are rewarded against their contribution to the companies' profit.

Despite the difficulty of making the walk-away decision, there seemed to be an agreement that pre-acquisition phases do break down. Some of the interviewees referred it to be more common than others, but all of them agreed that they do break. It was suggested carefully that 'the termination percentage' may be approximately 25–30 percent or 40–60 percent of the deals. However, it was pointed out that the situation is different with auctions in which someone will always win and some other will always be screened out. Nevertheless, these percentages were accompanied by concerns over the utilization of resources. As it was concluded by an interviewee:

If it is the acquirer's own decision to withdraw, then it didn't go badly. On the contrary, it went just like planned. Then it can be thought whether it had been possible to terminate the process already at an earlier stage.

Nevertheless, as it can also be understood from above, the decisions of terminating the pre-acquisition phases were usually experienced as the right ones. It was pointed out that at that point, there are generally several matters which justify the termination even though these causes would not all be factual. This is consistent with the statements of Aiello and Watkins (2000, 103). Moreover, it was concluded by a respondent that it is frequently the overall feeling or, in this case it could be even said the wisdom, and the combination of matters which result in the decision of terminating the acquisition process. In addition, because this general feeling is always subjective, it is difficult to analyze these terminated acquisitions afterwards.

5.4 The walk-away action and underlying elements

In order to be able to discuss the walk-away actions credibly, they have to be put in a bigger context. That is to say, the termination of the pre-acquisition phase is generally a sum of several factors. In figure 9, these settings of the walk-away action are described. The figure is based on the model introduced in chapter 3.4, but a selection of modifications has been made in order that the model corresponds better both with the findings of the interviews and, thus, with the reality.

