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CRITICAL FACTORS OF PRE-ACQUISITION DUE DILIGENCE IN CROSS-BORDER ACQUISITIONS

<u>Doctoral Thesis</u>

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ANNOTATION

Cross-border acquisitions play an important role in the corporate strategic development and international expansion. During the past decades, mergers and acquisitions were intensively researched through the lens of strategic management, corporate finance, behavioral finance etc. Despite the intense effort, the made progress is still fragmented and lacks unifying theories that approaches the whole acquisition process on the one side, and in-depth research of critical factors on the other side. The dissertation topic intends to establish vital link between research and practice, deeply exploring information asymmetry and role of exploratory learning in the pre-acquisition phase of cross-border acquisition. This thesis investigates the critical factors – and the scope of the due diligence, which is carried out in the pre-acquisition phase. Pre-acquisition due diligence theoretically conforms to the organizational learning theory, proposing that the more the acquiring firm learns about the acquisition target, the higher the probability of successful acquisition. The central hypothesis of the comprehensive model states that due diligence in the pre-acquisition phase is necessary for acquisition success. The empirical evidence is data sample of acquisitions made in the automotive manufacturing firms and their cross-border acquisitions in the European automotive industry. The main results support the proposition that Choice of Strategic Partner, Business Capabilities and HR Knowledge and Financial Factors and Acquisition Premium are critical factors of due diligence needed for acquisition success. The main effort lies in pinpointing the specific area by which the business capabilities and knowledge transfer build the main asset in the realization of synergy values in the acquisition phase. In this context, the valuation of the business capabilities of the acquisition targets is classified as the main challenge reflecting suitability of the acquisition price and establishing value generation from the combined firms in the post-acquisition phase. By studying acquisition risk and critical factors – both success and failure reasons – this research has tested and partially approved a theoretically sound assessment framework that can pre-determine the success or failure of planned acquisition efforts. From a practical standpoint, the research results provide acquisition management with proven method of performing the pre-acquisition evaluation of potential acquisition candidates. Such a reference offers critical factors evidence for firms with acquisition needs.

Key words: due diligence, information asymmetry, organizational learning, risk assessment, mergers, acquisitions, cross-border acquisitions

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Introduction

In the past two decades, business press reports almost daily about proposed bid or announcement of a takeover or merger. A series of mergers and acquisitions has increased substantially in volume and frequency. As the world's economies become increasingly integrated, mergers and acquisitions are a common strategy in many industries. The need for growth of the firms and the availability of financing funds from different sources are supportive for the mergers and acquisition markets in the future. While the first waves of mergers and acquisitions came from the USA, the Western firms increasingly acquire in other regions of the world and especially the cross-border acquisitions mergers are likely to become even more important in the future. The main driver is the globalization pressure, saturated domestic markets and antitrust regulations. On the global scale, more than one third of worldwide mergers and acquisitions combine firms from two different countries.

The object of the research are cross-border acquisitions. **The subject of the research** are the critical factors of pre-acquisition due diligence in cross-border acquisitions.

The actuality of the research comprises of four main topics:

1. Voluminous academic literature on mergers and acquisitions mainly consist of studies based on domestic deals. Despite many similarities with domestic target firms, the business profile of target firms abroad are different leading to less confidence in terms of operational synergies and cost savings that are normally associated with such acquisitions.

2. As the acquisitions number grows, the topic gets more important in terms of finding the right target profile and finding a determining appropriate acquisition price for the target firms. While popular with many firms, this mergers and acquisitions strategy is highly complex and bears risk. Despite the inherent goal of performance improvement, results of the acquisitions are often disappointing. Strategic aims of external growth through acquisitions can produce results ranging from outstanding success to dismal failure as indicated by various studies ranging from pioneering research from Haspeslagh & Jemison (1991) to the present (Auster & Sirower 2002; King et al. 2004; Shimizu et al. 2004; Hitt et al. 2009; Gomes et al. 2013;). Considering this studies, it is evident that mergers and acquisitions do not reliably yield in desired financial synergies and suggest failure rate of

50% or more. In the field of strategic and financial management literature, there are only fragmented studies investigating factors of failure and success of the acquisitions.

3. The vast majority of the studies concentrated on the post-merger and corporate overall performance rather than on interrelationships between critical success factor variables in the pre-acquisition phase and other acquisition success variables in terms of return on investment, disposal, and contribution to the value chain etc. The academic discussion surrounding the determinants of successful acquisitions has been intensified by several further factors, e.g. up surge in global activities, increased volatility of economic cycles and inconsistent methodologies used to evaluate factors of success.

4. The due diligence audit in the pre-acquisition phase should provide the basis for appropriate evaluation in terms of acquisition price. The assessment of the critical success factors, the strengths and weaknesses of the target firm ideally leads to successful acquisition. Despite the broader scope of critical success factors, due diligence research most frequently examined traditional areas: financial history, legal and commercial liabilities and tax issues. However, the increased business complexity and globalization tendencies require more versatile approach, which is not sufficiently investigated by the academics.

Purpose of the research is to provide managers in automotive industry with recommendations regarding appropriate due diligence in the pre-acquisition phase and achieve successful cross-border acquisition. The research addresses academics to provide future fields of research in the field of pre-acquisition due diligence. On the basis of fundamental mergers and acquisitions literature and analytical exploration of previous studies on the critical factors of cross-border acquisitions, it seeks to examine their inclusion in the due diligence extent. Based on empirical evidence from globally leading firms in the automotive industry and international acquisitions advisory experts it aims to prove the interrelationship of thorough investigation of critical factors and acquisition success, deriving suggestions for managers and academics alike.

The task of the research is to analyse and empirically examine the impact of the extended due diligence in the pre-acquisition phase and acquisition success in cross-border acquisitions. In order to achieve the aim of the thesis, the following tasks were conducted:

1. An analysis and exploration of theoretical concepts of cross-border acquisition research and an extensive theoretical analysis of the acquisition due diligence topic.

2. Systematization of the due diligence, a phenomenon stemming from the case law field, into a strategic finance scientific framework.

3. An exploration and categorization of twelve critical factors of pre-acquisition due diligence in a cross-border context into four categories. The categorization of these factors presents the scope of due diligence for cross-border acquisitions.

4. A modelling of the specific causal relationship between the critical factors as the independent variables and acquisition success as the dependent variable.

5. A formulation of hypotheses about the impact of the four critical factors categories in the pre-acquisition phase, and their impact on the success of a cross-border acquisition.

6. The development of research a instruments (cross-sectional questionnaire, specific sample, secondary data) in order to collect a reliable data set for quantitative proof of the theoretical model.

7. A confirmation of the research results by receiving feedback from managers in the automotive industry (qualitative research data).

8. Determination of a series of implications important for managers and future academic research with the aim of evolving a theoretical approach to due diligence in the context of mergers and acquisitions.

The main hypothesis of research is formulated as “A positive relationship is supposed between the pre-acquisition due diligence critical factors and cross border acquisition success”. In order to evolve comprehensive model, critical factors of pre-acquisition due diligence were researched: “Choice of Strategic Partner”, “Business Capabilities and Human Resources”, “Financial Factors”, and “Macro-Factors and Business Environment”. **The hypotheses of research** are formulated as follows:

H1. A positive relationship is supposed between pre-acquisition due diligence critical factors strategic fit and organizational culture fit and cross border acquisition success.

H2. A positive relationship is supposed between the pre-acquisition due diligence critical factors Business capabilities, Technological competence and Workforce capabilities and human resources and cross border acquisition success.

H3. A positive relationship is supposed between pre-acquisition due diligence critical factors Cash-flow generation, Debt servicing capability, the Fixed assets evaluation and the future investment and financing need of the acquired firm, and cross-border acquisition success.

H4. A positive relationship is supposed between the pre-acquisition due diligence critical factors Macro-factors and the business environment and cross border acquisition success.

Theses presented to defend

In the context of the hypotheses and the research question, the research intends to explore the impact of due diligence elements on acquisition performance by removing the information asymmetry in the pre-acquisition phase. Hence, the theses to defend are:

1. Comprehensive pre-acquisition due diligence positively impacts cross-border acquisition success.

2. “Choice of Strategic Partner” is critical factor of pre-acquisition due diligence in cross-border acquisition.

3. “Business Capabilities and HR Knowledge” of the target firm are critical factors of pre-acquisition due diligence in cross-border acquisition.

4. ”Financial factors and Acquisition Premium” of the target firm are critical factors of pre-acquisition due diligence in cross-border acquisition.

5. “Macro-economic Factors and Business Environment” are not necessarily critical factors of pre-acquisition due diligence in cross-border acquisition.

The research need in the field of due diligence in cross-border acquisitions is given as academic research has shown various failing reasons i.e. poor synergy, overpayment bad timing, cultural and organizational incompatibility, etc. The failure to identifying the risks in integrating two organizations with very different management and operational process delivers poor results such as management strife, political interference, employee rebellion and disastrous financial results (Perry & Herd 2004, p. 12). Hence, there is recognized need for research to identify a theoretical framework that helps in an efficient and comprehensive manner explain the critical success factors in the forefront of the acquisition (Shimizu et al. 2004). Although there is a large body of research on mergers and acquisitions performance, very little research concentrated on helping us better understand the assessment of failure reasons in the pre-acquisition phase to avoid negative outcome (Shimizu et al. 2004; Carbonara & Caiazza 2009). Considering the risk assessment, Gomes et al. (2013) attaches high importance to due diligence process in the pre-acquisition phase. In the traditional approach, the role of due diligence has been to document the financial background and to collect several legal documents on the firm being acquired (Price et al. 1998, p. 18; Angwin 2001, p. 54). Many of the theories and constructs used in prior research and practice to evaluate the effectiveness of mergers and acquisitions refer to old, manufacturing-dominated competitive environment. Yet, in high technology industries (e.g., automotive industry), business capabilities and knowledge are essential for success. Carbonara & Caiazza (2009, p. 95) argue that due diligence is not only the focused on risk reduction but also contributes to effectively manage the acquisition leveraging acquirer's resources and business capabilities so that the goals of the acquisition can be realized.

A number of research studies on due diligence scope in the pre-acquisition phase argue for broader scope than the traditional topics (Ahammad & Glaister 2013; Carbonara & Caiazza 2009; Hopkins 1999). However, only Harvey & Lusch (1995) and Price et al. (1998) have theoretically extended the traditional due diligence scope by dividing the risk factors in tangible and intangible issues for making more informed acquisition decisions. Cross-border acquisitions are generally perceived to be more risky than acquiring domestic companies as generic problems of the transaction can be compounded by different factors e.g. national cultures, language differences, political influences, and regulatory hurdles (Angwin 2001, p. 33). One of the shortcomings of the extant mergers and acquisitions literature is the relative avoidance to cross-border acquisition, i.e. Shimizu et al. (2004) argued in wake of their increasing popularity as a vehicle of competing in the international markets, more theoretical and empirical research on risk assessment in cross-border acquisitions is highly necessary. Hence, it is important to explore information gathering and evaluation process prior to signing the acquisition contract in order to avoid failures from cross-border acquisitions.

This dissertation examines the inclusion of critical factors of the pre-acquisition due diligence in the acquisition process by prior investigation of critical success and failure factors based on previous academic research and practical experience.

The novelties of the research is the consideration of the critical success factors in the due diligence process based on the academic research and practical studies.

- The relation of current theoretical approaches of a) **organizational**, more exactly the exploratory learning theory research and b) **information asymmetry** theory research, in the context of due diligence. The target specific learning effect, based on information received, enables the reduction of information asymmetry in the pre-acquisition stage. This allows a more exact assessment of assets and boundaries before the acquirer carries risk.

- A categorization of critical factors of pre-acquisition due diligence, as well as modelling and approving the causal relationship between critical factors in due diligence and acquisition success.

- The development of a new model using due diligence prior to acquisition closure to address, from an empirical point of view, the variety of critical factors in cross-border acquisitions.

- Approach to acquisition success from two different levels: success measurement on the operational synergy level and financial synergy level, which indicate a unidirectional approach to acquisition success (e.g. positive financial results), may neglect the operational synergy contribution for the acquiring company.

Research Methods

Using scientific databases and fundamental research, the phenomenon of mergers and acquisitions is viewed from the perspective of exploratory learning (inquiring, receiving and analyzing information), which is necessary in order to avoid information asymmetry and make an informed acquisition decision. In order to delineate a comprehensive overview of relevant critical factors in cross-border acquisitions, the crucial point of this research is the comparison of academic and practical studies. The comparison and categorization of the evaluated factors resulted in a structured overview of critical factors for pre-acquisition considerations in cross-border acquisitions.

The empirical evidence is based on primary and secondary data from the German automotive industry. The primary data was collected by cross-sectional survey (questionnaire), which was pre-tested by experts on mergers and acquisitions. The sample includes global players and experienced acquirers in the cross-border acquisitions. The data collected answers a very specific research question concerning due diligence extent. This data is confidential and not publicly available information. Secondary data sources, e.g. financial statements, financial markets performance data, etc., provided secondary information. The representative capacity of the sample arises from inclusion of 85 automotive firms in the survey – the majority of the total volume, measured by number of employees, in this industry sector in Germany. The main characteristic of the primary data is that the key informants include decision makers who have been highly involved in all phases of the acquisition.

The data set was tested for bias and measures to minimize or prevent biasing effects were applied. Beyond the application of an appropriate survey instrument and the sequence of questions, the factor analysis was applied to statistically check for common method bias. Chronologically, the content was pre-tested with academic experts and mergers and acquisitions advisers for understandability, logical consistency and topic completeness. The statistical method used was regression analysis complemented by factor correlation analysis. The research was completed by a qualitative data assessment carried out by presenting the research results to acquisition experts in order for them to check suitability and validity. These three research methods were done following the idea of triangulation.

Main results

The main results show that the acquisition failure problem can be reduced when the acquirer concentrates on a broadened range of critical factors in the due diligence. The reduction of information asymmetry forms a more efficient decision-making basis for successful acquisitions. Research results suggest the critical factors in due diligence are “Business Capabilities and Human Resources Knowledge”, “Financial Factors and Acquisition Premium” and the “Choice of Strategic Partner”. The empirical model further examines the predictive characteristics of the explanatory variables and thereby points out critical factors in the assessment of clear risk and opportunities profiles, and fair value of the target firm. Results also suggest that the acquirer who puts more effort into assessing these critical factors in the pre-acquisition due diligence, attains a more reliable information basis. The more informed acquirer is more likely to determine a realistic price for assets and synergy values (operational and/or financial). This dissertation provides several contributions to mergers and acquisitions research literature. The findings of this thesis lay the groundwork for future investigation by extending current knowledge in both strategic and financial management with a focus on critical factors of cross-border acquisitions. Secondly, the findings contribute to risk assessment literature on due diligence in the pre-acquisition phase, exploring the potential success and risk factors, relationships between the acquiring and the target firm, and the research methodologies. Thirdly, the research work documents the way in which due diligence – as a normally unobservable and highly confidential process – can be measured and which critical factors can be used as the basis for determining important issues, e.g. acquisition price premium, business capability, etc. and their impact on acquisition success. Finally, the results help managers in both the acquirer and target firms, to maximize the evaluation of critical success factors in the due diligence. The development of the model and defined indicators were specified with direct input from the scientific community. The main findings of the dissertation have been regularly presented and discussed at a series of international conferences:

1. International Conference on New Challenges of Economic and Business Development 2016. University of Latvia, Riga, May 10th – 12th 2016, report presented: “Critical Factors of Due Diligence in Cross-border Acquisitions”.

2. International Conference on Innovations in Science and Education, University of Central Bohemia, Prague, Czech Republic, March 23rd – 25th 2016, report presented “Business Capabilities and HR Knowledge as Critical Success Factors of Due Diligence in the Pre-Acquisition Phase.”

3. 7th International Conference EBEEC, the Economies of Balkan and Eastern Europe Countries in the Changed World. University of Macedonia, Kavala, Greece May 8th – 10th 2015, report presented: “Risk Assessment in Cross-border Acquisitions in Central and Eastern European Markets Based on Experience in the Automotive Industry.”

4. 4th International Virtual Scientific Conference on Informatics and Management Sciences. University of Žilina, Slovakia. March 23rd – 27th 2015, report presented: "The scope of due diligence in cross-border acquisitions."

5. 3rd 2014 International Conference on Business, Management and Accounting. University of Economics, Bratislava, Slovakia. September 10th – 12th 2014, report presented: "The scope of due diligence in the pre-acquisition phase in cross-border acquisition management in the German car manufacturing industry."

6. International Conference on New Challenges of Economic and Business Development 2014. University of Latvia, Riga, May 8th – 10th 2014, report presented: "Due Diligence in Mergers and Acquisitions in Emerging Markets – Evaluated Risk Factors from the Academic and Practical View."

7. International Business and Economics Conference, University of Applied Sciences Kufstein, Austria, November 29th – 30th 2013, report presented: "Due Diligence Proceedings in the Pre-Acquisition Phase in Cross-Border Mergers & Acquisitions."

8. International Conference on New Challenges of Economic and Business Development 2013. University of Latvia, Riga, May 9th – 11th 2013, report presented: "Handling of Mergers and Acquisitions Risk with Due Diligence in Emerging Markets – Comparison of Scientific State of Research and Practical Point of View."

9. International Business and Economics Conference, University of Applied Sciences Kufstein, Austria, August 3rd - 5th 2012, report presented: "Organizational Culture and its Assessment in Cross-Border Mergers & Acquisitions."

10. International Conference on New Challenges of Economic and Business Development 2012. University of Latvia, Riga. May 10th - 12th 2012, report presented: "Merger Syndrome – The Emotional Aspects of Mergers and Acquisitions."

Furthermore, the main findings of the dissertational research work were published:

1. Sacek, A., 2016. Critical Factors of Due Diligence in Cross-border Acquisitions. Article in: Contemporary Issues in Financial Management. Vol. 98. Edited by Dr. Simon Grima,

Dr. Frank Bezzina, Dr. Inna Romanova & Dr. Ramona Rupeika-Apoga, R. ISBN 978-1-78635-907-0.

2. Sacek, A., Šavriņa, B., 2016. Business Capabilities and HR Knowledge as Critical Success Factors of Due Diligence in the Pre-Acquisition Phase. CBU Conference Proceedings, Prague. ISBN 978-80-88042-05-1, pp. 167-174. Indexation processing in Thomson Reuters Web of Science current.

3. Sacek, A., 2015. The Scope of Due Diligence in Cross-border Acquisitions. Journal of Economy, Business and Financing. Vol. 3 (2). ISSN: 1339-3723. pp. 44-51.

4. Sacek, A., 2015. The Scope of Due Diligence in Cross-border Acquisitions in the Central and Eastern Europe. European Journal of Business and Economics. Vol. 10 (1). ISSN 1804-5839, pp. 20-25.

5. Sacek, A., 2015. Due Diligence in Mergers and Acquisitions in Emerging Markets - Evaluated Risk Factors from the Academic and Practical View. Journal of Modern Accounting and Auditing. Vol. 11, No. 7. ISSN 1548-65832015. pp. 363-372.

6. Sacek, A., 2015. Risk Assessment in Cross-border Acquisitions in Central and East European Markets Proceedings of the 7th International Conference The Economies of Balkan and Eastern Europe Countries in the changed World' EBEEC 2015, Greece. ISBN: 978-960-363-063-0, pp. 91-99. Scopus.

7. Sacek, A., Šavriņa, B., 2014. The scope of due diligence in the pre-acquisition phase in cross-border acquisition management in the German car manufacturing industry. Proceedings Book: The 3rd 2014 IBSM International Conference. ISBN 978-602-19725-6-4, pp. 31-46.

8. Sacek A., 2014. Due Diligence in M&A in Emerging Markets – Evaluated Risk Factors from the Academic and Practical View. Conference Proceedings: International Conference on New Challenges of Economic and Business Development. University of Latvia, Riga, ISBN 978-9984-45-836-6 pp. 325-326.

9. Sacek, A., 2013. Handling of M&A Risk With Due Diligence in Emerging Markets– Comparison of Scientific and Practical Point of View. Conference Proceedings: International Conference on New Challenges of Economic and Business Development. University of Latvia, Riga, ISBN 978-9984-45-715-4, pp. 511-521.

10. Sacek, A., 2012. The Merger Syndrome – The Emotional Aspects of M&A. Conference Proceedings: International Conference on New Challenges of Economic and Business Development. University of Latvia, Riga., ISBN 978-9984-45-519-8, pp. 566-575

Limitations of the dissertation

In the classification of the pre-acquisitions due diligence as presented in this dissertation, the critical factors are divided into four categories. The categorization of these elements leaves room for interpretation. A second limitation in the research design is the focus on acquisitions in the German automotive industry, and, therefore, the data may not be applicable to acquisitions in other industries. Investigating pre-acquisition due diligence is limited by confidentiality and the non-public character of the data. In this sense, secondary data sources, e.g. prior academic research, financial statements etc., provide information that is not directly comparable to the primary data. Furthermore, the acquired firms are largely consolidated in the acquirer's accounts, so tracking the success and/or failure of the once acquired firm is not directly possible. Finally, as each acquisition target has its own risk profile, the applicability of the extended due diligence process for managers varies from one situation to the next.