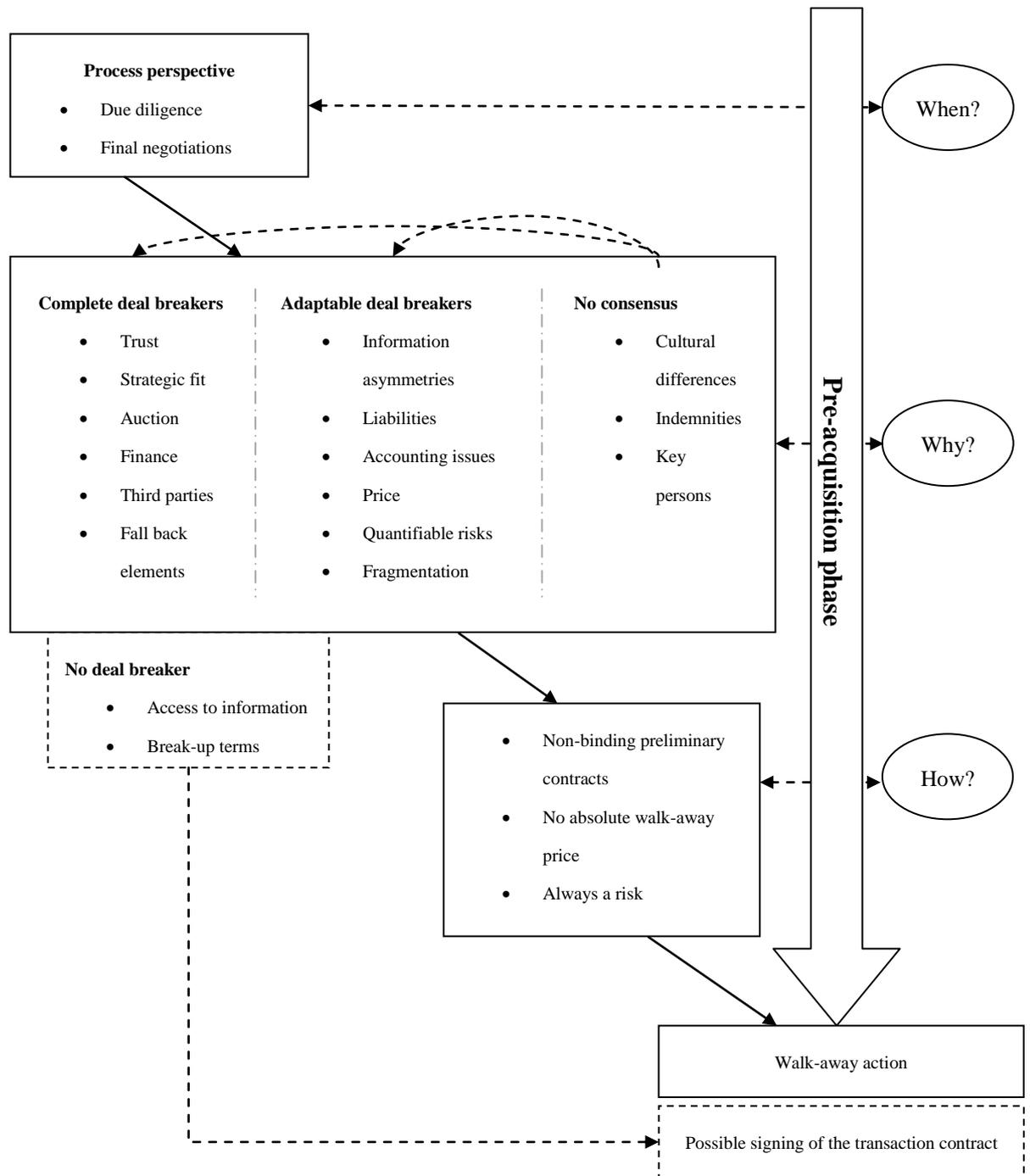


Figure 9 Settings of the walk-away action

First of all, the phases during which the termination is most likely to occur are described in the first box. Perhaps even naturally, the pre-acquisition phase is most probably terminated either *after due diligence as a result of a total surprise*, or *during the final negotiations as a result of the disagreements over the final contract terms*. Secondly, the next box summarizes the major reasons underlying the termination of the pre-acquisition phase. According to the interviews, it can be understood that some of the deal breakers do not necessary result in the termination of the pre-acquisition phase. This transformation into deal breakers can be avoided, for example, by renegotiating

and changing other contract terms. In addition, a deal breaker might not be such a significant factor that it would alone lead to the breakdown of the acquisition process. Thus, in figure 9, there is introduced a new and more relevant categorization to deal breakers – they can be categorized according to their probability to result in the termination. On the one hand, there are factors which can be described to be *complete deal breakers*. An interviewee demonstrated that this is the situation, for instance, if the seller has divested operations in the country A few years back and, as a result, it has agreed not to operate in this country for the period of five years. However, this might bargain for problems in the future, as the same interviewee demonstrated:

So if you then have a buyer coming along to acquire this business, if it has, if the acquirer has existing business in country A, it just, you know... That sort of like real, just complete deal breakers.

That is to say, complete deal breakers are matters which cannot be overlooked or corrected by making changes to some other factors. For example, lack of trust, non-existence of strategic fit, inadequacy of finance, and disagreements with third parties generally always lead to the breakdown of the pre-acquisition phase. The auction situation is also an extremely unambiguous deal breaker: either the acquirer's offer is high enough in order to keep the company on the competition or then the acquirer loses the game. In addition, the playing field of negotiations can also be included in this discussion because the factors that have fallen deep to the fall back level should be complete deal breakers.

On the contrary, *adaptable deal breakers* are factors which do not automatically lead to the breakdown of the pre-acquisition phase. For example, because of the information asymmetries the acquirer has not an all-inclusive picture of the target company, but this is not seen necessary as problematic because the acquirer can insist indemnities and contractual warranties; or because the purchase price is subject to a large negotiation range, it does not become a deal breaker quite easily. Other matters included in this category are the target company's liabilities, accounting issues, all quantifiable risks, and fragmentation of the acquisition process. Furthermore, the matters on which there was no consensus were cultural differences, indemnities, and key persons. For instance, on the one hand, cultural differences should not be major obstacles to the completion of the acquisition but, on the other hand, they hinder, for example, the understanding and interpretation of the counterparty's messages. Moreover, the aspects which were not experienced as problematic, on the contrary to the theoretical statements, were the access to information and the agreements on the break-up terms. Therefore, these are not described as deal breakers, and they have no, or at least they have only minor, effect on the signing of the transaction contract. This is described with a dash line in figure 9.

Lastly, matters which relate to the preparation in an event of possible deal breakers are described on the right corner of the figure. In general, acquirers prefer *non-binding*

preliminary contracts, and experienced acquirers are aware that there is *always a risk that there will be insuperable obstacles to the completion of the acquisition*. Moreover, *the walk-away price is a theoretical concept* which has no practical support. That is to say, it is extremely difficult to determine an absolute walk-away price.

6 CONCLUSIONS

6.1 Theoretical discussion

The significance of mergers and acquisitions in the business is considerable and well-known. Accordingly, when considering the number of these transactions taking place, it is noteworthy that the failures and breakdowns of the acquisition processes are not acknowledged to the same extent – or they are acknowledged but quietly. *Nevertheless, based on the interviews carried out it can be argued that the pre-acquisition phases do break down.*

In the existing theoretical frameworks it is noted that narrowing down a large amount of target companies to a few alternatives is natural and compulsory. In addition, decisions must also be made about this smaller number of targets because normally only one can win. Thus, it is inevitable that with some target companies the acquisition process simply does not move to the next level. Nevertheless, there might be insuperable problems also with the selected target company. In consequence, the acquisition process might be tight in terms of time, but the way from the initial negotiations and due diligences to the signing of the transaction contract is long and complex. Moreover, in academic discussions it is suggested that the problems faced in the post-acquisition phase may be traced back to the pre-acquisition phase but the challenges and decisions of this earlier stage are still lacking of theoretical support. Therefore, based on the literature and interviews it can be concluded that both the corporate merger and acquisition experts and the academic scholars (see, for example, Very & Schweiger 2001, 20) know that acquirers can and do walk away from the deals but the theoretical background and further discussions of why, when, how, to what extent this happens is still missing. Furthermore, when considering that these walk-away decisions have always been considered as the right ones, it can only be guessed to what extent there have been wrong decisions. That is to say, do higher executives sometimes consider whether they should have restrained themselves from acquiring the company at all?

Within the settings of the walk-away action described, three different components can be distinguished: First of all, the views that only total surprises are able to break down the pre-acquisition phase gives too unambiguous explanation for the walk-away actions. On the one hand, it is exactly the surprising findings which may result in the termination of the pre-acquisition phase, but frequently this occurs simultaneously with due diligence. On the other hand, the other phase during which the pre-acquisition phase is most likely to be terminated is during the final negotiations. In this case, the cause of

the termination is not a surprise. It is rather a matter on which there is no agreement between the acquirer and the seller but they both are aware of this factor. *Accordingly, unexpected factors result in the walk-away actions during due diligence whereas during the final negotiations it is, for instance, the contract terms which are more of a concern.* In a way this is extremely logical because during the final negotiations the major findings of due diligence are already known and, thus, if there would have been discovered remarkable surprises, these either would have been already settled or the acquirer would have already walked away. However, this view is inappropriate if the acquirer carries out confirmatory due diligence because then the negotiations have also proceeded further and surprises may emerge also at the later stage of the acquisition negotiations.

The walk-away decisions' effect on the managerial reputation may offer an explanation for the above mentioned lack of theoretical discussions on the acquisition failures and walk-away actions. Traditionally it is argued that the completion of the acquisition is a sign of good leadership and managerial capabilities. If the head of the acquisition team is able to prevent the transformation of possible deal breakers into actual deal breakers, it only confirms the person's reputation as a skillful employee and an expert. However, based on the interviews and existing literature it can be argued that it is more meaningful and rewarding both for the company and for the team itself if possible deal breakers are in general uncovered and announced, and that they are uncovered early enough. *Therefore, a person's capability to notice deal breakers can also be understood as a sign of professionalism which, thus, enhances the managerial reputation.* However, simply because of, for example, the non-disclosure agreements an expert may not be entitled to refer to these terminated acquisition processes afterwards as his or her accomplishments.