The content of the thesis

Chapter 1 presents the current state in mergers and acquisition research literature, exploratory learning theory and information asymmetry theory. Chapter 2 links theory with practical use of due diligence methods. The crucial point is the analysis of the explored risk fields from both academic and practical points of view, where the practical studies complement the theoretically explored risk fields. Chapter 3 describes research methodology and empirical methods for model testing. Chapter 4 presents the quantitative and qualitative results and interprets them in the context of the research question. The results discussion, conclusions and suggestions complete the thesis. The thesis consists of 199 pages, 28 tables and 16 figures.

The dissertation uses different sources from 1970s to today, both in German and English language. Hereby publications in scientific journals, monographs, miscellanies as well as collections of essays and papers are considered. Furthermore, official statistics of German Association of Automotive Industry, German Trade and Invest Association and Thomson Reuters were used. In addition, information gathered from members of management boards and corporate finance experts from all over Germany is part of the used sources as well.

Word of Gratitude

At this stage, I would like to express my gratitude to the University of Latvia for the well-structured doctoral program. In particular, my gratitude goes to the responsible people namely Prof. Dr. Baiba Šavriņa and Prof. Dr. Josef Neuert for the dedicated work on the program since the very beginning. Their support and enthusiasm were outstanding and their very important in making this work a success. I am very thankful for the honour of being supervised by Prof. Dr. Baiba Šavriņa who supported me in this dissertational work in every possible way. Her teaching and personal capabilities, clear analytics and ability to express even the most complex subjects in an understandable way made this dissertation possible. For personal discussions and advice concerning causal model my special thanks go to Prof. Josef Neuert. In addition, words of gratitude are paid to Prof. Signe Balina who supported me with all advice in form of content necessary to complete this kind of promotional work. Furthermore, I would like to thank the professors, lecturers and academic staff of the University of Latvia for their coursework. Overall, the doctoral program, which focusses on experts, is a vanguard and an excellent example of the benefits of an international scientific network. Finally, the researcher wishes to thank all organizations and employees who participated in the empirical research.

1 The Essence of Mergers and Acquisitions Theories and Critical Success Factors of Due Diligence in the Context of Cross-border Acquisitions

Firms generally grow through two methods: organically by developing growth from internal activities or through acquisition by buying growth from outside the firm, e.g. a lack of organic growth and a dependence on acquisitions for growth are the two major drivers of desperation.

1.1 Theoretical approaches of mergers and acquisitions

Changes in the structure and ownership of an enterprise are termed in mergers and acquisitions, synonymously merger and (or) acquisition. Empirical research in mergers and acquisitions has grown over the past decades and it has employed a broad variety of theoretical perspectives to address an increasing range of important and complex issues. The complex phenomenon which mergers and acquisitions represent has attracted the interest and research attention of a broad range of management disciplines encompassing the financial, strategic, behavioural, operational and cross-cultural aspects of this challenging and high risk activity (Belian 2006, p. 12; Cartwright & Schoenberg 2006). While in recent years research into the human and psychological aspects of mergers and acquisitions have increased in prominence, the mergers and acquisitions literature continues to be dominated by financial and market studies, with a high concentration of interest in the USA and United Kingdom (Cartwright & Schoenberg, 2006). The research on mergers and acquisitions in the emerging markets or cross-border is rare and mostly concentrated on transactions within the financial services industry (Gomes et al. 2013; Fritsch et al. 2007).

1.1.1 Types of the mergers and acquisitions

In the financial literature, the term mergers and acquisitions has developed into a widely used collective term representing all corporate transactions in which one company's ownership is transferred to different owner, where two firms (the target firm and the acquiring company) combine to form one legal entity or the ownership of one or several parts of a firm (target) changes to the entity of the acquiring firm. With the acquisition, the acquirer obtains control of the assets and in case of complete takeover, the acquirer absorbs all the assets of the acquired company and the takeover enterprise henceforth disappears. Hence, mergers and acquisitions need to be clearly set apart from collaborations such as strategic alliance, joint venture and other forms of cooperation. In general, cooperation is voluntary arrangement in which two or more entities engage in a mutually beneficial exchange instead of competing. Cooperation can happen in condition when adequate resources for both parties already exist or are created by their interaction. When two firms cooperate, there is no any effect on the legal independence of companies.

While the traditional distinction between 'mergers' and 'acquisitions' is mainly based on their differences in legal structure, five types of mergers and acquisitions are identified in this dissertation: conglomerate, horizontal, vertical, concentric and cross-border.

Shelton (1988, p. 280) developed a classification of mergers and acquisitions as related and unrelated distinguishing the between three types of transactions: related supplementary, related complementary and unrelated. Shelton concludes emphasizes the importance of strategic fit to create value and concludes that acquisitions permitting the acquirer to access new but related markets create the most value with least variance. The strategic management academics define conglomerate mergers and acquisitions to include the acquisition of firms which are unrelated, firms in different geographic markets, or firms without direct competitions fields with those of acquiring firm (King et al. 2004, p. 189). The consolidation of firms in the same industry and same markets is horizontal mergers and acquisitions. Typically horizontal consolidation achieve operating synergies by combining firms or units which were possibly competitors, or whose products or talents fit together (Mukharjee et al. 2003, p. 18). The value creation occurs with exploiting the cost-based and revenue-based synergies (Capron 1999, p. 988). Zhang (2013) defines vertical acquisition as the consolidation of firms at different points in certain industry's production value chain. Vertical integration is the extent to which a firm controls the production of its inputs or supplies and the distribution of its outputs or finished products. The acquiring firm often does not have internal resources – knowledge and time – to develop new technologies which could expand the chain-value and deepen the production process. On the other side, technology driven sectors in the segment of small and middle sized firms, are underfunded, with minimal prospects for generating cash flow for the near future (Rossi et al. 2013, p. 75). Vertical integration is the company's business scale expansion, incorporating the activities of suppliers and customers.

The new product’s technology and marketing aspects are in synergic position with the company's current products. It can be seen that this group has many similarities to the horizontal integration (new but related products are not introduced), as well as vertical integration – regarding the inputs as new related products. The conglomerate diversification strategies include a category for which there are no obvious technological or marketing synergies, or cross-selling opportunities (Porter 1987, p. 46). Further kinds of are the market-extension mergers and acquisitions where combining firms with different market orientation and distribution of the same products and product-extension merger, where combining firms have the same market orientation and distribute the different but no coherence products. The summary of the previous descriptions integrating the economic and legal perspectives is in the Table 1.1.

Table 1.1 Business combinations categorized by effect on legal independence

Criteria	Characteristic			
Intensity of the combination	Acquisition: Maintenance of the legal entity		Merger: combination to one entity	
Relationship of the involved parties	Acquisition: Subordination	Reverse Merger: Super ordination		Merger of Equals
Bidding Form	Tender offer		Proxy Contest, competing for proxy votes	
Payment form	Cash offer (Cash flow)	Combination of cash and share offer (capital increase)		Share offer (buy out)
Management perception	Friendly takeover		Hostile takeover	
Integration direction	Competitor (horizontal integration)	Vertical up- and down-stream (supplier, competitor)	Complementary business units	Non-complementary business units (conglomerate

Source: Author’s creation using work of Bauer (2012) and Belian (2006)

The other criteria of classification – perspective of mergers and acquisitions are discussed in articles and books. Here is given a list of some alternative classifications (Bauer 2012):

- Market perspective: Both partners focus on the same or different target consumers, distribution channels, technologies, products and services.

- Geographic perspective: Domestic versus cross-border mergers and acquisitions
- Technology perspective: Technology oriented enterprises versus non-technology firms
- Strategic perspective: Diversification (cross-industry, focus decreasing) versus concentration
(focus increasing)
- Financing perspective: Stock-financed versus cash-financed (self-finance or borrowed).

The various perspectives on the field of mergers and acquisitions emphasize how multifaceted and complex such an undertaking is. The really logic question appears after understanding the complexity of forms mergers and acquisitions, what are their main motives and why companies decide to merger or to acquire. In the literature, the acquisition process is task of the top management and is structured in different phases which range from the initiation phase of a possible acquisition until the full integration and success control. In most models there are three phases: pre-merger, transaction phase and post-merger phase, (Belian 2009, p. 54; Carbonara et al. 2009, p. 93; Schweiger et al. 2001, p. 12; Schuler et al. 2001, p. 243). As the thesis topic is mainly oriented from the acquirer's point of view, hereafter, correspondingly, the terms pre-acquisition, acquisition-phase and post-acquisition-phase will be used throughout the dissertation.

1.1.2 Waves and main drivers of mergers and acquisitions in the past

The development of mergers and acquisitions waves is pursued until the 19th century. The analysis gives information about cycles and aims in order to evaluate the current tendencies in acquisition activities. In the literature there are six waves considering the driving forces, and impacts on several industries. The waves were mainly implied by technological progress, political and regulatory changes, and management trends (Martynova & Renneboog 2008, p. 2173). Hence, consolidation waves are closely associated with abrupt changes in the market observed during periods of either technological breakthroughs or tumultuous economic upswings and downturns. In the recent years, the mergers and acquisitions market was driven by low capital cost and high evaluations on the stock markets. The six mergers and acquisitions cycles have one in common: they all ended with financial markets crashes and economic downturn. Several scholars proposed the temporal influence of the waves as factor effecting the market responses to acquisitions (Haleblian et al., 2009, p. 484). The first wave of mergers and acquisitions was mainly driven by the industrial revolution, overcapacities accompanied with price cuttings. Hence, there were mainly horizontal mergers implying combination for companies specialized in similar production industries. The concentration of the horizontally similar combines led to monopolistic market structures in almost every industry and circumvented the price deflation. The first wave ended with stock market crash 1904.

Table 1.2 Historical waves in mergers and acquisitions

Time Period	Driving Forces	Type of M&A	Key Impact	Factors contributing to end of wave
1897 – 1904	Drive for efficiency, Technological Changes	Horizontal consolidation	Increasing concentration in metal, transportation and mining industry (monopolistic)	1904 stock market crash
1916 – 1929	Entry into World War I., Post World War I. boom	Largely horizontal consolidation	Increased industry concentration	1929 stock market crash
1965 – 1969	Rising stock market, sustained economic boom, trends	Growth of conglomerates	Financial engineering and conglomeration	Increasing purchase prices, excessive leverage
1981 – 1989	Rising stock market and economic boom, under performance of conglomerates	Rise of hostile takeovers	Break-up of conglomerates, increased use of junk bonds to financial transactions	Recession, bankruptcies; 1987 stock market crash
1992 – 2000	Economic Recovery, booming stock markets, internet revolution, lower trade barriers, globalisation	Strategic mega-mergers	Record level of transactions (in numbers and prices)	Slumping economy and stock market crash (dot.com-bubble in 2000)
2003 – 2007	Lower interest rate, rising stock market, globalisation, Price value disproportion	cross-border transactions, horizontal mega-mergers, private equity influence	Increasing synchronicity among the world's economies	Economic slowdown in industrial nations and the beginning of the financial crisis

Source: Author's creation using work of Martynova & Renneboog (2008)

The second wave of mergers and acquisitions was driven by the investment capital influx to the stock markets as a result of the economic boom following World War I combined with favourable economic conditions. In this context the literature mentions "roaring twenties" which was strong economic boom and strong technological progress. This wave was characterized by company's strategies to dominate markets with strong external growth and increasing concentration. In this wave the vertical mergers dominate because of the imposed Antitrust-Laws in the USA (Clayton Act 1914). In the vertical integration the transactions mainly happened within the value chain as the companies merged either up- or downstream within the value chain. The economic intention of such mergers mainly implies reduction of transaction costs. The stock market crash in 1929 and the Great Depression ended this wave. The third wave started almost 40 years later and resulted in creation of conglomerates, where the regulatory conditions, especially in terms of competition law were loosened. Consequently, the motivation was broadening the product portfolio and diversifying in order to get more robust in changing economic cycles. The companies were keen of synergy effects and proposed to position in new and opportunistic business areas. The mergers and acquisitions in this phase were often based on stock swaps. Also the process of shares payment by shares was simplified due to introduction of first convertible securities during this period. The higher prices paid for targets in this period increased the leverage of the conglomerates and caused exaggerations that led to a collapse. The end of the third phase occurred 1969 with stock market crash which was mainly implied by tax reforms. The starting occurrence of the fourth wave was the liberalization of the anti-trust laws and the tax burdens which led to higher attractiveness of company transactions on buy side and sell side. Further empowerment came from positive economic tone and strong stock markets. The peak of the activity was reached in the time period 1984 and 1989 with most pronounced tendency being rapid growth of hostile takeover share, implying acquisition at which the acquiring company attempts to gain control by purchasing shares in the market without consent of the top management of the target firm. The involved companies concentrated on core competencies and synergy effects and horizontal mergers and acquisitions dominated. The transactions get financed by innovative financial structures with strong emphasis on hostile takeovers, leveraged buy outs, and aggressive debt financing with junk bond market. Private equity capital funds bought whole conglomerates or part of conglomerates and separately sold the business units. The fourth wave ended with the crash in stock markets in October 1989 and the collapse of the junk bond market, the savings and loan banks crisis and other loan and capital problems of commercial banks.

The fifth wave is earmarked by transnational acquisitions on international scale, since as resulted from nearly a century long consolidation; most sectors of the economy are headed by international companies. Their significant influence on the mergers and acquisitions process has become crucial and dominant which were mainly driven by desire of transnational companies to ensure stability of their development under the ever changing market conditions. The fifth wave took place in the longest economic expansion and stock market boom. The deal size surpassed the deal volume from the fourth wave by three times of the fourth wave biggest transactions (Feito-Ruiz & Menéndez-Requejo 2011). The high deal activity was advantaged by industry-level deregulation, free trade agreements, globalization tendencies, social, cultural political, regulatory etc. changes and the strong orientation towards shareholder-value principles (Martynova & Renneboog 2008). With the consolidation of the new technologies, mainly the internet and software sector, the fifth wave ended in 2001 followed by worldwide recession. The number of hostile takeovers diminished because the vulnerable target companies developed protection strategies and the recent failures of such transactions showed the post-merger difficulties when integration of the target companies failed.

The sixth merger wave is the shortest wave until now and is characterized by deregulation of the financial markets worldwide. Through the deregulation and low borrowing cost the institutional investors like private equity funds and hedge funds play an important role in the sixth wave, especially in terms of deal financing. The major difference to prior waves is the buyer origin (increasingly companies from emerging markets), however, still dominated by US firms. The wave was characterized by lenders who gave incentives for increase the lending volumes by accepting riskier loans and their securitization. The riskier loans resulted out of the risky payment structures of leverage buy-outs. The acquisition done on this way show stable growth in the profits of target companies to improve their loan interest coverage ratio, while the share of hostile takeovers showed a drastically rapid growth along with the possibility of "losing" earning asset (Martynova & Renneboog 2008). This historical overview, schematically shown in Table 1.2, shows the impact of waves and trends of mergers and acquisitions, either on global or national scale, as company and resource consolidation is an important strategic instrument driven by a different set of underlying motives. The regulation factors may well be the most significant driving factor behind the acceleration of international acquisitions. Common literature results show that waves occur in periods of economic recovery and end with market crash and economic depression caused by different exogenous factors i.e. war, asset evaluation, energy crisis etc. (Martynova & Renneboog 2005). Furthermore, the waves coincide with periods of rapid credit expansion and booming stock markets. It is notable that all five waves ended with the collapse of stock markets implying the high evaluation of capital markets as an indispensable condition for a takeover wave to emerge. Finally, takeover waves are preceded by industrial and technological shocks often in form of technological and financial innovations, supply shocks (such as oil price shocks), deregulation, and increased foreign competition (Haleblian et al., 2009, p. 485).

At present, the seventh wave which is measured on deal volume gets extended far behind the sixth wave. The further development is difficult to predict considering sovereign funds and fiscal crisis of the leading economies worldwide. On the other side, the role and capitalization of the private equity showed its potential in the recent transactions, as its share doubled in global mergers and acquisitions deals accounting for more than a third of total volume (Firstbrook 2008, p. 1). This leads to a further tendency in concentration process of the companies. On the global basis, the economies get through this concentration process even more interconnected. Given the tendency to deregulating and restructuring measures and the importance of time factor, it is generally accepted that mergers and acquisitions are an important part in modernizing industries, and positively contributing to value creation (Langford & Brown 2004, p. 5). Moreover, the need for corporate growth and its funding from new sources area are likely to reignite the mergers and acquisitions market in the foreseeable future (Firstbrook 2008, p. 6).

1.1.3 Cross-border mergers and acquisitions

Mergers and acquisitions strategy is the means of protecting the market share and expanding growth domestically and internationally. Herein, cross-border mergers and acquisitions are considered when the involved acquirer firm and the target firm whose headquarters are located in different countries, commit acquisition transaction. Cross border acquisitions have become, as natural extension based on globalization patterns of the world economy (Very & Schweiger 2001).

Diepold (2005) showed the economic perspectives such as transaction cost economics (TCE) and ownership-location-internalization (OLI) framework and provided the dominant theoretical foundations on which cross-border mergers and acquisitions research was based. From TCE perspective, the choice of entry mode is the one that minimizes the transaction costs due to the asset specificity, high frequency, uncertainty, and opportunism. TCE suggests that firms try to evaluate the cost and benefit of operating and transacting related to the different entry modes in the local markets. Since the market imperfection exists and causes the misunderstanding, conflict that leads to delay, breakdown, or malfunction, the choice of entry strategy depends on a comparison of coordination costs incurred from internalization and the transaction costs arising from interaction with potential partners in local markets (Datta et al. 2009). Another research stream about cross-border acquisitions is the examination in the context of foreign direct investments (FDI), with emphasis on entry mode decisions and resulting wealth creation. A major focus in this research stream has been the uncertainty and risk associated with different national cultures and institutional settings. This stream of work emphasized minimization of the risks and inefficiencies in entering the foreign markets in which transaction costs played a key role. Countries with high level cross-border acquisitions may not benefit from that efficiency gains. The government policy and related legal framework to garner positive effects from inward foreign investment need to accompany this process. Kang & Johansson (2001, p. 37) show with their study that poorly functioning factor and product markets impede industrial efficiency and diminish the efficiency potentials in terms of economic expansion and job creation. Through international acquisitions, the terms such as home and host countries become meaningless, as the firms have facilities, employees, production sites etc. in diverse countries. This demands greater cooperation among the countries in formulating related framework taking account of the ever-increasing international nature of the firms and markets. An important driver of cross border acquisitions in Europe is the integration of There is need to make corrections in summary in Latvian, it would be good in critical way to evaluate translation in Latvian language, in order to make text more reader-friendly, also improve work title in Latvian language and make correction in designcountries with consequently softened regulatory barriers and introduction of the joint currency. Suh et al. (2013, p. 60) see the globalization process and the technological innovation as the drivers behind the increasing number of acquisitions in Europe. In line with that, Frey & Hussinger (2011) assert the integration of European markets as strong contributor to the surge of cross border acquisitions as firms search beyond national borders for promising acquisition partners. From the view of acquirer, the acquiring is one way of foreign direct investment (FDI) which is an effective instrument to access foreign technological capabilities, human resources potentials and knowledge (Frey et al. 2011). Cross-border mergers and acquisitions occur in many technology sectors in order the pool material, human and capital resources and capabilities to remain competitive. Combined firms are motived by the desire to consolidate capacities to serve global markets and benefit from scale economies. The efficient use of resources on core competencies and the full utilisation of human capital increase competitiveness of multinational firms. These aims are easier to achieve with cross-border acquisitions than through other types of foreign investment (Kang & Johansson 2001 p. 37; Chapman 2003, p. 312). When pursuing cross-border acquisitions, firms consider various conditions, including country-industry-, and firm-level factors, which relate both to the acquiring and to the target of the firm (Kang & Johansson 2001, p. 31). At national and industry levels, factors such as capital, labour, and natural resource endowments, in addition to institutional variables such as the legal and political environment, are highly significant. Moreover, on the country level determinants include cultural issues, specifically cultural differences and cultural traits. At the firm level, organizations pursuing an internationalization strategy need to intensify and evaluate potential targets to acquire in the host countries. According to research from Zhu et al. (2011, p. 303), the competing motivations behind acquisitions in foreign markets are separated in the market for corporate control and the strategic market entry hypothesis. The motivations are different and for domestic acquisitions mainly driven by the corporate control aspects. The cross-border acquisitions are motivated by the market entry hypothesis. Differences in the profitability aspects do not exist. The strategic choice of a specific mode of entry is crucial to the success of the internationalization strategy. Consequently, there are several ways to enter a foreign market, and each has its own strengths and weaknesses. The high popularity of foreign acquisitions gets blurred by the fact that many of the foreign acquisition fail to achieve the planned efficiency results. Frey & Hussinger (2006, p. 26) found that domestic transactions are preferred over cross-border acquisitions with exception of the technologically driven acquisitions implying that the technological relatedness reduces the failure risk of the cross-border acquisition and the firms. Moeller & Schlingemann (2005, p. 560) found out that cross-border acquisitions have announcements returns hundred basis points less than domestic acquisitions. The empirical evidence shows acquisition’s operating performance is lower in countries with strict regulatory environment in developed countries. Apart from that, there is little research on cross-border and domestic distinct effects in acquisition and integration (Bertrand & Zuniga 2006, p. 406). The identified determinants on the firm level are multinational and local experience, product diversification and relative investment size. Hitt et al. (2009, p. 527) argues while cross-border acquisitions may reduce certain types of costs, they need to overcome the costs associated with the liability in the foreignness which consists of knowledge of the foreign culture, area regulations, and pervasive business norms of the host country.