Secondly, the primary model based on the theoretical framework was modified because *it is more relevant to describe deal breakers according to their significance:* complete deal breakers are such significant factors that they almost always lead to the termination of the pre-acquisition phase whereas adaptable deal breakers are subject to possible renegotiations. Moreover, an adaptable deal breaker alone may be too insignificant in order that it would be worthwhile for an acquirer to walk away from the deal. Furthermore, *from the group of possible deal breakers the strategic meaningfulness and fit is the most fundamental matter.* It can be thus argued that the motives for carrying out the acquisition lay the basis for the evaluation of other deal breakers, and these motives are, or at least should be, always cogent. In other words, the acquirers do not acquire companies simply because they are cheap. Furthermore, in the merger and acquisition literature, the financial aspect and the price to be paid have gained attention to a considerable extent. Nevertheless, the financial matters are important and they cannot be overlooked but other areas, such as negotiation skills,

trust, strategic fit, and third parties, are equally, if not even more, significant. Probably it is because of the traditional and deep-seated role of the finance field (see, for example, Very 2009) within the merger and acquisition literature why it is easy to assume that the price is a significant deal breaker. However, this is a misleading assumption because even if the price is a major factor affecting the walk-away decision, it cannot be considered as a separate element. For this reason, *a possible deal breaker, despite which deal breaker it is, is only one part of the playing field of the negotiations, and the acquirer must manage the whole field.*

Thirdly, because of this large negotiation room there cannot be determined an absolute walk-away point in terms of the purchase price. *Therefore, the usage of the walk-away price as an effective tool like it is suggested in the academic discussions does not come true in practice.* In spite of this, of course there is some kind of a limit for the payable price, for example, in the form of adequacy of finance. Nevertheless, it can be considered in this case whether the adequacy of finance is actually a control tool used by an acquirer or whether it is a tool used to control the acquirer. Furthermore, according to the interviews, it can be understood that the negotiation parties always consider which matters they reveal to the counterparty and which they do not. *Therefore, it can be argued that the acquisition negotiations are always competitive in nature,* and the view on open, honest, and clear information exchange is not even realistic. Nevertheless, it is worth noting that this is something that is not even expected in the transactions nowadays. This is perhaps a matter which has changed during the past years because the limited access to information is a fact rather than a deal breaker, and experienced acquirers already know the rules of the game.

Furthermore, *the acquisition parties are willing to show commitment to the extent that it is required but they do not want to be tied to each other.* Therefore, the non-binding nature of the preliminary agreements is of interest, and the contractual warranties, such as break-up fees, are built in a way that they do not restrict future actions. Perhaps because of this, the disagreements over the break-up terms are not generally experienced as problematic and as causes behind the terminations of the pre-acquisition phases. On the contrary, the indemnities provided by the seller are more crucial for the completion of the deal. Therefore, it can be understood that the break-up terms can be overlooked as long as the seller is willing to provide guarantees that the acquired company is what it seems like.

Frequently cross-border mergers and acquisitions are separated from the transactions taking place within the borders of a country. However, *in the context of the walk-away actions and deal breakers this grouping seems to be almost irrelevant.* The domestic market of mergers and acquisitions in particular for big acquirers is frequently inadequate and, thus, the perspective for executing mergers and acquisitions has to be worldwide. As a consequence, it can be argued that the concepts of ‘mergers and

acquisitions' and 'cross-border mergers and acquisitions' are little by little losing their essential difference among the big players, and the prefix 'cross-border' may soon be almost unnecessary.

6.2 Managerial implications

As it was argued above, open discussions on the failures and terminated acquisition processes are required in addition to the discussions on the successful transactions. This cannot be done, however, without companies' representatives, their experiences, and their practical views. Accordingly, *forming of the theoretical background for a managerial challenge is extremely difficult if there are no tools or material from which to commence*. Nevertheless, every deal is always unique and in order to be able to understand all the underlying facts, reasons, and consequences an academic researcher has to become rather an insider employee within the case company than an outsider observer. In that case, it can be argued that the researcher is no longer acting as an independent researcher and his or her objectivity is hindered. Moreover, companies probably cannot afford to invest in ex-post analyses of the executed transactions; if it can be already suggested that resources are wasted with the terminated acquisitions, the same statement can be adapted their ex-post analyses. However, it can also be noted that this would be an investment in the future as the future walk-away actions could be minimized.

The outcome of the acquisition negotiations and the avoidance of deal breakers are to a large extent dependent on the negotiator's skills and capabilities. Therefore, *this is an area of which development should be in the interest of future merger and acquisition experts, and companies should be able to provide the conditions for it*. Moreover, it must be noted that the negotiator's skills together with a company's negotiation tactics may be interpreted to be cultural differences by the counterparty. Accordingly, the matters which can be included in the cultural differences are always subjective. In addition, generally it is believed that a delicate advance preparation for the negotiations is important. However, if cultural differences are derived from the negotiation tactics to some extent, it is difficult to determine the counterparty's tactics upfront, in particular if the acquirer is not familiar with the counterparty and its negotiators. This problem is relevant in all transactions because even though the acquisition parties would be located in similar countries, there might be differences in corporate cultures.

Possibilities of renegotiations, considerations of all contract terms instead of concentrating only on one element, thoughts whether too many resources have been wasted, and uncertainty about the decision's effect on the managerial reputation result in the fact that walking away from the deal is extremely difficult. The walk-away

decision is frequently based both on several variable factors and on the general feeling. Therefore, *it is important that the executive who is responsible for this decision is self-confident enough even if there were no exact facts to support the decision.* Naturally, the person's self-confidence and determination may also affect conversely and hinder the possibility of the walk-away action. Consequently, it can be discovered that the walk-away decision and the settings for it contain subjectivity to a large extent, and this is also a matter which is overlooked in the theoretical frameworks. For instance, this can also be seen as a way in which the trust is emphasized during the pre-acquisition phase. It is always a person who trusts on another person; companies cannot have trust in each other. Furthermore, because it is such a clear matter that the control both over the pre-acquisition phase and over deal breakers is to some extent dependent on the corporate expert's experience, these experts are extremely valuable to companies. In particular this is the case for companies which carry out acquisitions on a regular basis and for which acquisitions form an element of the company's overall growth strategy. Therefore, *it should be assured that this tacit knowledge is not totally lost if the expert changes the employer.* For instance, this could be solved partly by making sure that within the merger and acquisition team there are people of different ages and at different stages of their careers, and in this way ensuring the continuity of knowledge.

6.3 Limitations and suggestions for further research

This research has minor limitations which, however, simultaneously result in new research possibilities. Firstly, the research was carried out at an extremely general level without focusing on a single case or aspect. Therefore, because every terminated acquisition process is unique it could be worthwhile to study only one case, either a transaction or a company. However, as already discussed above, there might be problems with the access to this information, and the results are difficult to transfer to other contexts. Secondly, the comparison between auction situations and bilateral negotiations is quite superficial in this study even though their difference is acknowledged. Accordingly, the analysis of the walk-away action and deal breakers could be limited in future to auction situations. In auctions it is the seller who is in control of the acquisition process, and it is thus able to force the acquirer to walk away from the deal by not accepting the acquirer's bid. Thirdly, the differences between hostile and friendly acquisitions are overlooked in this study, and, this aspect is emphasized, for instance, by Very (2009). Consequently, the future research could also be limited only to hostile deals as the hostile nature of the deal probably changes, for example, the playing field of negotiations. Nevertheless, these two last matters require that the selection of cases and experts is considered carefully and without time pressure.

Fourthly, partly because of the convenience sample employed, the challenges relating to Russia are emphasized. Nevertheless, the findings could be different if the case companies and experts have carried out acquisitions also in other developing regions, such as in South Africa or Asia. Therefore, within the future research possibilities, on the one hand, it could be ensured that these other regions are also covered in the research and, on the other hand, it could be focused on discussing whether it is exactly the cultural differences which make Russian acquisitions such challenging.

The acquisition negotiations in general offer an extensive basis for research: what kind of tactics are used; are these determined in advance or can they change during the process; to what extent companies prepare for the acquisition negotiations; what is the main interest of the negotiation parties, the person's own or the company's prosperity, and so on. It is also suggested (see, for example, Haleblan et al. 2009; Very 2009) that new research methods and research problems should be developed within the merger and acquisition field in order for the academic research to bring additional value to actual company issues. Accordingly, it could be, for example, considered that a researcher would participate in the acquisition negotiations as an observer. Nevertheless, there is always a risk that case companies do not agree to this. In addition, then the considerations of possible research questions should be done together with corporate experts. As a result, both the academic scholars and practitioners would receive new aspects to the issues of mergers and acquisitions.