Very & Schweiger (2001, p. 20) emphasized the difference between domestic and cross-border acquisition to bear more problematic issues than only cultural issues. In domestic acquisitions, acquirer's management faces familiar environment and possesses more knowledge and experience, from the stage of target selection until the full integration of the acquired firm. The authors also emphasized the notion of domestic vs. cross-border acquisitions, as the acquirer' problems are specific for each category of acquisitions. Another approach strongly considering the profitability was presented by Bjorvatn (2004 p. 1212), setting up a theoretical comparison of the advantages for firms to engage in cross-border than in domestic mergers and acquisitions. Basically it is an approach of to grow in foreign markets either with cross-border mergers and acquisitions or through greenfield investment. The key variable is the analysis of entry cost and their impact on the profitability of cross-border acquisitions. The study results highlight the uncertainty in forecasting success of cross-border acquisitions compared to domestic. While cross-border could provide unique market-access benefits, there are also entry costs to consider in ultimately determining the expected outcomes. Possible obstacles are cultural differences, political factors, tax differentials, relative openness and the legal origin of a country affecting the investor protection and accounting standards (Diepold 2005, p. 38). Chatterjee (2007, p. 51) blamed challenges in melding cultures, communication, different management styles - all things that could impact any acquisition - for the numerous unsuccessful cross-border acquisitions. Implicitly, while the potentials in the cross-border acquisition are higher, the risk profile is negative.

Rossi & Volpin (2004, p. 300) supported it with empirical research that countries with higher corporate governance characteristics and better investor protection are associated with higher acquisition returns. Erel et al. (2013, p. 1049) proposes that corporate governance arguments are relevant in the pre-evaluation phase, as the due diligence audit has broader information scope and the seller might be sued for potentially uncovered risks. Among multiple processes involved in cross-border acquisitions certainly is due diligence, paralleling with negotiation, contract signing and integration (Carbonara et al. 2009, p. 94; Collins et al. 2009, p. 1330). The international acquisitions seem to be inevitable when competing globally and meeting the market driver needs, cost drivers and government drivers. The critical success factors of these determinants are far more complex than within domestic acquisitions (Vermeulen et al. 2001, p. 471), requiring broader scope of the thorough due diligence proceedings.

1.1.4 Motives of acquisitions

In general, the realization of mergers and acquisition transactions must consider financial and rational aspects conforming to enhance shareholder value and enterprise continuance. Empirical research shows the versatility of different acquisition motives, which cannot be considered separately. The research on acquisition motives are mainly thematically separated in financial or shareholder value maximizing motives and soft factors. Trautwein (1990, p. 283) developed an investigation framework which digests the acquisition motives with deriving of single theories, which are based on empirical results. In this context, it is pointed out that the strategic explanation is linked to the efficiency theory and thus the strategic motives have little explanatory value. The overview of the motives is described by reviewing prescriptions for merger and acquisition strategies, such as selecting the target and the integration, arguing that these theories are based on efficiency arguments.

The Table 1.3 schematically differs between the motives and the stated theory. Trautwein's argumentation pillar is the survey of merger and acquisition motives and the evidence of seven theories based upon three clusters, including:

1. acquisition as rational choice,
2. acquisition as process outcome, and
3. acquisition as macroeconomic phenomenon.

Table 1.3 Theories of mergers and acquisitions motives

<table>
<tr><td rowspan="5">Merger as a rational choice</td><td rowspan="4">Merger benefits bidder's share-holder</td><td>Net Gains through synergies</td><td>Efficiency Theory</td></tr>
<tr><td>Wealth transfer from custom-ers</td><td>Monopoly Theory</td></tr>
<tr><td>Wealth transfers from target's shareholders</td><td>Raider Theory</td></tr>
<tr><td>Net gains through private information</td><td>Valuation theory</td></tr>
<tr><td colspan="2">Merger benefits managers</td><td>Empire-building Theory</td></tr>
<tr><td colspan="3">Merger as a process outcome</td><td>Process Theory</td></tr>
<tr><td colspan="3">Merger as a macroeconomic phenomenon</td><td>Disturbance Theory</td></tr>
</table>

Source: Author’s creation using work of Trautwein (1990, p. 284)

Rational choice can be classified into two parts, including acquisition aims either for shareholders’ value or managers’ personal goals.

The efficiency theory considers the achievement of synergy effects in order to improve the overall enterprise efficiency and the "new" entity should operate more efficiently than the unique entities prior to the acquisition. Preferred grouping is based on scarce evidence and, additionally presents that several academics support the efficiency theory which are not the most plausible motive. This efficiency is derived from financial, operating and management resources synergies. Based on academic and professional support the efficiency theory should not be rejected, rather considered as the predominantly of mergers in spite of Trautwein’s (1990, p. 284) arguments. According to the monopoly theory, the mergers and acquisitions are considered as the instrument for achieving market dominance. The concentration oriented acquisition of competitor leads to limited competition and the monopolistic market structure allowing higher market power. This strategy concentrates not only on horizontal competitors but also on conglomerate level to e.g. use the generated profits to defence or strengthen the market position in an another market, or to limit the competition in the own market, or to implement market entry barriers to protect the market from potential market entrants (Trautwein 1990, p. 284). The main driver of monopoly is the market power, in the literature often referred as the monopoly power, is defined as the ability to set and maintain price above competitive levels (Price et al., 1998, p. 19). There is little empirical evidence that the firms combine to increase their monopoly power (Hayward 2002, p. 36). According to the strengthened regulatory prescriptions and high control levels from anti-trust agencies, the possibility to achieve monopolistic market position is low.

According to Raider theory, the raider is the person who causes wealth transfers from the stockholders of the companies, bids for in the form of greenmail or excessive compensation after a successful takeover (Trautwein 1990, p. 289). This theory has not have an empirical evidence is unambiguous and not often considered in the M&A research.

The valuation theory is based on the assumption that certain persons have differently evaluated the acquisition target because of information asymmetry. This leads to different valuation than the stock market value where the target company is undervalued and the acquirer is able to realize gains. Valuation theory conflicts with the market efficiency hypothesis. The specialty of this theory is the consideration of the uncertainty factor (Trautwein, 1990, p. 287). Numerous valuation approaches can be used to estimate the value of the target company, in the practical and research literature, two approaches are set as standard and approved valuation methods: discounted cash flow approach and the market multiple method (Mukharjee et al. 2003, p. 8). Valuation with the discounted cash flow method requires forecasting post-merger cash flow forecasts and estimating a discount rate to apply to these projected cash flows, which are complex in the estimation and bear certain level of uncertainty, i.e. high sensitivity to assumptions made for growth, profit, margin, and terminal value. The market multiple analysis involves applying a market determine multiple to net income, earnings per share, sales, book value, or other measure (Mukharjee et al. 2004, p. 8). This approach helps to identify a value range for the target and is useful when there are no acceptable comparable transactions or comparable public companies. The evaluation approach is oriented towards finding rational decision process and the benefits of acquirer's shareholders. The Empire Building theory explains the role that hubris drives the manager in acquiring firm may play important role in explaining takeovers. The hubris hypothesis implies that managers seek to acquire firms for their own personal motives and that the pure economic gains to the acquiring firm are not the sole motivation or even the primary motivation in the acquisition. Nguyen (2013, p. 33) uses this hypothesis to explain why managers might pay a premium for a firm that the market has already correctly valued. Managers have incentives to bring their firms to grow beyond the optimal size, when simultaneously power increases by increasing the resources under their control. In such hubris driven acquisitions, their own valuation is superimposed over that of an objectively determined market valuation. The pride of management allows them to believe that their valuation is superior to that of the market. Implicit in this theory is an underlying conviction that the market is efficient and can provide the best indicator of the value of a firm. However, this theory is not oriented towards enhancing firm's value but to enhance the prestige and hubris phenomenon which is theoretically drawn on wide body of empirical evidence (Kim et al. 2011, p. 53).

The Agency Theory also can be subsumed under the Empire Building theory. This theory is based upon the idea of self-interest utility maximization of both the principal as well as the agent but not those of the shareholders (Haleblian et al. 2009, p. 489). While the shareholder wants to achieve as much firm value as possible, the directors on the other hand might for instance solely be interested in gaining money and power. This conflict of interest between a principle (shareholder) and an agent (directors) is called ‘agency conflict’. As the director has the advantage of information asymmetry, he is in the position to take advantage of it in order to consider his personal interests. The agency theory provides a unique, realistic, and empirically testable perspective on problems of cooperative effort (Eisenhardt, 1989, p. 72). The basis of Process theory lies in the rational decision making, but mangers have only limited information and base decisions on imperfect information which often leads to suboptimal decisions (Trautwein 1990, p. 288). Jemison et al. (1986) discuss the influence of environmental, political and other contextual processes in decision making in the M&A process. According to this theory the some acquisitions are seen as the consequence of discussed outcomes of an entire corporate decision making procedure. Compared to the efficiency theory, where the acquisition decision making is based on rationale arguments, process theory contradicts in the point of view that acquisition procedures are an inherent element of the acquisition process. This theory model has been researched very often but with different outcomes. However, the available evidence is supportive (Trautwein 1990, p. 289).

Disturbance Theory has its primary application to public companies, as it is based on earnings forecasts, stockholder base and those who do not have stocks in the company. According to Martynova & Renneboog (2005, p. 12), the business shocks and crisis matter influence the forecast and expectations. Mergers and acquisitions waves are caused by economic disturbances:

Economic disturbances cause changes in individual expectations and increase the general level of uncertainty, thereby changing the ordering of individual expectations. Previous non-owners of assets now place a higher value on these assets than their owners and vice versa. In moments of changing market prices, the acquisitions take place. Consequently, the most acquisitions take place in the bear markets, when the as the distinction between shareholders and potential buyers significantly differs. The critical note of disturbance theory might be the fact that the volume of acquisition activity enhances in phases when the share prices increase, while acquisitions decrease during falling stock markets. In sum, Trautwein (1990) argued that among the seven competing theories, the valuation theory, empire-building theory, and process theory are the most plausible ones, in the order introduced. Furthermore, he also argued that the most dominant theory, the efficiency theory, has produced only limited validity.

Another view in context of explaining motives for mergers and acquisitions is the resource-based view (RBV). It possesses theoretical basis for demonstrating the competitive advantages between the firms and how these advantages can be preserved over time (Barney 1991, p. 100). The resource-based view’s underlying assumption is that the firms are bundles of resources which are heterogeneously distributed across firms, and those resources differences persist over time (Barney 1991; Penrose 1959). The resource-based view literature suggests that capabilities and resources are the key factors of a firm’s competitive advantage (Barney 1991, p. 101). Implicitly, the resource-based view proposes the key motivation of acquisition is to gain access to foreign strategic assets such as natural resources, managerial and operating resources and marketing channels as well as achieving economies of scale (Langford & Brown 2004; Gomes et al. 2013; Early 2004; Dauber 2012, p. 389). Technological advances create new products and industries, e.g. smartphones, social networks, e-readers etc. Tax considerations when acquiring a company can play a role if the target firm has accumulated losses and tax credits which may be used to offset the future profits generated by the combination of the two firms. The taxable nature of the transaction often play a role in determining whether the merger takes place than do any tax benefits accruing to the acquirer. The seller may view the tax-free status of the transaction as a prerequisite for the deal to take place. The transaction structure can allow the shareholders to defer any capital gain until the acquirer's stock received in exchange for their shares sold (Brauer 2006, p. 773).

The versatility of the past research, from the acquirer's perspective, shows diverse motives for an acquisition. The main motives have been categorized as strategic, financial and personal in the Table 1.4. Such categorization helps understanding these researchers' motives on the functional areas in developing hypotheses on explaining performance.

Table 1.4 Theoretical frameworks of motives and approaches in mergers and acquisitions

Strategic	Efficiency, Synergy Effects	Profit enhancement and cost reduction via Economies of Scale and Scope in the financial, operational and management area	Efficiency Theory Resource Based View	Trautwein (1980); Penrose (1959); Lubatkin (1983); (Adolph et al. 2006); Das&Capil (2012);
	Market Power Growth Internationalization	Reduction of the competitors powers, Market entrance barriers, geographic expansion	Monopoly Theory	Trautwein (1990); Ansoff (1966); Eckbo (1983)
	Resource Allocation/Inefficient Management	Reallocation of resources towards an efficient application, replacement of inefficient management	Resource based view	Capron (1998); Phene et al. (2010)
Financial	Diversification, internationalization and risk reduction	Expansion into future technologies and markets aiming for reduction of the entrepreneurial risk	Portfolio Theory, Transaction Cost Based Theory	Ragozzino & Reuer (2009); Moeller & Schlingemann (2005); Mukherji et al. (2013); Francis et al. (2008)
	Tax advantages, Access to Capital Markets	Reduction of the funding costs and tax burdens	Capital Markets Theory; Tax Hypothesis	Diepold (2005); Nguyen (2013)
	Undervalued target company	Taking advantage of undervalued market assets	Evaluation Theory	Trautwein (1990); Zhu et al. (2011); Haleblian et al. (2009)
	Free funding volume for Investments	Free-Cash-Flow is used to pursue own aims	Agency Theory Free-CF-Hypothesis	Angwin (2001, p. 33); Cording et al. (2002); Bruner (2004);
Pesrsonal	Management Hubris	Overestimation of the takeover effects; not recognizable acquisition advantages	Management Hybris	Gomes (2013); King (2009); Haleblian et al. (2004)
	Empire Building, Prestige, Independency	Enhancement of power and prestige; reducing replacement risk; reducing hostile takeover risk	Empire Building Hypothesis; Management/Hybris	Trautwein (1990); Walter & Barney (1990); Cartwright & Schoenberg (2006)

Source: Author's creation using sources in the Table

Haleblian et al. (2009, p. 472) proposed a framework combining the antecedents (the factors that lead firms to undertake acquisitions) and the moderators (internal and external factors that moderate acquisition performance) to classify the variables. Antecedent's motives influence the acquisition behavior in the pre-acquisition phase. Haleblian et al. (2009, p. 472) discuss why firms acquire and categorize acquisition motives into value creation, managerial self-interest (value destruction), environmental factors, and firm characteristics. Antecedents with the greatest impact on acquisition performance and value creating effects are still not clear. However, the overall assessment of the moderators is the basic step in the pre-acquisition phase in order to avoid wrong conclusions and overpay for the target firm. In line with Haleblian et al. (2009), King et al. (2004, p. 197) state the scholars have recognized that there is no theoretical framework been developed which explains the relationship between acquisition antecedents and subsequent performance.

1.1.5 The role of synergy effects in cross-border acquisitions

The aims of mergers and acquisitions are highly heterogeneous as the involved stakeholders perceive different claims, i.e. employees' aims is jobs preservation while the management is expected to reduce the costs and achieve more efficient production activity (Dauber 2012, p. 380). Apart of that stakeholder oriented heterogeneity of expectations, the aims can also be influenced by external factors, i.e. technological progress, shorter product life cycle and increased competition environment and other factors require constant change in defining the aims of mergers and acquisitions (Eisenhardt 1989, p. 39). Given that the speed of decision necessity and time to market increased, it is not astonishing that companies increasingly more often buy than build basic resources, new technologies and competencies (Eisenhardt 1989, p. 40). Walter (1990, p. 79) describes two methodological research directions concerning the mergers and acquisitions' aims. The first one investigates the different aims in consideration of acquiring new companies; the second investigates the specific aims which encourage the managers to make acquisitions. Complementary to the motives of mergers and acquisitions, aims also show different categories i.e. increasing volume, time oriented advantages, market entrance, risk diversification, cost reduction effects, gain of competencies etc. (Eisenhardt 1989, p. 80). Lamprecht et al. (2007, p. 809) divide the aims into two categories: first type which intends to use synergies and growth potentials and second type which intends to generate financial consolidation and divestments through increase of efficiency being accomplished through cost reductions, employee layoffs etc. The mergers and acquisitions motives cannot be considered separately or individually, these decisions underlie subjective perceptions. The strategic mergers and acquisitions aims need to comply with overall strategic planning of the company, as the long-term aims of mergers and acquisitions is the sustainable enhancement of the enterprise value through strengthening the market position (Mcdonald et al. 2005, p. 8). An enterprise has competitive advantage when the offered products and services have strong market position and competitive prices. The sustainable competitiveness is characterized by stronger market performance and higher profit margin than the competitors.

Lindstädt (2006, p. 62) reduces the mergers and acquisitions aims in two dimensions: management object and management focus defining the four aims of the strategic value management as follows:

- Efficiency, "doing the things right"
- Effectiveness, "doing the right things"
- Management of activities and resources
- Management of relationships and dependencies.

The four aims cannot be pursued simultaneously. Generalization of the aims of mergers and acquisitions are not plausible as the initial situation of each company differs. Consequently, this leads the acquirer to pay higher acquisition price. In general, such value enhancing, improved management skills may be valid when fast growing company is acquired by a large company. Smaller companies lacking management skills may limit its ability to compete in the broad marketplace and aim to be acquired by large firm offering management skills as an asset and achieve enhanced growth. The tendency is mostly driven by motive of influence, the market power and efficiency gains in order to generate further profits. It can be summarized that there are various motives and aims of the acquisitions and that no generalization or single motive or aim can be pointed out, rather there is a synthesis of various motives which determine the acquisition behaviour of decision maker. Hence, the rational for acquisition is the search for synergy or the concept that the sum of combining two firms is greater than their individual parts (King et al. 2004, p. 188). The concept of synergy however is at the core of resource-based thinking, which dates back to Edith Penrose’s (1959) seminal contribution. Penrose, without using the actual word, was concerned with two forms of synergy: the possibility of sharing particularly managerial resources, which is brought about due to inevitable indivisibilities of resources, and transfer of excess (and limitedly tradable) resources. The term synergy in acquisitions refers to the ability of a corporate combination leading to higher efficiency and higher profitability than those of individual parts of the involved firms (King et al. 2004, p. 188). The combining parties anticipate the existence and realization of synergy effects that impact the acquiring firm's subsequent performance. Cullinan et al. (2004) distinguishes the synergies as either of quantitative, qualitative or intangible nature. There are operating and financial synergies.

The operating synergies are categorized into three types:

1. Economies of scale arise from mergers and acquisitions, and allow the combined firm to improve cost efficiency and profitability. Achieving higher efficiency on the scale of operations allows the firm to reduce its average cost of production, research and development, marketing, distribution etc. Economies of scope may reflect both declining average fixed and variable costs and increasing pricing power. In general, economies of scales occur in acquisition of firms in the same business field.

2. Combination of different functional activities - combining the similar and supportive activities to decrease the cost basis. A common example of overhead and sales-related combination includes having as single department (e.g. accounting and human resources). Acquisitions aim to transfer functional strengths across as many business fields as possible.

3. Higher growth in new or existing markets, arising from the combination of the marketing and distribution channels - this occurs often when established firm acquires an emerging market firm, with an established distribution network, production site etc.

In general, operating synergies can affect margins, returns and growth, and thus the value of the firms involved in the merger or acquisition.

The financial synergies refer in acquisition either to higher cash flows or a lower cost of capital (discount rate) or both. The financial synergies are categorized into four types:

1. Improvement of the cash position - An acquisition of a firm with excess cash, can yield a payoff in terms of higher value for the combined firm. The increase in value comes from

the projects (i.e. enhanced revenue through entrance of new markets) that can be taken with the excess cash that otherwise would not have been taken.

2. Increase of the debt capacity - An acquisition of a solidly financed firm can increase the overall stability, as their earnings and cash flows may become more stable and predictable. This, in turn, allows the new firm more positive borrowing capacities than they could have as individual entities. The cost savings realization stems from lower securities' issuance and transaction costs. Another example is better matching of investment opportunities with internally generated funds.

3. Tax benefits can occur when the combined entity either takes advantage of tax laws to write up the target company's assets or from the use of net operating losses to decrease combined income. Profitable firm that acquires a money-losing firm may be able to use the net operating losses of the latter to reduce its tax burden. Alternatively, a firm that is able to increase its depreciation charges after an acquisition will save in taxes and increase its value.

4. Diversification is the most controversial source of financial synergy. Diversifying through acquisition outside of current industry category may lead to new revenue sources and have a positive impact on the risk profile of the firm. There is a considerable evidence that acquisitions resulting in unrelated diversification frequently result in lower financial returns when they are announced that non-diversifying acquisitions.

The main challenge for acquirer is the realistic estimation of the value and cost and revenue synergies, and the difficulty of achieving them. Synergies from intangibles represent access to brands, reputation, intellectual property, access to human resources, i.e. people, knowledge, experience, technologies etc. With those efforts the acquirer gains access to superior managerial practices, business models and operations. Porter (1987, p. 48) defines interrelationships which create synergy: Company's ability to transfer skills or expertise among similar value chains, and the ability to share activities. Even if Porter (2008, p. 35) sees the nature of rivalry in an industry altered by acquisitions that introduces new capabilities and ways of competing, he strictly denies the rivalry remove in order to decrease the competitors power. Such undertakings found place in some industries, where companies turned to mergers and consolidation not to improve cost and quality but to attempt to stop intense competition, but to eliminate rivals. Eliminating rivals is a risky strategy, however. The five competitive forces tell us that a profit windfall from removing today's competitors often attracts new competitors and backlash from customers and suppliers (Porter 2008, p. 39).

1.2 Determination of critical success and failure factors in cross-border acquisitions

The slogan "*Deal making glamorous; due diligence is not.*" (Cullinan et al. 2004, p. 2) is popular in the literature. With this simple statement the expert explain why so many companies have made unsuccessful and not value creating acquisitions in the past. It is not the case that acquirer performs no analyses in the pre-acquisition stage, but the scope is often narrowed by verifying the financial statements rather than conducting a thorough analysis of strategic rationale and the evaluation of the critical success factors of the planned acquisition target.

1.2.1 Critical success factors in cross-border acquisitions

The key critical success factors are factors that determine the success of a business or, in the context of this dissertation, the cross-border acquisition success (Tewes 2001, p. 4). The majority of existing financial literature considers, in terms of return of sales, shareholder value, return on investment, change in market share etc., as the critical success factor of the post-acquisition integration success (Haleblian et al. 2009, p. 493). Looking at the broader way, the success is the degree to which the intended aims and the success have been achieved. The success of an acquisition needs to be measured in accordance to the aims established prior to the acquisition (McDonald et al. 2005, p. 4). The performance measures have limitations that will be discussed. One performance measure is better than the other is when its theoretic base is more connected to the theoretic dimension of the research question. Zollo & Meier (2008) analysed 88 empirircal studies and identified different approaches for assessing the impact of acquisition. Based on their research and other research studies, Table 1.5 summarizes different methods into four categoryres how the acquisition success is being measured.

Table 1.5 Summary of measuring acquisition performance

Performance Measure / Unit	**Research Source**	**Main issues of the performance measurement method**
Event Studies Stock market based returns	Haleblian et al (2009); Bruner (2004)	• Event studies are designed to measure whether there was an abnormal stock price effect associated with an mergers and acquisitions event. • Researcher defines the event window over which the impact of the event will be measured. • Advantage of the method is the easy data collection (public) and big data samples. In addition, the data is not subject to industry sensitivity. • Disadvantages of the method are only monetary effects can be measured and that synergistic effects are not taken into consideration. A caveat is also that only publicly listed acquirers can be researched (sample bias).
Accounting based studies Accounting statements	Cording et al. (2002), Martynova & Reneboog (2008), Bertrand & Betschinger (2011)	• Accounting based studies consist of comparison of accounting ratios prior and subsequent to a takeover. It is supposed that the strategic aim of a business is to earn satisfactory return on investment, gain further financial effects (e.g. cash flow generation). • Advantage of the method is the data availability and data history. • Disadvantage is the weak comparability of accounting figures in cross-border acquisitions and that data fail to measure direct acquisition effects. In addition, some financial ratios are affected by method of accounting and the method of financing the acquisition (cash/debt or equity).
Expert informant's assessment and Management's perceived performance Objective and subjective view	Schoenberg (2004 and 2006), Hayward (2002)	• In this method, management and acquisition responsibles are asked to rate to what extent acquisition have realized their preliminary objectives several years after acquisition completion. • Advantage of this method is that performance can be measured in multidimensional way with financial and non-financial data. In addition, researcher receives direct, unbiased and non-public data. • Disadvantage is the very difficult data collection, as the top management is very difficult to reach and motivate for survey purposes. The acquisition process is depicted by confidential data (non-public information). • Using this method, the research data must be checked for bias due to informant's in multiple ways.
Disposal criteria Disposal (Y/N)	Cartwright & Schoenberg (2006)	• The method relies on publicly available information about the fact if the acquired firm has been sold or not. • Advantage of the method is the easy information assessment, while the disadvantage is short information that often lacks disposal background.

Source: Author's creation using Barkema & Schijven (2008), McGrady (2005)

Each acquisition is a unique event occurring in different environment and under multiple kinds of circumstances, the event studies have also provided a long stream of research (Haspeslagh & Jemison 1991, King et al. 2004, Haleblian et al. 2009, Chatterjee 2009). More than a half of the research studies have shown weak results after the mergers and acquisitions for the acquiring firm, and the other half only reached small abnormal returns (King et al. 2004, p. 196). A common theme in the literature is the appropriate measurement of performance management in the context of knowledge-based acquisitions (technological competence, workforce knowledge etc.). The reason is that there is seldom quantitative measurement which can be expressed in accounting figures, stock-price evaluation etc. (Rossi et al. 2013).

Capron (1999, p. 998) considers the available data to gross to permit differentiation *"between the types of fine-grained value-creating mechanisms"*. Bruner's (2004, p. 57) meta-analysis did not find consistent pattern of either improving nor worsening profitability directly related to the post-acquisition financial performance. Very similar results were conducted for measuring the mergers and acquisitions success with event studies using the stock price as the measurement variable. Even though the short-term performance studies of the stock performance dominate the field, doubt exists on whether stock is an appropriate to gauge the performance of the mergers and acquisitions (Hopkins, 1999, p. 220). Andrade et al. (2001, p. 117) showed in a study comprising the operating performance of 4,000 mergers and acquisitions 1973 - 1998. In assessing the average abnormal operating performance, findings showed that the combined target and acquirer operating performance is strong dependent to the industry and has improved slightly in the post-merger phase. Moreover, Andrade et al. (2001) compared the announcement-period stock market assessment; results found that the improvement in post-merger cash flow performance is consistent with the positive announcement-period stock returns on the combined target and acquirer firms. The cumulative abnormal returns around acquisition announcement dates reflect investor's response to the announcement, based on evaluations with future cash flows of the combined firm. The researcher consider abnormal returns, under the assumption of efficient markets, as the most effective technique to measure acquisition performance, also under the assumption that the market has some ability to predict post-acquisition performance. Haleblian et al. (2009) does not support this view and considers the cumulative abnormal returns approach as to short-time oriented to serve as performance measure. In their meta-analysis they encourage to consider also the acquisition price premiums and divestments of the acquired firms short after the acquisition. Divestments of acquisitions would also serve as long-term performance based on the assumption that short-lived engagement in the acquired firms implies poor acquisition performance (Haleblian et al. 2009; Hitt et al. 2009, p. 4). Conclusively, the event study methodology may lead to generalization and falsify the theoretical constructs. Moreover, the research sample would be limited only to publicly-listed companies.

The accounting studies are based on the analysis of annual reports comparing pre- and post-merger operating performance of how firms' earnings respond to acquisitions. Such studies measure profitability based on published figures in the financial statements and compare return on equity, return on assets, return on capital employed, return of sales and operating margins (Cording et al., 2002, p. 6). The problem with this measurement method is that the operating performance may be driven by other factors than the acquisition. In addition, accounting standards across different jurisdictions varies, making this kind of research method difficult in terms of data validity.

Empirical studies research the success factors from the perspective of the acquirer's owner or shareholder, as the acquisition risk might directly impact the financial results and pay-out ratios, and implicitly the shareholder value (Gomes et al. 2013, p. 19). The method Manager's perceived performance and Expert informant's assessment surveys managers. Usually, they are asked to give their overall rating about the entire performance of the acquisition and what operative and strategic steps were undertaken in order to successfully acquire (Schoenberg 2006). Examining success of mergers and acquisitions using survey of the managers involved in acquisitions is based on their judgment ability. The assessment may consist of survey through field interviews or through the distribution of questionnaires, whether the intended acquisition aims achieved and to what extent. Assuming the acquirer's management determines pre-acquisition objectives and measures of success for the acquisition, and then the same management also knows well whether these objectives were achieved.

The advantages of this measurement method is that in this way it is possible to examine many aspects related to the acquisition success and it is possible to isolate in an efficient way the impact of the acquisition on the success from the other impacts (Bruner 2004). A disadvantage is the low responding rate and lack of objectivity causing biased survey results (Cording et al. 2002, p. 7; Bruner 2004, p. 16). The bias in the measurement of the success can derive from the managers natural tendency to give positive feedback of the business processes in which they are personally responsible (Schoenberg 2006, Bruner 2004, p. 51; Walter & Barney 1990, p. 85). Implicitly, uncertainty that this type of questioning will precisely present a picture of the success remains current. Bruner (2004, p. 51), who queried fifty senior managers who were involved in an acquisition on the degree of success of acquisitions. When the managers were asked in general about acquisition motives, on the average they replied that only 37% of the acquisitions produce value for the acquirers and 21% of the acquisitions achieve the acquirer's strategic goals. However, when managers were asked the same question, but this time regarding the acquisition in which they were personally involved, 58% believed that the acquisition in which they were involved created value for the acquirer and 51% believed that the acquisition achieved the strategic goals.

Zollo & Meier (2008) and Schoenberg (2006) examined relationships between the different measurement methods. Schoenberg (2006) did not find relationship between objective and subjective measures of acquisition performance. Zollo & Meier (2008) found that there is no relationship between the short-term event study and other metrics based performance measurements. Summing up, the accounting-based assessment, manager's assessment and expert informant's assessment were correlated. There is no perfect measurement method but a suitable one. Researcher must select the measurement method and connect it to the theoretical logic behind the research. The aim of this research is the identification of critical issues in the pre-acquisition phase and which factors need to be examined on positive or negative impact on acquisition. More exactly, the success of the acquisition is assessed on performance in terms of created value, operational and financial synergies level, for the new parent firm. The created value may evolve from profit contribution, return on investment but can also include intangible contribution such as acquired technological or efficiency increasing skills leading to cost savings and extension of the parent firm's business capabilities and value chain.

1.2.2 Critical failure factors in the cross-border acquisitions

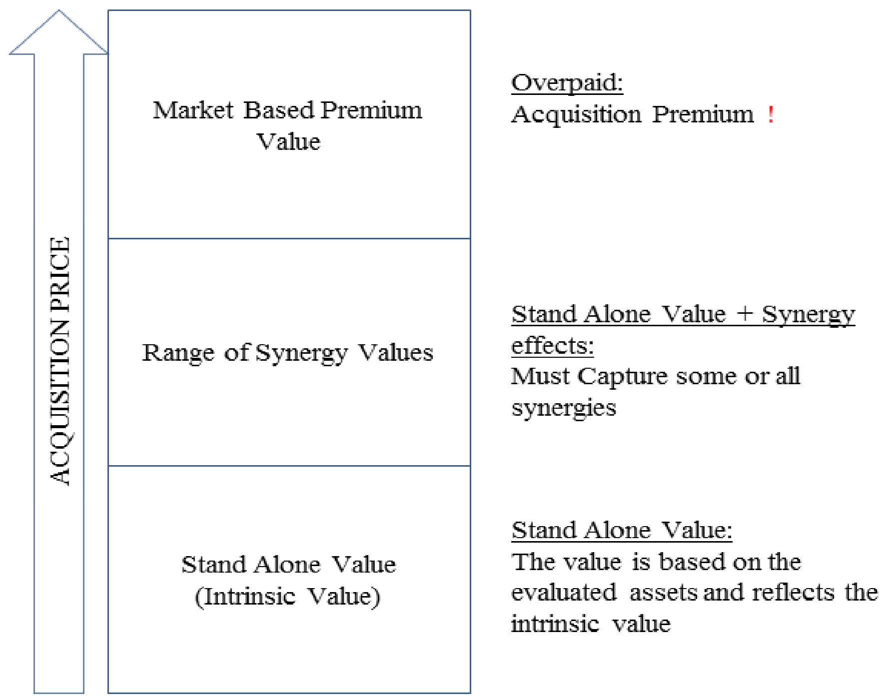
Various research work of the causes of the many acquisition failures exist, and the most emphasized reason is the lack or the inability of realizing the strategic and organizational fit and the high acquisition price (Adolph et al. 2006, p. 6; Gomes et al. 2013, p. 19; Hopkins 1999, p. 212; Mcdonald et al. 2005, p. 4). The realization of the identified strategic and organizational synergies in the pre-acquisition phase, mainly benefiting from relatedness may stick because of the large cultural distance between the two companies. Cartwright et al. (2006, p. 28) emphasize the lack of cultural compatibility and organizational culture change as the most difficult issues for the human resources as the pre-existing culture of the acquired unit is one of its main characteristics. Applebaum et al. (2009, p. 54) analyzed ten case studies and investigated discovered that it is no imperative to have a full cultural fit, but it is very important to understand the differences and the methods handling the culture of the two combining companies. Abolishing the assessment of the cultural fit and the cultural potential only guarantees the fate of the integration and leads to failure of the mergers and acquisitions. In the category of organizational fit, the operational fit (e.g. IT systems compatibility, supply chain management, other operational issues) is needed to realize synergy effects in the post-acquisition phase. Morrison et al. (2008, p. 23) tested with survey supply chain management and IT as the two operations that are often overlooked in the pre-acquisition phase. Only half of the survey participants involved in acquisition activities focus on visible or accountable issues missing to assess operational complexity and fit of areas like integrated supply chain management systems, logistics and subcontracting and manufacturing issues.

In line with Zollo & Meier (2008, p. 72), the transaction success measurement needs to consider multiple measures of acquisition performance because of the existence of different acquisition rationales which lead to distracted view on what is successful and what failed acquisition.

Martynova & Renneboog (2008) studied the long-term profitability of corporate takeovers in Europe, and found that both acquiring and target companies significantly outperformed the median peers in their industry prior to the takeovers, but the profitability of the combined firm decreased significantly following the takeover. In this context, Dunne et al. (2013, p. 8) argue against the measurement methods of the success or failure with the common metrics (earnings approach) and finds the evaluation of the business fundamentals as the more suitable way to evaluate acquisition merits. A.T Kearney (Rothenbuecher, J., Hoyningen- Huene 2007) research results show that 60-80% of all mergers are financial failures when measured by their ability to outperform the stock market or to deliver profit increases.

The most frequent failure reasons of cross-border acquisitions are the poor integration of the acquired firm and the paid acquisition premium – or the price paid. Malhotra & Zhu (2013, p. 272) indicated that the theoretical perspectives on acquisition premium mostly rely on synergy, bargaining power, managerial hubris or information asymmetry. The main conclusion of their studies show however those acquirers are rather oriented according to comparable acquisitions than detailed due diligence assessment. When valuing acquisition target firms acquiring companies often rely on market based price measures. They reflect the acquisition prices of the recent comparable transactions but they do not reflect the fair value to specific buyer. In the Figure 1.1, the acquisition price consists of three parts: stand-alone value (sole valuation of assets and liabilities), the possible synergy values which may be only realized in combination with the acquiring firm and the acquisition premium consisting of positive market environment or when bidder drive the prices – but not the value – up. Hence, to avoid such overpayments and value destruction, the adequate evaluation based on reliable, complete information basis in the pre-acquisition phase.

Figure 1.1 Components of the acquisition price



Source: Author’s creation using work of Malhotra & Zhu (2013), Kim et al. (2011)

The consequence of the price premium is shown in the financial statements of the acquiring firm as goodwill. Goodwill arises when the price paid for a target firm is exceeds the fair value of the firm’s net assets that the acquirer recognizes in consolidated financial statements. In IFRS, the treatment of the goodwill is regulated that it needs impairment test at least annually. Goodwill cannot be separated from the company or sold to third party (Olante 2012; Glaum et al. 2015). Hence, it is impossible to determine the fair value or the value in use of goodwill in isolation. The goodwill must be allocated to one or more "cash generating units" and the tests are then performed on that level of these units.

The goodwill is an appropriate aspect to include when the question arises, whether the acquisition has been a success or failure. Thorough investigation in the pre-acquisition phase (e.g. due diligence) creates adequate information basis in order to support the decision-making and avoid the possible overpayment.

1.3 Origins and Systematization of due diligence in cross-border acquisition

The traditional due diligence audit is based on financial audit of the target company according to the formal definition of an audit of financial status as formulated auditing profession organisation, which is regulated in Statements of Auditing Standards, Codification of Auditing Standards and Procedures, as follows:

> The objective of the ordinary examination of financial statements by independent auditor is the expression of an opinion on the fairness with which they present financial position, results of operations, and changes in financial conditions in conformity with generally accepted accounting principles.

The origins of due diligence lie in the US case law, where the term "due diligence" was anchored in the section 11 (b) (3) of the Securities Act of 1933. In this section the defence of due diligence was provided to those who had made reasonable investigation of into matters contained in a prospectus for the issue of securities. In common law countries, the principle underlying the issuance of shares or business sale is caveat emptor, or "let the buyer beware" (Slaughter et al. 2007, p. 6), which means the seller is not obliged to reveal defects in the selling unit. On the other side, the acquirer would rather incur costs in investigating than buying non-investigated unit. The caveat emptor principle explains the acquirer's motivation for contractual protection (i.e. warranties clauses) which provides the post-completion price adjustment mechanism. Due diligence audit does not replace the contractual protection but helps to define the content of the acquisition contract. Since the 1980s, a lot of research has been done on risk field of merger and acquisitions but less on due diligence audit in the pre-acquisition phase (Firstbrook 2007; Gomes & Angwin et al. 2013). Due diligence is generally accepted method of risk assessment in the world of mergers and acquisitions (Morrison et al 2008, p. 23). Due diligence proceedings are not standardized, but they are roughly categorized in two forms in the literature. The due diligence assessment of the financial status of the company to be acquired is based on the audited financial statements, which provides observations of material weakness in the accounting control of the company (Harvey & Lusch 1995 p. 17). In a study from Deloitte (2012), more than a half of the survey participants' reported conducting extremely or very extensive due diligence in the pre-acquisition phase. In a broad based survey at the Annual Due Diligence Conference, the participants considered weak due diligence as the main reason that many acquisitions failed within few years (Morrison et al 2008, p. 23). The core point of due diligence is to provide an acquirer with enough basic information about a target to pave the way for an informed decision about whether to pursue acquisition and under which conditions. The basic function of due diligence is to assess the benefits and the liabilities of a proposed acquisition by inquiring into all relevant aspects of the past, present, and predictable future of the business to be purchased.

Table 1.6 Summary of definitions of due diligence from different viewpoints

Viewpoint	Definition	Source
Geographic	In USA the term due diligence describes a general duty to exercise care in any transaction. The origin of the due diligence is in the US Securities Law 1933, Section 11. In most circumstances, case law in the United States suggests the ordinary standard of being diligent putting reasonable investigation efforts in the acquisition process.	Harvey & Lusch (1995, p. 17) Sjostrom (2006, p. 569)
Time/Process	Due diligence' is a process whereby an individual, or an organization, seeks sufficient information about a business entity to reach an informed judgement as to its value for a specific purpose. The due diligence assessment of the financial status of the company to be acquired is based on the audited financial statements, which provides observations of material weakness in the accounting control of the company.	Strauch (2005) Harvey & Lusch (1995)
Materiality	The key objective of corporate acquisition due diligence investigations is to understand every material aspect of the target firm's assets and liabilities, so as to be able to provide the management of the acquiring company with enough information to make an informed decision as to whether or not it would be worthwhile to proceed with the acquisition. Due diligence is intended to be an objective, independent examination of the acquisition target. In particular, it focuses upon financials, tax matters, asset valuation, operations, the valuation of a business, and providing assurances to the lenders and advisors in the transaction as well as the acquirer's management team. The results of due diligence are documented as a protocol for a careful evaluation of both the hard financial and soft personnel and organizational issues that are critical to organizational success. The document has proof function in possible court trials.	Sjostrom (2006, p. 569); Epstein (2005, p. 42); Angwin (2001, p. 35)

Viewpoint	Definition	Source
Risk orientation	Modern acquisition due diligence goes far beyond straightforward audit of financial statements. The scope includes wide range of risk management and qualitative characteristics of the target that are difficult to identify and often future oriented. The due diligence audit contains, in particular, a systemic strengths and weaknesses assessment of the target, analyses of the risk linked to the purchase, as well as, a sound valuation of the assets.	Strauch (2005, p. 140) Knecht & Calenbuhr (2007, p. 425)
Legal orientation	Due diligence is the diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation. In the contract creation process, basically when acquisition terms are negotiated, due diligence is a process by which clients, lawyers, and their other advisors define the learned characteristics of target firm before committing to buy it. The crucial content is 1) the general state of the business; 2) the way the business has been conducted in the past; 3) whether the business has been operated according to industry standards or in a unique fashion because of certain factors, right, or assets that the purchaser may or may not acquire; 4) actual and contingent liabilities; and third-party interests.	Sjostrom (2006, p. 569);
Analytical function	Due Diligence conducts analytical review of assets, contingent liabilities, revenue, and expenses and evaluation of culture, strategic and organizational fit and other non-financial elements and ensure the appropriate acquisition price determination. The most sophisticated acquirers must go beyond these fundamentals to identify the target's desirable core competencies, carefully analyze and value them, and creatively structure purchase-and-sale agreements to ensure that the skills and knowledge that comprise the core competencies are secured.	Epstein (2005, p. 41); Harvey & Lusch (1995); Price et al. (1998); Ahammad & Glaister (2013)
Learning Function	Due diligence standard advice to prospective buyers is to thoroughly evaluate a potential acquisition and go a step further than that using the due diligence phase to learn about the company's strategy, markets, operations, and employees.	Ahammad & Glaister (2013); Very & Schweiger (2001)

Source: Author's creation using various sources stated in the Table 1.5

Those making this assessment should focus on risk, carrying out an investigation of a potential investment serving as a confirmation of all material circumstances related to the transaction with the final purpose of giving confidence to the acquirer of the value and risks of associated with the target company (Angwin 2011; Belian 2011; Meier 2011). The due diligence investigation goes beyond audited annual accounts, as they do not serve as the assurance for the acquirer, providing the basis for negotiating suitable warranty extent, including the appropriate annual statements. The application of due diligence essentially occurs in situations where the assets are to be transferred from one party to another.