7 SUMMARY

During the past 30 years, mergers and acquisitions have become a remarkable method of executing the company strategies alongside with other internationalization and growth strategies. Despite the frequency of these transactions and the vast amount of research, only less than 25 percent of the transactions achieve their goals in general and acquisition processes are also terminated already before the transaction contract is even signed. In that case, for example, the target company proves to be something else than it was expected and, therefore, the acquirer decides to walk away from the deal. These failures and breakdowns are difficult topics to analyze not only because of companies unwillingness to discuss them but also because of the transactions' complexity and uniqueness. However, by understanding also the other side of the coin in addition to the success stories, the outcomes of mergers and acquisitions could be improved. Accordingly, the purpose of this study was to understand the acquirers' walk-away actions from the pre-acquisition phase and the factors underlying this procedure. This purpose was met with the assistance of three sub-objectives:

- to describe in which stage of the pre-acquisition phase acquirers can still walk away
- to explain the reasons for these walk-away actions
- to describe how acquirers prepare for possible deal breakers and walk-away actions.

The scope of the research was limited to the pre-acquisition phase and, even more precisely, on the process occurring from the acquisition negotiations to the announcement of the deal. However, there were no limitations regarding the acquisition target, its nature, its business, or its location.

The theoretical framework was built in conjunction with several academic disciplines, namely with management, finance, and organizational research fields. The focus was in particular both on preliminary contracts, on due diligence, on valuation and walk-away price, on acquisition negotiations, and on break-up terms. In order to understand why, when, and how the acquirers walk-away from the deals, five semi-structured expert interviews were carried out. All interviewees had experience of many years' in mergers and acquisitions. Three of the respondents act in the consulting business and provide advisory services for the acquirers, and the rest of them act or have been acting as representatives of the acquirer and have thus participated in the execution of acquisitions.

The findings indicate that there are two major phases during which the pre-acquisition phase is most likely to be terminated: either during due diligence as a result of a discovered surprise or during the final negotiations as a result of a disagreement over the final contract terms. The possible causes behind the walk-away actions are

numerous but frequently it is several factors together and the general feeling which are decisive. Thus, it can be argued that the acquirer must manage the whole playing field of the negotiations instead of concentrating only on one element. Furthermore, it was found out that the deal breakers can be categorized according to their significance: complete deal breakers, such as a lack of strategic fit, are factors which almost always lead to the termination of the pre-acquisition phase, adaptable deal breakers, such as information asymmetries, are subject to possible renegotiations, and there are also factors, such as break-up terms, which were found not to be deal breakers at all (the settings of the walk-away action are further illustrated in figure 9). It was also discovered that the acquirers do not want to be bound to the transactions and, thus, the non-binding preliminary contracts are preferred. In addition, the usage of the walk-away price as a management tool is not employed in practice to the same extent than it is emphasized in the theoretical framework. However, the acquirers are aware that there is always a risk that the pre-acquisition phase breaks down. Accordingly, the walk-away decision is a difficult decision to execute, and the decision-maker has to be self-confident enough even if there were no exact facts to support the walk-away decision.

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APPENDIX

APPENDIX 1 INTERVIEW FRAMEWORK

Theme 1: BACKGROUND

1. In which position and how long have you worked for the company?
2. In what kind of M&A's have you been involved?
3. What has been your duty in these M&A's?
4. What has been typical for these terminated M&A's?

Theme 2: PRE-ACQUISITION PHASE

5. How would you describe the pre-acquisition phase occurring between the target choice – the final contract?
6. Which are the most challenging elements during this phase (i.e. pre-acquisition phase)?
7. What is the role of due diligence phase in relation to the termination of the acquisition process?
8. To what extent the purchase price affects the termination?
9. How companies determine so called walk-away price?

Theme 3: NEGOTIATIONS

10. How would you describe the negotiation process?
11. What is the most challenging in negotiations?
12. What are the most important aspects while negotiating? Which aspects are not negotiable?
13. What is the role of cultural differences in the termination of the acquisition process?
14. To what extent the negotiator's own characteristics affect the termination?
15. How due diligence impacts on the negotiations?
16. To what extent companies usually prepare for the negotiations?
17. How would you describe the relationships between the acquirer and the target company in these terminated acquisitions?
18. To what extent companies use break-up terms (e.g. break-up fee, termination fee)?

Theme 4: WALKING AWAY

19. What are the issues which affect most the decision of terminating the process and, thus, walking away?
20. What kind of a decision-making process is it?
21. To what extent the initial motives for the acquisition affect the willingness of walking away?
22. To what extent these walk-away decisions are acknowledged to be good at later on?