The due diligence proceedings appear differently defined in the literature, however only selectively in the context of financial strategic management. Table 1.5 summarizes academic view on due diligence from different angle of academic views.

Due diligence achieved high practical use in various business cases where the ownership transfer is the end consequence of the transaction. The main function is the application of diligent care prior to and during the technical preparation of the ownership transfer (pre-acquisition phase). The results of such an investigation need to integrate the claim in case of future damages in the acquisition contract.

1.4 Information asymmetry problem and the exploratory learning in the pre-acquisition process

In the pre-acquisition phase, the due diligence refers primarily to an acquirer's review of an acquisition target to ensure that the acquisition would not bring up unnecessary risks to the acquirer's shareholders. The basic function is the assessment of the benefits and liabilities of a planned acquisition by inquiring all relevant aspects of the past, present, and foreseeable future of the business to be purchased.

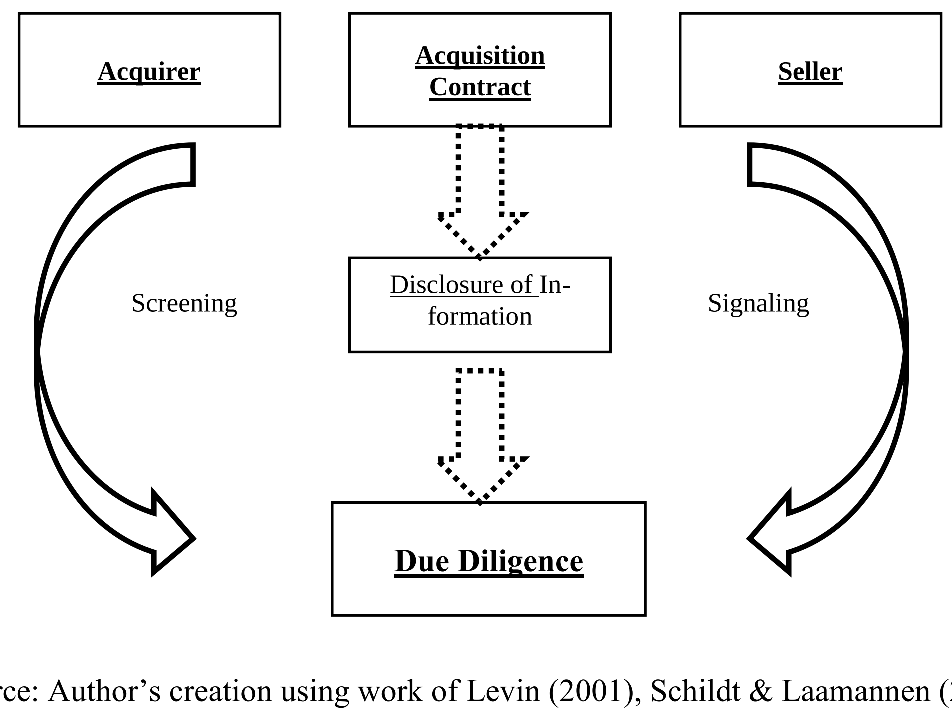
1.4.1 Information asymmetry problem in the acquisition process

In the acquisition, the acquirer and the seller have different information basis. This may lead to incomplete evaluation and increase or decrease of value creating factors. In the literature it is proposed that the acquirer has less information than the seller (i.e. buyer has not access to full information) about the acquisition target. The gap in the different stage of information can be declared as the information asymmetry problem. Information asymmetry is a condition where different parties in a transaction have different level of information. According to Akerlof (1970, p. 490), information asymmetry develops when the seller has more information than the buyer about the goods or services being exchanged. The ownership of a product makes the possessor better aware of the quality of that product, and gives an informational advantage, which creates asymmetry in the information available to those who do not own similar products. This disparity in the available information makes the choice of a product risky for a prospective buyer. Information asymmetry therefore develops a contextual environment in which different parties to a transaction perceive the value of the product in different ways. Information asymmetry implies that each bidder has full set of information and this difference in sets of information can give a competitive advantage to one of the parties in an exchange.

The concept of information asymmetry has received considerable attention in the domain of acquisition finance (Schildt & Laamanen 2006). Strategic management researchers use these insights to understand the failure reasons of the mergers and acquisitions and to identify the way that the managers can cope with the challenges presented by knowledge difference across acquirer and seller (Reuer 2005, p. 15). Different attributes of information, such as quantity, quality, and type, influence the distribution of information among individuals. The presence of varying information quantity, quality, and content within the information bank (the information about a product that they have accumulated through search or experience of each individual leads to asymmetries of information and consequently to unique perceptions about a decision making problem. The basic argument is that a firm’s information environments play a significant role in acquisition decision-making. Acquirers identify and evaluate acquisition targets on the basis of their existing knowledge and the information they gain through different information search contexts, like thorough risk assessment in the pre-acquisition phase. Implicitly, information asymmetry contains the risk of improperly evaluating assets, leading to overpayment (Mukherji et al. 2013, p. 40). Schildt & Laamanen (2006) researched the implications of the asymmetric information which is distinct for foreign acquirers in terms of evaluation of synergies and other acquisition potentials.

The acquirers with poorer information of target's value are more likely to overpay the target firm. The cross-border matter directly impairs the quality of information as firm's ability lacks to absorb distant knowledge. The main reason here fore is lack of personal contacts, the other mechanisms requiring spatial proximity and long-term screening. In bidding process with other potential acquirer's preparing bidding offer, foreign bidder who is not aware of information quality and strategy is likely to overpay the target firm. When there is no potential for screening and signalling a price equilibrium will not occur as the confidence about the real value cannot be established (Levin 2001, p. 657). Hence, the acquirer needs to accumulate information about the target firm with screening the available information within the due diligence scope (Ragozzino & Reuer 2009). On the other side, the seller needs to disclose information to level the information asymmetry between the parties. Only on this way a confidence can be established in order to proceed with the acquiring (from the acquirer's point of view) or selling the firm (from the seller's point of view). Otherwise it bears risk of adverse selection or the risk of overpayment. Moreover, the risk of attempting to distinguish acquisition targets that are attractive or unattractive, and the due diligence results are not efficiently usable (Ragozzino & Reuer 2009). Ideally, all information is placed in the acquisition contract which serves as the document for determining the acquisition (legal) framework. The Figure 1.2 outlines the information flow and exchange in the context of due diligence as the tool for abolishing the information asymmetry.

Figure 1.2 Due diligence in the process of signaling and screening information



Source: Author’s creation using work of Levin (2001), Schildt & Laamannen (2006) and Reuer (2005)

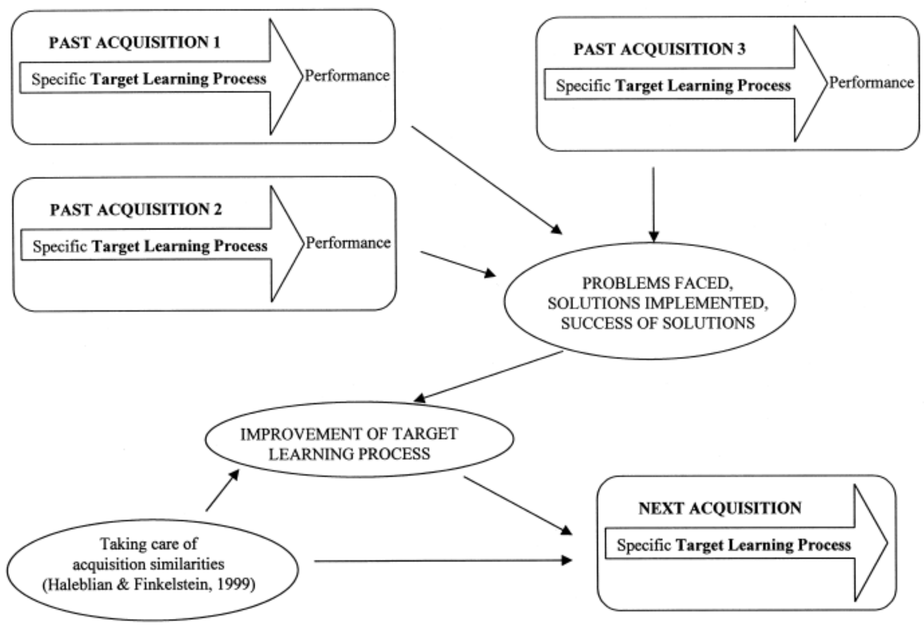
As the quality of the sellers information increases, their confidence base also increases, as does the probability of reaching a consensus regarding the acquisition price. However, the opposite also may occur when the information drive the acquirer to cease the acquisition interest. In the forefront of the acquisition, due diligence is considered as the most important part in gathering information in the acquisition process (Epstein 2005, p. 39; Hopkins 1999, p. 212). Schildt & Laamanen (2006, p. 111) proposes that in the boundary extension process the information environment can limit a firm's choices, leading firms to mainly acquire in the familiar environment. The basic argument is that the firm's information environments play significant role in acquisition decision-making. This seems logically, then the acquirer identifies and evaluates acquisition targets on the basis of their existing knowledge and the information they gain through different information search contexts (Schildt & Laamanen. 2006, p. 112; Rosenkopf et al. 2003, p. 763). However, Schildt & Laamanen (2006) cite Akerlof (1970) underlining the point that acquirer's lack of accurate information regarding the target limits the acquisitions as combining companies can only occur when the information asymmetry can be managed. The extent of the due diligence needs to identify the domains of information that are required to make a more informed acquisition. mostly conforms with the perspective of organizational learning theory, more precisely the exploratory learning (Barkema & Schijven 2008; Shimizu et al. 2004). Very & Schweiger (2001, p. 18) describe the difficulties in collecting and evaluating reliable information by the acquirer. Therefore, common practice is the engagement of experts, i.e. consultants, lawyers, appraisers etc. in order to overcome the information asymmetry and learn more about the target firm in order to evaluate the acquisition potential. Due diligence audit involving different internal and external experts is such a tool which deals with available information and delivers an adequate groundwork for decision making in the acquisition process.

At the beginning of due diligence audit, mostly publicly available information are screened prior to focusing on crucial topics that include also non-public information which are provided by the target firm (Mehler 2009, p. 116). However, the due diligence process is divided into diverse focus steps which will be described in the following chapter, where the information sources will also researched. Schildt & Laamanen (2006, p. 112) name sources of information about targets from prior business relationships, alliances, technological domains and other sources. These three sources can substitute each other and be used in the subsequent acquisitions.

1.4.2 The role of organizational learning in cross-border acquisition process

The organizational learning theory provides insight into firm's understanding and evaluating of the business environment. Organizational learning provides explanations for the firm's ability to find and develop intangible resources in order to enhance the possible strategies which can be employed (March et al. 1991, p. 84). The need for learning and renewing the knowledge is given in order to keep up with changing conditions. Hence, acquiring new resources and knowledge represents new sources for growth and strengthening the competitiveness. The key aspect of organizational learning research in mergers and acquisitions research is resource and knowledge acquisition, which is based on existing knowledge, gaining understanding from experience, evaluating and observing the competitive environment (Uhlenbruck et al. 2000, p. 8). Previous researches on organizational learning theories argue that cross border acquisition process is a dynamic learning process. Dynamic learning process is divided into strategic management and organizational learning, whereby the strategic management is associated with a firm's prior acquisition experience increasing the probability of subsequent international acquisitions (Collins et al. 2009, p. 1330). Hayward (2002, p. 36) showed that acquisition experience is insufficient to ensure acquirer learning. The firms rather benefit from a variety of experience, experimenting and further develop the learning skills. The organizational learning is based on the proposition that both previous domestic and cross-border acquisition activities contribute to knowledge increase in future acquisitions (Barkema & Schijven 2008; Hitt et al. 2009 p. 527). Very & Schweiger (2001) emphasizes upon a learning perspective, the process of cross-border acquisitions is influenced by prior knowledge accumulated by an acquirer about a targeted company. On the contrary, problems of necessary information for evaluating deal closing are more likely when the acquisition is a first entry into a country, as there is a lack of local information and knowledge. As the firms engage in cross border acquisitions, they gain process knowledge regarding the pre-acquisition evaluation and the post-acquisition integration. Experience in cross-border acquisition process leads to key source of competitive advantage because of gathering experience and learning from the mergers and acquisitions process increases the success of the next acquisition (Shimizu et al. 2004, p. 347). Collins et al. (2009, p. 1330) emphasize the repetition aspect of firms engaging in international mergers and acquisitions as advantageous because of gained experience by repeating a specific action. This repetition momentum puts acquiring firms into a position to gain experience and confidence as their knowledge regarding routines improves. The repeated replication and usage of acquiring skills reinforces improvement of organizational learning capability (Haleblian et al. 2006, p. 367). The learning factor based on knowledge of the acquired firm has positive impact on expanding own business capabilities. Vermeulen et al. (2001, p. 470) also show in their study how firms revitalize their knowledge based on acquiring another firm. Very & Schweiger (2001, p. 25) separate the acquisition process in a double-level learning process: 1) experience accumulation process, when the acquirer learned from the past acquisitions and applies it to managing better subsequent deals, and, 2) target learning process, when the acquirer learns about a target and its environment, business process and synergies.

Figure 1.3 Target learning process



Source: Author’s creation using Very & Schweiger (2001)

In order to receive reliable information level the acquirer needs to analyze as much as data are available about the target, gathering and interpreting the necessary information in the pre-acquisition phase. Such a process is similar to the behavioral learning process (Hitt et al. 2009, p. 526; Very & Schweiger 2001, p. 25). In order to divide the two different knowledge phases in the acquisition phase, the exploratory and exploitative knowledge sharing are being used. Both are recognized as dynamic capabilities that influence relationship performance. Knowledge sharing capability is defined as an organizational capability to acquire and exchange internally and externally generated knowledge that is pertinent to the organizational development (Mukherji et al. 2013, p. 40). In the context of acquiring a firm, all pre- and post-acquisition processes are dynamic and involve learning. In each of them, the acquirer should improve his knowledge of how to use each of the processes to reach a successful conclusion. The internally generated knowledge consists of the gather experience in the past, the externally knowledge consists of gather information of the industry and the potential acquisition targets. Shimizu et al. (2004, p. 330) propose that the learning in acquisition largely conforms to exploratory learning because, while an original structure to the approach is needed to ensure that all major information is evaluated, and effective risk assessment or effective due diligence also has an exploratory nature. If some information is identified that poses further questions, answers to them must be pursued even if they require movement outside of the original structure. *"Thus, good due diligence can be described as semi-structured, containing both primary and exploratory inquiries"* (Shimizu et al., p. 330). The explorative learning means that firm concentrates on the knowledge and routines which may contribute to its business success and to screen out those routines, which do not have success in the current setting. March (1991) proposes that firms primarily learn from acquisitions in related industries. Vermeulen et al. (2001, p. 469) found that acquisitions in unrelated domains may not lead to learning effects, as the acquirer lacks the basic knowledge which is necessary to absorb the resources. March (1991) argues that the mode of expansion reflects the balance between the exploration of new knowledge and the constant improvement of the existing one. King et al. (2004, p. 189) emphasizes the relatedness and industry familiarity as the factors which can eliminate or significantly diminish the need of acquiring firm managers to learn the business of the acquired firm, and facilitate the learning from the acquisition process. Based on that, acquisition of related business firms simply reduces the failure risk and can have positive impact on the overall acquisition performance. Hitt et al. (2009, p. 526) emphasizes if the acquirer learned target's complementary capabilities and taps that capabilities from the acquired firm, he is more likely to build new capabilities and enhance their own competitive position in the market. Porrini (2004, p. 547) draws on acquirer’s prior alliance with the target as a special case of organizational learning from the previous experience and knowledge gathered from the business relations. Implicitly, this target-specific knowledge reduces the information asymmetry in the acquisition process and allows a more exact valuation for the target firm. Beyond that, findings indicate that previous thorough knowledge of target benefits acquisition performance.

In general, companies that have operations in a foreign country are more likely to acquire within the same country because they effectively use their lessons learned in the prior acquisitions

(Shimizu et al. 2004, p. 348; Collins et al. 2009, p. 1333). Collins et al. (2009, p. 1330) derive from various sources of literature that the gained experience flows into routine (knowledge) and over time, these routines enhances the path of constantly improved acquisition learning. According to this perspective, the acquiring firm develops specialized knowledge and skills through which helps in the acquisition process in subsequent acquisitions (Shimizu et al. 2004, p. 335, Kim & Haleblian 2009, p. 621).

In comparison with firms with little or no acquisition experience, the firms with acquiring experience are more likely to be involved in acquisitions. In order to range the learning behavior, a differentiation between domestic and international acquisitions requires different expertise for international and domestic geographic expansion. The globalization tendencies set up new when entering and competing in new international markets - these aspects if being learned in the previous acquisitions help acquirer dealing with these challenges (Kim & Finkelstein 2009, p. 624). Firms with strong learning abilities adjust their strategies to the market conditions in which they operate and use the complementary opportunities for value creation. On the operative level, the acquirers learn faster to deal with selection of appropriate target firms, assessing the critical success factors with due diligence audit, negotiation of the acquisition deal and the post-acquisition actions (Collins et al. 2009, p. 1333). Hence, the target learning capabilities from previous acquisition experience allow development of acquisition process knowledge and skills regarding due diligence, price determination and, finally the successful integration in the post-acquisition phase.

In conclusion, the theoretical research has shown various critical success factors and failure reasons i.e. poor synergy, overpayment bad timing, cultural and organizational incompatibility, etc. The failure to identify risks when integrating two organizations with very different management and operational process yields in poor results, such as management strife, political interference, employee rebellion and disastrous financial results. Hence, there is a recognized need for research that identifies a theoretical framework which would help explain the critical factors in an efficient and comprehensive manner prior to the acquisition. Summarizing Chapter 1, the main points are:

- The acquirer's lack of accurate information regarding the target impacts acquisition success as combining companies only occurs when the decision-making is not biased by information asymmetry. Cross-border acquisitions carry higher risk than domestic, as generic problems of the transaction include further factors e.g. national cultures, political and regulatory influences. Information collection and evaluation build the ground for an informed decision basis in cross-border acquisitions.

- There are different perspectives and benchmarks underlying the measures for assessing the acquisition success. However, there is no perfect performance indicator but the suitable one. Based on theoretical logic and research aim, the performance measurement needs to be aligned.

- Due diligence is able to reduce information asymmetry. It focusses on risk reduction and contributes effectively to evaluating the potentials, such as leveraging the acquirer's resources and capabilities, which can be realized in the future.

- The assessment of evaluated factors needs to be included in pre-acquisition due diligence. Both, the traditional approach of due diligence' documentary role and to be based on legal matters must be expanded since acquisitions complexity has increased, e.g. the technological component in the automotive industry carries further critical factors, business capabilities or knowledge of the workforce, which are essential for success.

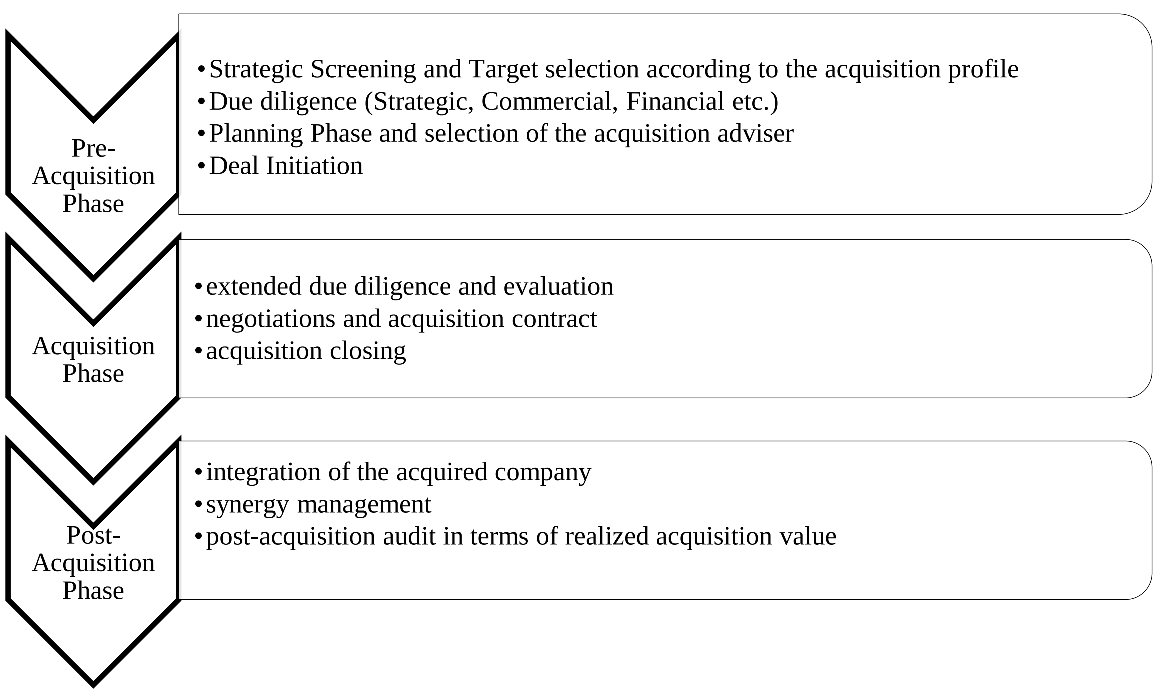
2 Identification of Critical Factors and the Modelling Relationship between the Pre-Acquisition Due Diligence and Success in Cross-border Acquisitions

Ignorance of critical success and risk factors impedes the acquisition and price determination process. Such ignorance in the pre-acquisition phase is the most common cause of failure in cross-border acquisitions. The previous academic literature review suggests an efficient due diligence process would consist of different elements, which serve as the acquirer's decision-making process. A comprehensive due diligence in the pre-acquisition phase enables the acquirer to learn target firm's strengths and weaknesses, e.g. those not fully revealed risks and potentials. The informed acquirer will be able to factor in discovered risks and potentials in the acquisition price.

2.1 Due diligence in the acquisition process and synergy management

The acquisition process is structured in different phases which range from the initiation phase of a possible acquisition until the full integration and success control. The phases, from acquirer's point of view are being separated in pre-acquisition, acquisition and post-acquisition-phase as shown in the Figure 2.1.

Figure 2.1 Three phases approach in the acquisition process



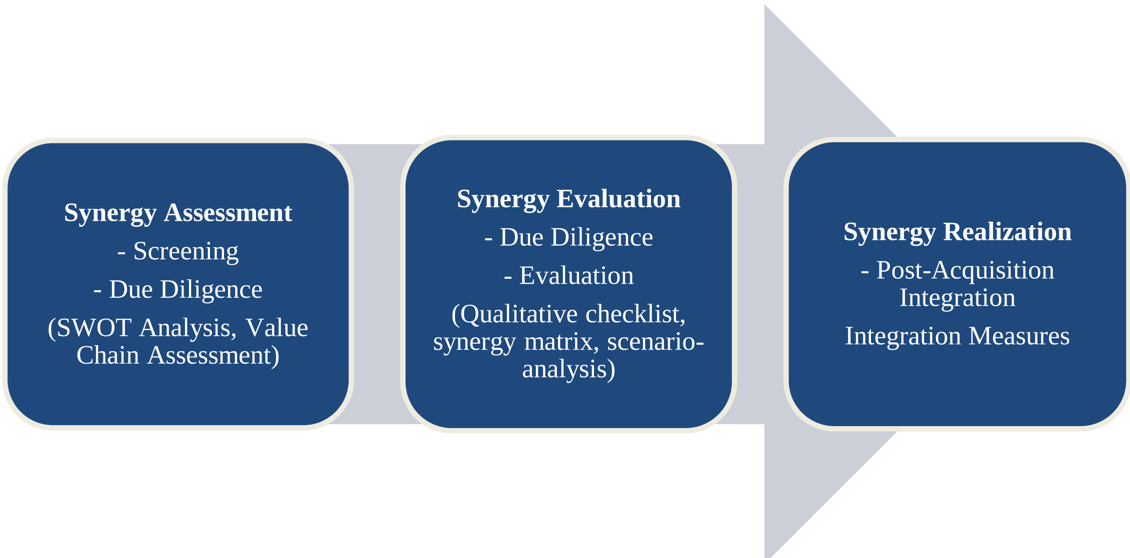
Source: Author's creation using Schuler & Jackson (2001) and Hopkins (1999)

The pre-acquisition phase is characterized by target selection in accordance with the acquirer's corporate strategy in order to enhance the shareholder value. In the pre-acquisition phase, the acquirer needs to carry out a strategic due diligence to pinpoint the strategic rationale and the value creation opportunities of the acquisition (Adolph et al. 2006, Brauer 2006, p. 775). The strategic due diligence builds on strategic planning of the company as sets the characteristics of the potential target how to fit into the overall strategy (McDonald et al. 2005, p. 8). The strategic due diligence is focussed on assessing the competitive strength of the target, the critical capabilities and resources which need to be retained, and evaluating the operating models that should be adopted in the whole organization. The acquirer must have a clear picture of own strengths and weaknesses and consider the opportunities and threats the acquisition might bring (Gomes et al. 2013, p. 19). Due diligence proceedings in that phase are mainly based on publicly available information and external expert interviews. The motives of the acquisition can have different nature reaching from potential synergy effects and cost efficiency until acquiring special knowledge and skills of the selected target company. The review of the synergy potentials and expected cost build the core task in due diligence considering it as the most important motive of the intended acquisition (Hopkins 1999, p. 212).

When the acquirer has selected one or more target companies and the first contact occurred and acquirer's intent has been communicated, the acquisition enters the technical phase. This phase is characterized by the technical elements, especially detailed audit proceedings, due diligence audit, negotiation phase, evaluation etc. Once the negotiation started, a much more intense level of due diligence audit begins considering legal, financial, human resources, technical etc. aspects. That information is non-public and is disclosed by the target firm’s management. Due diligence audit aims to decrease the information asymmetry problem and satisfy the contract partners. The acquirer condensed and operationalized results of the due diligence have an important role in determination of the "fair value" and implicitly the acquisition price of the target company (Breuer 2006). The acquisition phase ends with signing of the acquisition contract and fixation of the transaction end date (so called closing). In this phase it is not unusual to break off the planned acquisition, especially if there are any unfinished items of due diligence inquiry which cannot be anchored in the acquisition contract.

In the post-acquisition phase, also contemplated as the integration phase, the operational part of the acquisition stands in the midpoint of interest. The quality and consistency of due diligence findings are in this phase used to make the acquisition successful (Rothenbuecher 2011, p. 2). The integration management consists of planning of the integration processes so that the value enhancing potentials of the previous phases can be realized and the formulated aims accomplished (Schweiger & Very 2003). Many of the critical success factors of the integration phase are so called soft factors or shared values of intangible nature. In order to evaluate different individual factors, McKinsey's 7S Model (1980) is being used. In general, the model depicts the hard elements and soft elements. The way the model is presented shows the interdependency of the elements. “Hard" elements are easier to define or identify and management can directly influence them: These are strategy statements; organization charts and reporting lines; and formal processes and IT systems. "Soft" elements, on the other hand, can be more difficult to describe, and are less tangible and more influenced by culture. However, these soft elements are as important as the hard elements if the organization is going to be successful indicating how a change in one affects all the others. Thus, there is no exact evaluation possible but the consideration is of high importance. The intangibility is a non-quantitative factor which is difficult to forecast, especially in the pre-acquisition phase. Nevertheless, these will be assessed in thorough due diligence proceedings (Gomes & Angwin, 2013, p. 19). Finally, the integration success is measured, i.e. acquisition controlling tools, the synergy realization is being evaluated. On this basis, the integration managers determine further measures depending on reasons of acquisitions success or failure. The above description of the acquisition phases shows complex process which needs an integrative and simultaneous approach of all relevant parameters. The planning and execution of the growth strategy through acquisitions requires comprehensive analytical and conceptual investigation in order to reach the acquisition aims and achieve a positive yield-risk ratio. Combined value is the incremental value received by the acquirer, including the stand alone value of the acquired company and the fully realized synergy components from the combination of the two organizations. The quantification of the synergy value is difficult - as it is unique from the two specific organizations, and it is only realized as the result of the post-acquisition integration activities. If the expected synergies are expected, then they build an important factor in the acquisition price, acquisition premium is paid for the target firm above the true market value. The price paid is to high when the intended synergies have hot been materialized as planned and implemented by the acquiring company (Schweiger & Very 2003).

Figure 2.2 Synergy in the three-phase mergers and acquisitions approach



Source: Author’s creation using Berens et al. (2011)

Based on the theoretical review in the chapter 1.1, the consideration of the strategic importance and capital commitment are necessary to determine the appropriate analytical and strategic tools in the pre-acquisition phase. Figure 2.2 presents the role of synergy evaluation throughout the three acquisition phases. It indicates the crucial evaluation in the pre-acquisition phase, when due diligence critical factors are investigated.

As one of the most important transactions in firm’s strategic development, acquisitions are handled with extreme care and external expertise (Very & Schweiger 2001, p. 28). The use of external due diligence servicer needs to be weighed against the value of the information gained for the external information (Hindle 1994).

2.2 Traditional due diligence in the acquisition process

As acquisitions are one of the riskiest investment in company’s life and the acquiring firm only has limited information about the about the target firm and its environment, due diligence in the pre-acquisition phase has imminent role (Very & Schweiger 2001, p. 15). Even if the acquirer gets information in the acquisition process, there will be information buried within the target firm’s bookkeeping and records, and thus difficult to find and consider in the evaluation efforts. This information asymmetry is even more present in the cross-border acquisitions. Usually the acquirer audits beyond the provided data and engages audit experts in order to do further investigation steps and validate main assumptions and receive a clear risk profile of the target firm. The process of evaluation of the prospectus issues according to the Section 11 (b) (3) of the Securities Act of 1933, the scope has been extended internationally beyond investigations into the accuracy of prospectuses to include investigation into the acquisition of the company or assets in a commercial context, risk analysis in financing structures and general pre-contractual enquiries. This scope was extended into general deal making in the USA and then with the globalization also worldwide in mergers and acquisitions. The majority of traditional due diligence projects are done by the lawyers and tax and financial accountants, as the primary obligation are possible concerns with prospective liabilities and the concerns of the financial data integrity.

In the past years, the scope of the due diligence has broadened as the business complexity and globalization tendencies have increased (McDonald et al. 2005, p. 4). The most frequently examined areas in the due diligence are the financial, legal (corporate law) commercial capabilities (Harvey & Lusch 1995; Angwin 2001; Gomes et al. 2013). According to Harvey & Lusch (1995), the traditional due diligence has mainly a legal and financial course of action, first designed to avoid litigation and risk, second to determine the value, price and risk of the acquisition, and third to confirm various facts, data and representations. Strauch (2005) also theoretically consider further topics than the traditional approach but the additional areas are all combined with the financial and legal outcome without considering the critical areas, which often led to failure of the mergers and acquisitions. Harvey & Lusch (1995) state the traditional due diligence process has been primarily focused on tangible assets or documents relative to the operations of the company resulting in a *"mechanical verification"* of legal, accounting, and tax matters. The concentration on the traditional focus leads to the avoidance of different kinds of risk, i.e. human resources, intellectual properties and rights and property which could be covered by legal due diligence, tax insurance.

The newer research criticized the predominant focus of due diligence on financial and legal issues although the track record of acquisitions points to shortcomings in the traditional due-diligence approach (McGrady 2005). Thus, the approach is divided in intangible (i.e. quality of leadership, personal retention etc.) and tangible assets (i.e. market share, related parties etc.), comprising of secondary consideration of intangible assets like macro-environment, production, management, marketing, and information systems etc. Junni (2011, p.318) approach is to conduct a due diligence before the acquisition that focuses on social and cultural aspects, to find out whether individuals perceive the acquisition as something positive or negative.

Ahammad & Glaister (2008) emphasizes the need of the explorative function of due diligence, considering interconnection between different risk area allowing acquirer to understand the target company in sufficient adequate detail and ensuring the legitimacy of what is actually being purchased. Subsequently, due diligence is not a mere confirmation of the facts, but rather bridging the strategic review of and completion phases of the acquisition process. Connecting this aspects of due diligence, Very & Schweiger (2001, p. 19) found positive impact in conducting interconnected due diligence. Barkema & Schijven (2008) see the handling of the problem in the organizational theory that can be solved by due diligence process exploring the relevant critical factors based on provided information. Table 2.1 categorizes critical factors in order to mitigate the information, operating and litigation risk relevant for the acquirer in the process of information inquiry.

Table 2.1 Summary of due diligence inquiry areas and acquisition factors

Risk Type	Area of Inquiry	Critical factors related to the acquisition
Information Risk	Financial Statement Review	• Compliance of financial statements with GAAP • existence and valuation of assets/liabilities • identification of undisclosed contingencies and liabilities • assessment of internal accounting policies • taxation issues • effectiveness of internal control and accounting information systems
Operating Risk	Operations review	• operational performance and efficiency • condition of the productive assets and infrastructure • post-acquisition integration strategies • evaluation of management control systems • key customer and supplier relationships
Litigation Risk	Litigation review	• compliance with relevant laws and regulations • contractual rights and obligations • exposure to antitrust litigation • intellectual property protection and litigation risk • assess risk under consumer protection law • assess risk under environmental law • assess risk under employment law • negligence • improper disclosure

Source: Author's creation using Barkema & Schijven (2008), McGrady (2005)

The reason for the expanded due diligence scope is the increase in operational complexity and faster innovation pace of enterprises in the recent years, mainly driven due to substantial internationalization. The companies implemented integrated supply chain management systems, logistics operations which must work real-time and across the borders and use extensive subcontracting and manufacturing partners (Knecht & Calenbuhr, 2007, p. 431). In line with that, the due diligence approach shifted to newer scientific work including assessment of employees, benefits, environmental issues and intellectual property (McGrady 2005, p. 19).

The elements of the due diligence and their scope have been analyzed and separated according to the most common due diligence views in the literature: financial, marketing, commercial, strategic, tax, legal, organizational culture and human resources.

2.2.1 Legal due diligence

In contrast to the financial due diligence, legal due diligence is mostly non-quantifiable as it investigates the legal rights over assets to be purchased, ensuring that the entity is legitimate and free of any legal impediments which may affect the acquisition process subsequent to the purchase (Hopkins 1999). The focus of legal investigation is on intellectual and intangible assets that can be owned in legal sense. Governmental regulatory concerns (i.e. monopolies, employment law, taxes, environmental restrictions etc.) may also be investigated as part of legal due diligence. The purpose of the legal due diligence is the assurance for the acquirer that

- correct value of assets;
- the seller is the real owner of the assets and they are free from encumbrances;
- identification of risks or liabilities that might reduce the value or use of the assets;
- exclusion of other existing or potential liabilities with adverse effects target firm.

Therefore, primary purpose of the legal due diligence is to corroborate legal affairs and avoid potential legal risks. Harvey & Lusch (1995) describe two facets of legal due diligence, which insures the acquirer:

1. discovery of facts having legal, business, or financial implications that could put damages on the acquiring company and

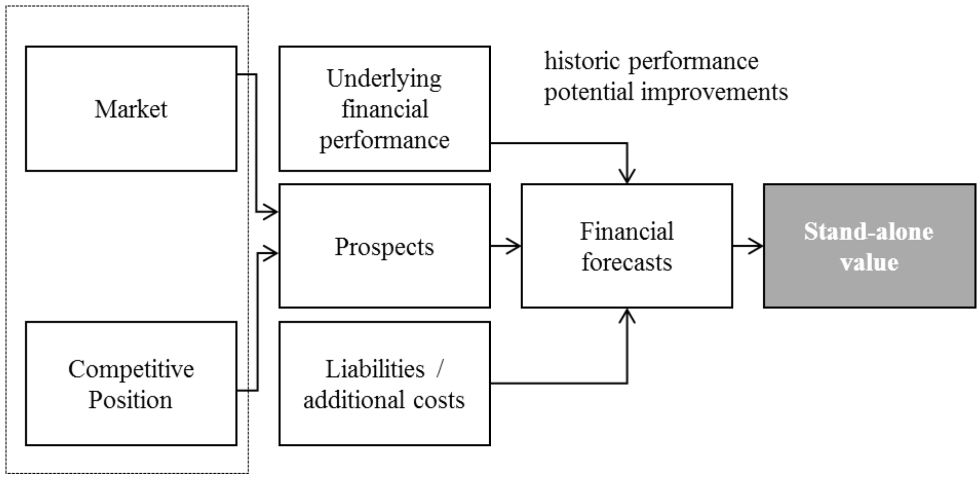
2. review of the legal setting in which transaction takes place, and ensure the knowledge of the significance of those facts and the enforceability of the transaction itself.

Strauch (2005, p. 159) defines tax due diligence as fundamental process of identifying, analysing and assessing tax risks that may be inherited as part of purchasing a business (whether that is via purchasing the entity that operates the business or purchasing the assets that comprise the business). In conducting the tax portion of the purchase investigation, as well as the overall purchase investigation, consideration should be given not only to the hidden "liabilities" of the target, but also to the hidden assets or planning opportunities of which the target and other competitive bidders may not be aware (Price et al. 1998). A tax purchase investigation generally focuses on the tax returns and tax examinations of the acquisition target. In addition, the tax review should focus on the buyer's ability to amortize a portion of its investment through proper tax planning strategies, utilization of the seller's tax attributes and similar tax opportunities. The principal goal of the acquirer is the tax reduction and factoring in the possible arising tax burdens. Additionally, the acquirer attempts to minimize the tax costs of the transaction to the seller in order to gain advantage as a purchaser. Generally, the parties are interested in structuring the acquisition to minimize the aggregate tax costs of the seller and the buyer, and will allocate the tax burden between them through an adjustment in the price. The tax review essentially begins with questioning if the seller paid all its tax liabilities on a current basis, and if there has a reasonable reserve been accrued for known and anticipated adjustments likely to arise in current and future audits by various taxing authorities. Although the procedures used to examine these issues varies depending on the size of the deal and the complexity of the target's particular tax situation, these inquiries generally entail a review and analysis of tax returns for all open years with special emphasis on the reconciliation between financial statement and taxable income and analysis of book and tax basis balance sheets, together with a review of the most recent revenue agent's reports made by relevant taxing authorities. Having completed this, the results are then compared to reserves for taxes to determine whether the seller has adequately provided for any tax exposures. This obviously can tie into determining whether the buyer's cash flow projections in the evaluation model with respect to the target are correct. Tax deferrals can have negative impact on target value and the purchase price. In cross border acquisitions, if the target company has foreign operations, information need spreads during the purchase investigation concerning the structure of the target's multinational operations. The level of detail required will depend on the size and complexity of the international operations at issue. In addition, consideration is given, particularly in the case of large foreign subsidiaries, to a separate review of the local tax situation and related exposure with respect to the foreign subsidiaries. Based on the fact that the surrounding legal and tax framework becomes more complex that no one individual can have sufficient expertise to address all issues, the involvement of legal and tax advisor and therein the legal and tax due diligence has become usual in mergers and acquisitions. The ever-increasing interconnection of globally active companies bear even higher risk of potential tax liabilities which need to be factored in the purchase price building process. In case of cross-border acquisitions, legal due diligence determines the legal factors different to the acquirer's country and may increase the length of the legal review process. Thus, it makes sense to engage the legal counsel in the early stage of the pre-acquisition phase using local knowledge and network.

2.2.2 Commercial and marketing due diligence

A target firm is acquired for the past performance, but for its ability to generate profits in the future. In its traditional form, the commercial due diligence is the investigation of a company's market, competitive position, and derived from the latter variables the future prospects. According to Lambkin & Muzellec (2009), commercial due diligence extensively appraises the business plan reviewing the likely strategic impact of the combined entity by identifying the drivers which underpin forecasts and business plans. The result of this assessment is quantification ability of the target's businesses to achieve the projected sales and profitability growth post-acquisition. Further focus is the view of a company's markets, prospects, and competitive position to reinforce its projected future. The future profitability of any product is significantly affected by the market environment it enters and the purpose of commercial due diligence is to investigate that market focusing on key drivers of value for the product, principal areas of risk and forming an opinion as to whether the unit sales forecasts prepared by management are realistic. The investigations are based on public information, but most importantly from industry experts which are to be found in the same market as the target firm. Beyond the original function, commercial due diligence has a complementary function to other forms of due diligences, especially financial, technical, cultural and sometimes the legal. In the opposite way, the commercial due diligence can derive useful information in the financial due diligence, i.e. debtor lists delivering customer overview and the market penetration issues (Harvey & Lusch 1995, p. 11).

Figure 2.3 Elements of commercial factors in the evaluation process



Source: Author’s creation using work of Lambkin & Muzellec (2009)

In the Figure 2.3, the due diligence components is shown in the context of deal evaluation process. The modern commercial due diligence project is a major project management exercise pulling together information from many different sources and distilling it into a reasoned view of a company’s future. The answers from the commercial due diligence include investigation into the market in terms of current size, historic and anticipated future growth trends. The impact of competition is also considered in terms of both existing competition and the potential for new players to enter the market. The regulatory environment may also be an investigation area of commercial due diligence, i.e. EU driven tightening of environmental legislation and its impact on the clean/green technology market. Referencing the customer will often play an important part in the commercial due diligence process in order to verify the relationship and image that the business has in its market place. Care often needs to be taken to ensure that the right type of questions are asked so as to preserve confidentiality and not to ‘spook’ any key customers (GrantThornton 2004, p. 14).

The marketing due diligence has intersection points with the strategy, commercial and financial due diligence. Marketing, if not considered only in its operational process of the "marketing mix" consisting of promotion, product, pricing, distribution, process, people, is closely correlated with the creating shareholder value (McDonald et al. 2009, p. 47). The definition of marketing has both sides: the strategic (understanding the markets and customers, defining the target segments and the value propositions) and the operational (delivering and monitoring value) activities. The marketing due diligence begins with assessing the strategy and the sustainable competitive advantage which ensures that the growth will persist as forecasted in the part of financial due diligence. This assessment results in a clear definition of which customers are to be served and what products/services are to be offered to him. This explicit strategy is than separated in market risk, share risk and profit risk (McDonald et al. 2009, p. 47). The market risk is defined as the possibility that the market may not bear the potentials from the forecasted business plan or the extent which would be necessary for achieving the synergy value (i.e. new markets, new products, etc.). The share risk is the possibility that the business plan may not deliver the forecasted market share because the competitive strength is not powerful enough. Share risk is high when different segments are targeted with specific value propositions and with direct exposure to direct competition and negative future trends. Profit risk arises if the forecast could not deliver the intended profits because of aggressive cost assumptions, strengthened competition environment and substitutable product/service. The final step in the evaluation is to consider the previous risks and in what extent they have an impact on creating or destroying shareholder value, or transferred on the acquisition, the combined value creation.

A thorough marketing due diligence builds on different data sources, e.g. internal sources, employees responsible for the market and product development etc. On the one side, the market data sourced from customers, suppliers and competitors. On the other side, the data can also be pulled from independent industry experts and information from different benchmark studies of other industries, market and companies. The more strategic issues are often building on the marketing due diligence results.

According to McDonald et al. (2009, p. 51), the marketing due diligence consists of three stages:

- Stage One: makes the marketing strategy explicit
- Stage Two: the risks associated with the marketing strategy are in-depth analyzed
- Stage Three: the risk evaluation is used to calculate the whether or not the marketing strategy is able to provide added value (for the acquirer).

The external analysis comprises of market analysis, industry structure and the competition analysis. While the analysis of the market considers the market potential, market structure to characterize the competitiveness, the industry analysis considers the strategic aims of the acquirer to forecast the future development of the target's performance compared to the direct competitors.

Lambkin et al. (2009, p. 70) states that the branding issues have low priority in acquisition negotiation process, but in the post-acquisitions phase gets the intention which is very late. In doing so, the possible extractable synergies may be overvalued and the acquisition price to high. Typically, assessing marketing aspects insures accurate assessment of the “premium” paid above the tangible assets of the company being acquired (Price et al. 1998, p. 20). Measuring and valuing the intangibles as brand is based on replacement cost, what would the acquirer need to establish the same value of the brand, and can be considered as not exact. The final stage of the marketing due diligence determines the target firms profit potential adjusted by the identified risk levels and sensitivity what might be possible in creating combined value. The "worst" outcome of the due diligence is when no results were gained, as the acquirer cannot verify the potential added value factors. In such a case, the acquisition would be too risky execute.

Simplified, the commercial and marketing due diligence may not eliminate the whole business and market risk, but it can reduce them to an acceptable level. Especially in validation target's forecast, it has implications for the reliability and success probability of the business plan. The learning effect out of marketing and commercial due diligence, having assessed risk profile, gives comfort to avoid risky acquisitions and investments. In such a way, the risk remains identified, located and understood which implies the correct risk treatment in the acquisition process, and later in the integration process.

2.2.3 Strategic due diligence

Strategic planning is the crucial part when undertaking external expansion, because strategic due diligence cannot occur without the strategic plan (Cullinan et al. 2009, p. 18). The determination of the suitable target firm full fills the strategic plan. Most of the strategic due diligence work has been done in the strategic planning process. Objectives identified through the strategic planning can inform the conduct of due diligence in both domestic and cross-border transactions. Strategic due diligence needs to reveal the most important insights regarding a company’s future value. Broadly defined, it represents the set of activities involved in evaluating a target company’s markets, customer relationships, competitive position, and strategic direction (Davidson 1993, p. 20). The knowledge gained from this evaluation becomes the critical input into determining the target’s value to the acquirer. This information can be leveraged to drive the bid and negotiation strategy to ensure that the largest portion of the value created from the transaction is captured by the buyer’s shareholders. The strategic fit is the first area to be focussed on when assessing the suitability of the acquisition target. Shelton (1988, p. 280) argues, the strategic business fits may be ranked in descending order of synergy creation potential as follows:

1. Identical: the results of combined firms in similar products being offered to new customers,
2. Related supplementary: where similar products are offered to new customers,
3. Related-complementary: where new products are offered to similar customers,
4. Unrelated: where new products are offered to new customers.

This different categories offer different values to the combined firms. In contrast, there is an evidence that the unrelated fits provide the least amount of value creation in mergers (Gleich et al. 2009, p. 7; Chatterjee 2007, p. 48; Shelton 1988, p. 281). The assessment of the strategic fit comprises of:

- comparison of assets,
- SWOT-Analysis,
- examination of the market segments served by target and its capabilities within those market segments,
- determination of potential synergy effects in the operational area.

The critical step in the pre-acquisition phase and the strategic due diligence is the subjective judgement why the target firm is strategically attractive to the acquirer, and which specific attributes it needs to bring to the acquirer in order to make a strategic difference. Adolph et al. (2006, p. 1) considers the strategic due diligence as an important deal screening filter which puts the acquisition firm to discover not only the potential deal value to justify the acquisition, but also that the business is really capable to realize the expected value. Having judged this, the essential strategic rationale for an acquisition is set and the sharp profile for further information gathering in order to evaluate the prospective deal. The acquisition price is based on these results. The acquirer should demand a price that is adequate with the level of integration risk uncovered and avoid the overpayment (Chatterjee 2007, p. 49). Acquisition of target firm with resources and capabilities that fill acquirer's gaps makes the combined organization in the segment with full range of capabilities and more valuable.

Strategic due diligence is typically organized into two distinct phases involving activities:

1. Phase One: market and competence assessment, customer analysis, competitor analysis
2. Phase Two: valuation analysis, sensitivity analysis and negotiation strategy.

The overview of the Phase One, the external market environment, consists of sub-steps as outlined in the Table 2.2.

Table 2.2 Overview of the external market environment

Market Assessment	– market volume – strategic segmentation of the market – potential growth of the market segment – potential threats from substitute technologies and products; can suppliers or any other external factor control the market?	– literature queries – industry database queries – expert interviews – development of a market model
Customer Analysis	– determination of target's major customers and their key decision criteria – target's performance based on the key criteria – potential changes of customer needs – substitution cost of the customer when changing the supplier	– segmentation of customers into strategic groups – identification of the key decision makers – interviews representative sample of current customers – interview of non-customers and former customers
Competitor Analysis	– determination of key competitors – determination of the key rivalry – examination of their strengths and weaknesses – examination of the market entrance barriers for new competitors	– literature queries – review of the competitors materials – interview of competitors and experts – profile relative strategic positions

Source: Author's creation using work of Cullinan & Holland (2002) and Porter (2008)

In the market assessment the objective is to establish the current market size and to determine the expected growth in the relevant segments. In essence, the competitive position of the combined entity needs to be calculated, including its impact on customers, competitors, and overall market dynamics. Adversely, the customers and competitors will react to the combination and try to achieve advantage for them and threaten the value-creation assumptions of the combined entity (Adolph et al. 2006, p. 2). In terms of customer and competitive responses, technology issues, and culture changes, the associated risks need to be weighed and the risk potential calculated.

After strategic segmentation for the target's market, the acquirer needs to ascertain in which segments the target firm competes today and where it has the capabilities to compete in the future and implicitly add value to the acquirer. The final step is the growth forecast of the relevant segments as means of setting demarcation of around the target firm's revenue upside potential. Such a forecast is being set by using diverse sources of market information, i.e. industry reports, interviews with experts, diverse literature queries, and feedback from competitors and customers. The result of the first phase is a robust market model which clearly defines the size of the relevant market and product segments and allows reliable forecast and evaluation models.

The second phase, valuation and negotiation, builds on the qualitative results of the previous phase in order to find the appropriate quantitative value for the target firm (Langford & Brown 2004, p. 6). Furthermore, to make informed decision in the negotiation process also builds on results from the previous phase. While the asset evaluation does not seem to be problematic, the revenue potential and other key drivers of the target firm bear more pitfalls in the process of evaluation. The evaluation process consists of two stages. The first step is to forecast the stand-alone value of the target, assuming that the company continues as it is. This value represents the seller minimum price for divesting the firm. In the second of the analysis, revenues, cost, balance sheet synergies associated with your ownership of the target are added to the stand-alone value. The one-time cost of transaction completion diminishes the synergy value for the acquirer. Simultaneously, this is the cap maximum price to be offered in order to acquire the target firm. Paying over the synergistic value is overpayment and rather value destroying (Kim et al. 2011). When the stand alone value and the synergistic value have been determined, the next step is to set up few "what if" analysis, as despite the thorough strategic due diligence, there will uncertainty remain regarding a few of the key assumptions. Experts deal with such uncertainty in setting up a scenario analysis, or varying the key assumptions around the range of uncertainty and measuring the impact on the target firm's value.

In the sensitivity analysis, when various possible scenario assumptions are being supposed, the following criteria are considered (Hindle 1994, p. 69):

- highlighting the most critical factors driving the valuation of the target firm,
- quantifying the size of the acquirer's economic risk when deciding to either bid or not to bid for the acquisition target, and
- if the transaction is completed, this analysis can serve for the post-acquisition integration measures.

The arguments of strategic due diligence have serious impact in the acquisition price negotiation. The use of the due diligence in order to distinguish the between different kinds of synergies and estimate their potential value and the probability of their realization. The more precise and thorough the valuation analysis according to the offering price range including the synergistic values, the more supporting arguments and more exact offering value can be used in the negotiation process. However, in when competing bidders exist, the price might overwhelm the own calculations. As creating value through acquisitions is a risky strategy, the strategic fit of the planned acquisition needs to fit into acquirer’s strategy overall planning (McDonald 2005). The strategic due diligence is a tool which helps maximize the probability of achieving a value-creating acquisition when valuing companies is a defined, systematic approach which outlines the chances and threats of the target firm.

2.2.4 Organizational culture and human resources due diligence

Organizational and cultural fit models show the importance of cultural compatibility between organizations in the acquisition (Cartwright & Schoenberg 2006). Cultural fit explains the organization’s level of correspondence between the corporate cultures of the acquirer and the target firm. The poor cultural fit is has contributed to the failure of several acquisitions that appeared to be suitable strategic partners. Thus, several authors point out the importance of assessing organizational culture issues in the pre-acquisition phase (Appelbaum et al. 2009, p. 35; Schraeder & Self 2003, p. 513; Hofstede 1990, p. 286). Hofstede et al. (1990) performed a large cross-national and cross-organizational culture study concluding that the national and organizational cultures are not the same and need to be viewed separately. The lack of full assessment of the compatibility of cultures is the outset in the future is decreasing the success chances of an acquisition. The findings indicate that organizational fit can have a sustained influence on acquisitions performance. The implication for the acquisition process is that both, acquisition scholars and the consulting studies support the use of "organizational due diligence" in the pre-acquisition phase. In line with organizational matters, the cultural matters are comprised in such risk assessment phase. Cartwright & Schoenberg (2006, p. 8) found most of the failure in acquisition has been explained by culture clashes, which arise when the combined company have dissimilarities in their corporate cultures. The differentiation perspective like integration perspective does not deny ambiguity rather it emphasis on subcultures and the differences between them, for example the difference between marketing culture and engineering culture, and does not even acknowledge sources of organization wide agreement. Cultural clashes result out of different factors such as ignorance - lack of understanding of the other organizational culture, disrespect for another company's norms, and arrogance (i.e. a belief that one culture is superior). Consequently, companies have begun to acknowledge the existence of divergent cultures, identify cultural components that potentially hinder successful combination, and prioritize the cultural dimensions believed to be most important for a successful combination. This process of assessing the fit between two independent organizations is cultural due diligence (Chakrabarti 2009, p. 226). Harding & Rouse (2007, p. 129) define the assessment of the organizational culture and the roles of, capabilities attitudes of the employees as the human due diligence. The main focus of cultural due diligence review is the verification of the target's culture compatibility with the acquirer's to allowing connection of the organizations (Harding et al. 2007, p. 125). Cultural assessment includes description and evaluation of both companies - the acquirer and the target in order to find and measure the match of each philosophy, values, leadership styles, teamwork value etc. (Schuler et al. 2001, p. 244). Ignoring the review of the determination of the degree of difficulty in harmonizing the organizational culture bears the risk of weak productivity in the post-acquisition phase. In comparing and contrasting the organization's cultures, the qualities such as attitudes, styles, procedures and internal communication build the starting point. By adding cultural due diligence to the process of the acquisition, the acquirer gains substantial competitive advantage over those firms who do not preserve the values that makes the acquirer grow successfully. Harding & Rouse (2007, p. 129) explains the high failure rate by not conducting the same kind of due diligence proceedings as the on culture, organizational issues and processes of an acquisition target as they do on the financial balance sheet. The culture assessment starts with the prove target's culture coherency, functioning organizational structure permitting the execution of decisions effectively, and addressing the internal dynamics of the target firm. The source of that information usually is organization charts, head counts and job descriptions, and most important, interviews along the organizational hierarchies and approach decision makers. Hence, the cultural due diligence requires commitment from senior executives and allocation of necessary resources.

Research into organizational culture began as a means to explain the complex differences between organizations (Angwin & Vaara 2005, p. 1445). The important feature of organizational culture it is a particular set of characteristics of an organization adopted by its members, and it distinguishes the organization from other organizations. Cartwright et al. (1992, p. 56) consider organizational culture as 'the way in which things get done within an organization'. The cultural assumptions and beliefs of an organization are learnt by its members through socialization. According to Schein (1985, p. 19), the definition of organizational culture is "…A pattern of shared basic assumptions that the group learned as it solved its problems of external adaptation and internal integration, that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way you perceive, think, and feel in relation to those problems." In the framework of Schein's model (Schein, E. 1985, p. 19), organizational culture is defined as a pattern of basic assumptions that is invented, discovered, or developed by a given group as it learns to cope with its problems of internal and external influences. These basic assumptions are considered valid and are to be taught to new members of the organizational culture as the correct way to perceive, think, and feel. Since organizational culture comprises shared learned experiences, groups of individuals must work together for an extended amount of time to allow for the free exchange of perceptions, ideals, and values. Edgar Schein's statement seems very useful, as it presents culture not only as in its static aspects, but also in its dynamic ones, i.e. its origin, formation, and possible changes over time. In Schein's (1988) model, culture exists on three levels: First level is Artifacts, which are difficult to measure and they deal with organizational attributes that can be observed, felt and heard as an individual enters a new culture. Second level is Values which deals with the espoused goals, ideals, norms, standards, and moral principles and is usually the level that is usually measured through survey questionnaires. And third level is underlying assumption – which deals with phenomena that remain unexplained when insiders are asked about the values of the organizational culture. Information is gathered in this level by observing behaviour carefully to gather underlying assumptions because they are sometimes taken for granted and not recognized. According to Schein, the essence of organizational culture lies in this model. It is only once that all three levels are identified and the culture will be completely understood (Appelbaum, S.H., et al 2004, p. 651).

The previous theoretical approaches show the importance of considering organizational culture within the acquisition process, as there is a significant impact on future organizational performance of the acquired firms. Cartwright & Cooper (1996, p. 65) build up on Schein's three level model and distinguish four culture types:

a. Power Culture

   These companies have often one charismatic leader who decides about everything in the organization. The leader is benevolent and has loyal parent-child type of relationship to his employees. In general, the employees tend to be well informed in such organization culture. The employees need to get their satisfaction from the work and their commitments to the colleagues.

b. Role Culture

   This type of organizational culture is characterized by logic, rationality and the achievement of maximum efficiency. Bureaucracy acts as the bible rules. Roles are often specialized, and they are the focus rather than people or personalities. The hierarchy is all important, competition between departments is common. Employees are strongly status oriented and status symbols exist. This kind of organizational culture works in stable conditions but is slow for changes. The innovation process is slow, frustrating, and impersonal.

c. Task Achievement Culture

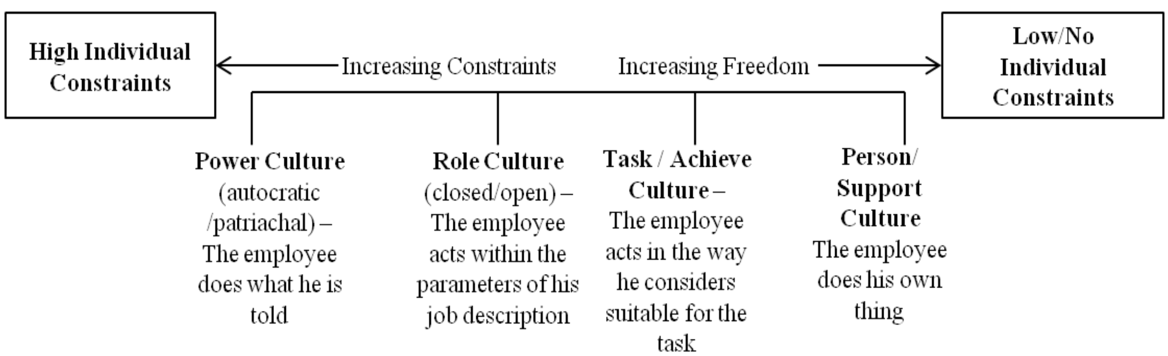
   The main specific of this organizational culture is the goal orientation rather than processes. The focus often lies on securing the necessary resources and skills. Such culture can often be found within organizations, as a subculture, especially in research driven companies, e.g. start ups, technology or services oriented companies. The culture acts as team culture and is committed to tasks. The low customer orientations make this cultural type vulnerable.

d. Person/Support Culture

Egalitarianism is key value and the organization exists to advance the personal growth and development of its employees. There is less structure and information, influence, and decision-making are shares equally. Because of the fact that these four culture types are rarely found, the authors modified their model to cover spectrum reflecting different degrees of individual constraint.

One might assume that compatibility merely requires cultural similarity and the partners could be different but still compatible. Cartwright et al. (1996, p. 85) provided the expected direction of movement of the organization along the spectrum in Figure 2.4 is to the right. The culture is explained further to the right on the continuum are more satisfying than those to the left, as they have more individualistic approach and offer more participation possibilities of the employees.

Figure 2.4 The varying degrees of restraint of the four culture types on individuals



Source: Cartwright et al. 1996, p. 80

The employees are likely to be more willing to assimilate into cultures to their right on the continuum than to their left, "separation" can occur, e.g. the acquired company attempts to continue its original culture and retain own processes. Employees cannot adopt with their own culture nor with the new culture can feel alienated. Both separation and alienation have an adverse effect on performance. Success depends on willingness of the acquired company to conform by changing. So each of the four culture types react differently in a traditional relationship. For instance, person/support cultures across all four cultural types. Power cultures can readily be assimilated into any of the other three. When both the acquirer and the acquired company are power cultures, the success might depend, on how acceptable the new leader is and whether the removal of the previous leader is tolerated. If the previous leader is retained, he must be seen to have been fully integrated into the new power culture. Task/achievement cultures and role cultures characterized either by similar cultures or by those that are less constricting in each case. Both types will resist the traditional acquisition by a less satisfying and more restraining organizational culture. Table 2.3 shows the cultural suitability of different buyer and candidates.

Table 2.3 The suitability of culture combinations in traditional acquisition

Culture of the Buyer	*Culture of the acquisitions candidate*		
	Potentially good candidates	Potential problem candidates	Potential disaster candidates
Power	-	Power	Role, Task, Pers./Support
Role	Power, Role	Task	Pers./Support
Task/Achievement	Power, role, task	Pers./Support	-
Person Support	All Culture Types	-	-

Source: Author using work of Cartwright et al. (1996, p. 87)

Collaborative relationships is a true merger of equals in the sense that both parties want to combine technology, practices etc. for mutual benefit. The compromise is that both must change. Success requires both companies to perceive aspects of the other’s culture as attractive and worth keeping. The greater the distance apart on the continuum, the greater the compromise needed to achieve the middle ground in a merger. The authors therefore recommend that merger partners be of adjacent or some types, rather than at opposite end of the continuum. They also state that mergers of equals are rare and not recognized as collaborative by employees. Employees assume that a traditional relationship will prevail, that in place of true collaboration, domination will take place. The management communication needs to concentrate on mutual benefits and shared power, help employees to see what is attractive in other organization’s culture, help diffuse uncertainty. Open relationships are acquisitions where the acquirer does not interfere and tolerates differences, gives autonomy and the support needed for development and growth. These relationships tend to occur where the acquirer is happy with the performance of the acquired company and has confidence in its management. As little integration is required, cultural compatibility is less of an issue. Porter (1987, p. 49) published interesting findings about mergers and acquisitions strategies in a study which comprised 33 firms. Around two thirds of their acquisitions in new fields was divested in near term after acquisition. He discovered that majority of divestitures in unrelated acquisitions, so he concluded that executive often overlook the better off test in their strategic analysis, opting for more subjective explanations of “arm waving or trumped up logic”. This might mean that some mergers and acquisitions decision lack sound and objective evaluation. When a potential partner has been identified, the acquirer usually performs due diligence, a process which comprises detailed analysis of the target firm’s financial and commercial shape. Based on research so far, it can be supposed that the success rate of mergers and acquisitions could be enhanced through incorporating cultural compatibility into the identification, evaluation and selection of potential target firms.

Krug (2009, p. 2) performed an analysis of turnover patterns which showed that M&As lead to abnormally high turnover rates among target company executives for ten or more years after an acquisition. The conclusion was that mergers and acquisitions usually destroy any leadership continuity, as the new leader may have difficulties to adapt the new organizational structure and/or resign out of his personal reasons.

In general, if the two prospective companies have similar beliefs, values, cultures, and missions then the integration plan will be much easier to implement and follow through to fruition. Conversely, the more distinct the cultures are from each other, then the more difficult the integration plan will be. Applebaum et al. (2009, p. 34) argues the cultural similarity is not necessarily decisive success factor. In addition, different cultures can be combined into a productive unit but in the pre-acquisition phase, it is necessary to reveal the dissimilarities and handle this factor with increased communication, direction and leadership capacities. In the due diligence of human resources, which fit into organizational issues, the focus lies on compensation and organizational issues. The objective is to validate any assumed efficiencies and identify any unanticipated opportunities or potential risks. On the broader scale, the assessment of the assumed expense synergies and determine their impact from the human capital perspective (Schuler et al. 2001, p. 242).

The functional assessment comprises of understanding target firm's personnel policies, benefit plans, compensation structure, information systems as well as union agreements are applicable. Additional areas include the date dealing with employee turnover, employee surveys, litigations etc. The source of human resources due diligence are policy handbooks, intranet, benefit plan documents, pension plans, and any other benefit plans it may offer (Strauch 2005, p. 114). The next step in human resources due diligence is the investigation of the impacts on valuation considering departmental integration and associated synergies and possible layoff expenses. Having benchmarked the cost of compensation and benefits of the acquired firm against the market and the own firm, an input in determination if the cost need to be adjusted in after the acquisition takes place. Especially in case if the target firm is being evaluated in labour issues (versus capital) intensive and compensation and benefits comprise of large percentage of overall operating expense. The compatibility of the cultures allows building of necessary bridges between two organizations. The results of the provide a visibility for the acquirer that in optimum case the ongoing needs of the combined organization are quantified, as well as the formulation of the need how to optimize efficiencies in creating value after in the post-acquisition phase.

2.2.5 Operational due diligence

The operational due diligence scope builds on strategic and organizational due diligence issues. As these issues are interconnected, setting up a focused and comprehensive due diligence which allows deduction of the key material risks contained in the target firm's operations and management is useful. Arrington et al. (2002, p. 53) states the well-executed operational due diligence allows the acquirer to determinate the degree of how the two companies will conduct its business to maximize earnings. Typical operational review finds out which benefits can be realized on a certain timeline and what the estimated cost will be. Typical result of the operational due diligence is expected in efficiencies, synergies increasing acquirer's competitiveness and profitability. On the opposite side, the negative factors and operational risks which may be unacceptable for the acquirer. In case of manufacturing acquisitions, the due diligence reviewer has the focus on production and process efficiencies (Mehler 2009). In the functional assessment the reviewer assesses the supporting infrastructure of the target firm. Such infrastructure items are real estates, supplier contracts, manufacturing process, inventory management and product fulfilment. In manufacturing environment the focus is on duplication of assets and economies of scale and other operational efficiencies. The impact on valuation is typically the greatest in case of combining or relocating existing facilities and redundant real estates and production sites (Arrington et al. 2002, p. 54). Beyond the determination of the duplication assets, the operational reviewer plays an important role in harmonizing operational activities of the target firm with those of the acquirer (Morrison et al. 2008). A thorough operational due diligence uncovers the important business matters and highlights areas of concern. The result of the review is the validation of expense synergy assumptions made prior to the due diligence (Perry et al. 2004, p. 12). These results are used in the valuation process in the post-integration phase also. The projections of the operational due diligence results form a basis for the pricing, structuring and negotiation of the deal. Interviews have been proven as the method of assessing riskiness of the operations. Before the interviews, valuable source are analyst reports, articles in the press, analyses from credit reporting agencies and other traditional business research sources. Morrison et al. (2008, p. 24) defines the areas of operational due diligence reviewing and combining the human resources, finance, accounting, information technology, legal (intellectual property, environmental issues, insurance etc.). Supply chain and the IT set up are operations that deserve special attention in the post-acquisition integration when the focus lies on generating cost savings at the expense of issues such as quality, inventory turns, supply disruption and order fill rates (ibid, 2008, p. 23). The increased operational complexity is a part of synergy effects and thus they need to be placed in the pre-acquisition phase in the operational due diligence, where the major risks and potential deal breakers area exposed before the acquisition momentum has not achieved a level of no return. Also the assessment of the true investment need and estimate the operating costs of combined activities after the acquisition. Those figures are valuable in adjusting post-acquisition cash flow projections from the financial due diligence, which are often extrapolated based on percentage estimates and projected cash flows in the target evaluation.

Arrington et al. (2002, p. 55) also links the operational issues with the strategic issues including

- workforce needs, staffing assumptions and practices,
- environmental issues, other potential liabilities arising from the company's operations,
- cross-border issues, exchange rate risk, tax burdens, political risks, and other macro-level issues like supply of power, raw materials etc., and
- information technology infrastructure, insurance, projected capital expenditure needs.

The role of operational due diligence in cross-border acquisition bears an even higher importance, as the risk of misunderstanding because of is far more existent than in the domestic acquisitions (Perry et al. 2004, p. 12). Here is the link to the cultural due diligence, which is based on communicating ways, corporate culture etc. Additionally, manufacturing, engineering and quality standards might be different. The engineering embodied in physical plants, re-engineering for compatible platforms may be required at higher cost (Arrington 2002, p. 56).

2.2.6 Financial due diligence

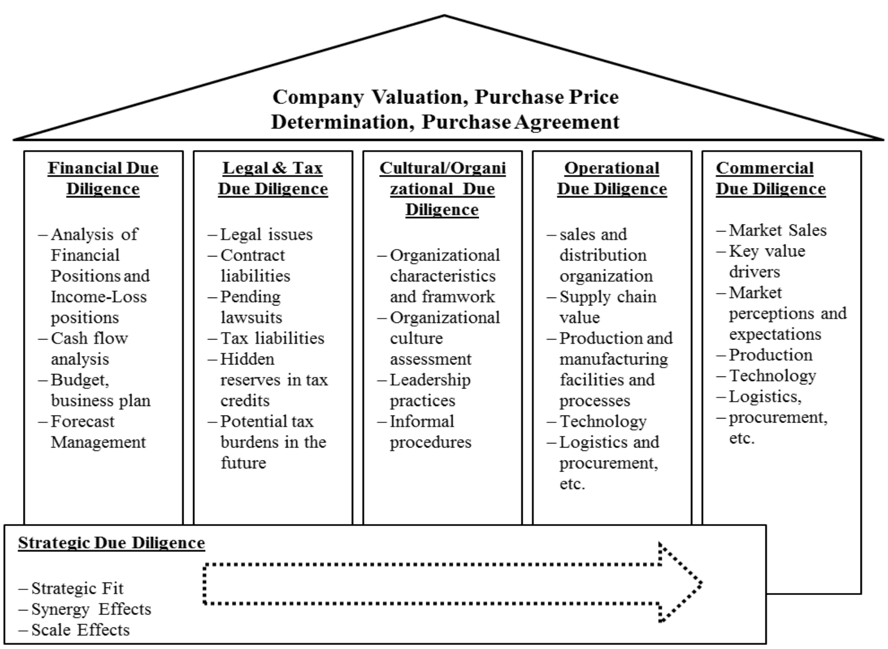
The financial due diligence is seen as the core of the due diligence process, analysing the historic financial data in order to find potential burdens and to determine the basis for estimating future performance of the acquisition target. The operations consist of audit and verification of financial results, reviewing the forecasts and budgets, pinpointing areas where warranties or indemnities may be needed, and providing confidence in the underlying performance (and future profits) of a company. In case of cross-border acquisitions, the transformation of the foreign financial statements is necessary to achieve greater understanding for the acquirer. The reconciliation from national generally accepted accounting principles to the acquirer's group accounting standard making the potential financial effects visible. The first information sources of the financial due diligence are the annual reports and accounts but also the internal accounts and the budget forecast for the upcoming years (Harvey & Lusch 1995, p. 16). In the analysis of the financial situation, the acquirer considers annual statements of at least of the last three years, with a critical analysis of the valuation guidelines. Financial due diligence audit field examples are:

- Fixed Assets: A basic appraisal of the extent of the hidden reserves or burdens. The non-operating assets, a review of depreciation policy and depreciation versus additions to fixed assets; and an impairment test on intangibles; future investment need
- Accounts receivable/liabilities (e.g. doubtful debts), future financing obligation and need
- Working Capital analysis with determination of normalized average working capital demand, cash flow projections, debt servicing history etc.;
- Off-balance sheet risks: Contingent liabilities; loan commitments; guarantees and comfort letters.

The investigation of assets and liabilities give a picture of the takeover risk and opportunities, the audit of profit and loss situation to forecast future income potentials. The audit of the income statement also considers the last three to five years and the business specific ratios are compared to industry’s average to measure the sustainability of the business model and find past infrequent circumstances that might dilute the potential strength of the acquisition target. Further points in financial due diligence is the assessment of medium and long term financial planning data which should contain a plausibility analysis of the business plan for the next three to five years. Especially in cross-border acquisitions, the turnover planning needs to be checked with externally available market research and comparative benchmark studies to check the plausibility of the cost structure, pricing policy and other determinants (Gleich et al. 2009, p. 24).

Thorough due diligence in the pre-acquisition phase includes the impact of potential synergy effects resulting out of operational activities of a company can be more narrowly estimated and considered in the evaluation models. In the real world, it might be impossible to carry out a comprehensive due diligence into every aspect of the combined firm. Thus, it is important to focus on strategic deal rationale, based on strategic due diligence, and set up review that examines products, markets, synergies and other complementary issues. The results of such focused effort will provide a reasonable basis to make appropriate decision in directing or terminating negotiation. Finally, in the negotiation phase, when the acquisition price is the topic, the acquirer can set a limit price and not overpay the acquisition which possibly will never create value. Based on previous overview of the kinds of due diligence proceedings, the kinds and essential fields of due diligence can be graphically summarized as shown in the Figure 2.5:

Figure 2.5 Overview of common due diligence kinds based on literature review



Source: Author's creation based on previous literature review

Despite the growing number of acquisition experience, many acquisitions fail to create value, and some diminish it. As there is no single reason for the high failure rate, many transactions fail because of avoidance of detailed risk assessment by means of thorough due diligence. In the discussion of failure factors, there has not been single reason for unsuccessful acquisitions. Frequent acquirers avoid exploring the risk and fail to execute acquisition in line with corporate strategic plan and miss the opportunity to identify explicit value and define explicit expectations and benefits in the pre-acquisition phase (McDonald et al. 2005). These goals set up the requirements in the due diligence framework and only in such manner efficient audit procedure can be carried out. During the early decision making period prior to closing acquisition, firms analyse the feasibility of the acquisition. Accordingly, the acquiring company struggles to value the target firm's resources and the need for the parties involved to agree on a fair value (Reuer 2005, p. 15). In the past decades, the complexity of the acquisitions increased in wake of use of different financial instruments and regulatory issues have stimulated interest in due diligence (Price et al. 1998, p. 20). These developments had direct impact on the content of the traditional due diligence process, which is being re-examined in the recent decade. The level of due diligence is being impacted by variety of issues conducted during the acquisition process. Basically, the importance to explore how the due diligence scope must be used to enhance the probability of a successful acquisition.

Harvey & Lusch (1995) categorize the issues in information asymmetry, time restrictions, cost constraints, and situational factors. The present dynamic business environment requires expanded scope of due diligence and combined to get the view of relevant critical factors. The higher dynamic in the acquisition market often causes due diligence audit to fast-paced, hectic and short. The acquirer mistakenly believe to gain time, save money or simply put too much confidence into target firm's management and miss out on valuable, one time chance to assess inherent risk prior to signing acquisition agreement. Restricted time hinders effective examination of the whole range of critical issues as they do not go beyond the major financial, legal, tax and future sales projections – does not occur. Finally, situational factors for performing a limited due diligence is most notably with cross-border acquisitions and hostile takeovers because the competitive nature of bidding for a company has required or has not allowed full scope due diligence.

The addition of academic research to practical acquisition experience undermine the importance of thorough analysis of the strategic fit, organizational culture fit, business capabilities and other evaluation issues as fundamental topics to addressed in the pre-acquisition due diligence. Experience from the practical studies add more details to areas already researched, and there are many factors impacting acquisition value which are not attributable to financial statements or legal documents. This is especially so in cross-border acquisitions where foreign jurisdiction, culture, reputational issues and foreign market conditions come into play. The high acquisition failure rates demands higher attention draws on the imperfect research in covering the current necessary pre-acquisition needs of the acquirer in domestic and cross-border markets.

The research rationale, based on current theoretical and practical status shows that the due diligence extent is mostly researched separately. In order to make successful acquisition, due diligence should assess as much as possible critical factors. In ideal case, combination of critical factors helps getting interconnected picture of the target firm abroad.

2.3 Analysis of critical factors of pre-acquisition due diligence from the academic and practical points of view

In current literature, suggestion which factors should be included in due diligence to cover a number of critical aspects about the target firm (Ahammad & Glaister 2013; Harvey & Lusch 1995, p. 9; McGrady et al. 2005, p. 18). In the past years, due to globalization, the complexity of mergers and acquisitions has increased implying the change in the extent of pre-acquisition due diligence as the key process for successful cross-border acquisition (Carbonara & Caiazza 2013).

2.3.1 Evaluated critical factors based on academic research

The literature review consisted of computerized and manual queries of published research reports. The databases used were Proquest, Science Direct, Scopus, Elsevier. The keywords used were due diligence, merger, acquisition, risk factor. Given that literature sources were limited, the review includes qualitative and quantitative studies. Further research consisted of screening of the bibliographies, textbooks and conference working papers with internet search machines. A total of 42 empirical studies, specifically relevant to critical success and failure factors in mergers and acquisitions were analysed and categorized.

The single issues of each approach are summarized in Table 2.4 as follows:

Table 2.4 Summary of evaluated critical factors of pre-acquisition due diligence in cross-border acquisition (academic research)

Evaluated Factors	**Selected Research**
a. Choice of the Strategic Partner	
Strategic Fit - Strategic market position	Gomes et al. (2013, p. 13); Fustec et al. (2011, p. 496), Kim & Finkelstein (2009, p. 640); Cullinan et al. (2009); Firstbrook (2007, p. 53); McGrady (2005, p. 14); Gleich et al. (2010, p. 6); Epstein (2005, p. 40); Perry (2004, p. 16); McDonald (2005, p. 3); Angwin (2001, p. 35); Adolph et al. (2006); Zademach et al. (2009, p. 771), Price et al. (1998); Haspeslagh et al. (1991, p. 323); Harvey et al. (1995, p. 14); Perry (2004, p. 16); Bertrandt (2012, p. 417); Cullinan et al. (2009, p. 4);
Organizational and Culture Fit (IT Compatibility, operational issues)	Fustec et al. (2011, p. 496), Kissin (1990, p. 53); Harvey et al. (1995, p. 16); Mehler (2009, p. 17); Morrison et al.(2008, p. 26) Hitt (2009, p. 8); Fustec et al. (2011, p. 496), Firstbrook (2008, p. 2); Lodorfos (2006, p. 1407); McGrady (2005, p. 22); Shimizu (2004, p. 325); Very et al. (2001, p. 20); Marks et al. (2001, p. 83), Schuler et al. (2001),
Acquisition experience of the acquirer	Kim et al. (2011); Haleblian et al. (2011); Eppstein (2005); Hitt et al. (2004); Hayward (2002);
b. Business Capabilities and Knowledge Management	
Business Capabilities	Haspeslagh et al. (1991, p. 323); Morisson (2008, p. 27); Galpin et al. (2007, p. 233); Ahammad & Glaister (2013, p. 4); Bertrandt (2012, p. 417), Porrini (2004, p. 547)
Technological Competence	Phene et al. (2010, p. 756); Makri et al. (2010); Hitt (2009, p. 6); Bertrandt (2006, p. 418), Epstein (2005, p. 40); Rossi et al. (2011, p. 67); (Junni, 2001, p.6)
Management Competence	Hitt (2009, p. 5); Marks & Mirvis (2001, p.84); Harvey & Lusch (1995, p. 14);
HR and Workforce Capabilities	Mukherji (2013, p. 41); Fustec et al. (2011, p. 496), McGrady (2005, p. 19); Weber &Tarba (2010, p. 209); Lodorfos (2006, p. 1408); Krug (2009, p. 13); Krug et al. (1998) in Shimizu (2004, p. 329); Perry (2004, p. 18); Lemieux et al. (2013 p. 1420)

Evaluated Factors	**Selected Research**
c. Financial Factors and Acquisition Premium	
Financial issues evaluation: a) Fixed assets b) cash-flow generation and the debt servicing capacity c) Expected capital expenditure for the acquired unit: Future financing and investment need	Gleich et al. (2010, p. 23); Knecht et al. (2007, p. 423); Epstein (2005, p. 40); Harvey et al. (1995, p. 16); Marks & Mirvis (2001, p. 84); Hindle (1993, p. 11);
Evaluation and acquisition price premium	Gomes et al. (2013, p. 19); Malhotra et al. (2013, p. 271); Kim et al (2011, p. 27) Hitt, et al (2004, p. 3); King (2004, p. 190); Hindle (1993, p. 11);
d. Macro-Factors and Business Environment	
Political and Regulatory Factors	Carbonara et al. (2009, p. 95); Very et al. (2001, p. 15); Harvey et al. (1995, p. 12), Hopkins (1999, p. 233)
Differences in legal and tax system	Kissin et al. (1990, p. 53); Haspeslagh & Jemison (1991, p. 325); Very & Schweiger (2001, p. 15); Firstbrook (2007, p. 53); Hopkins (1999, p. 233); Price et al. (1998);
Corporate Governance Factors a) Environmental Issues b) Corruption, Bribery and related parties issues	a) Harvey & Lusch (1995, p. 11); Knecht et al. (2007, p. 423); Morrison et al. (2008, p. 24) b) Knecht et al. (2007, p. 429); Rossi et al. (2004, p. 298); Bertrandt (2012, p. 417)

Source: Author’s creation using literature sources in the Table 2.4

Based on literature review, the analysis of evaluated critical factors allows that they can thematically be categorized into four categories:

1. <u>Choice of strategic partner</u>
   1.1. Strategic Fit incl. business and technological capabilities that enable positive synergy effects in the combined resources in the post-acquisition phase.
   1.2. Organizational Culture including compatible values on the cultural level in the firm, human resources capabilities where the workforce capabilities and transferable knowledge enable realization of synergy effects in the post-acquisition phase.
2. <u>Business Capabilities and HR Knowledge</u>
   2.1. Business capabilities are distinct competencies that work together in a system and are organized to support company's strategy, integrate different HR profiles, processes and technologies,
   2.2. Technological Competence includes the technological knowledge embodied in products, processes and knowledge of the workforce to deliver inventions,
   2.3. The Management Competence include the managerial skills of the firm in order to efficiently use the firms resources,
   2.4. Workforce Capabilities are connected to industry specific education and working experience of the operational and management personnel. This builds the ground for successful realization of technological knowledge and combined synergies.
3. <u>Financial Factors and Acquisition Premium</u>
   3.1. Financial assessment of the historic and current financial indicators which measure the financial capabilities (cash flow generation, debt servicing capacity, value of assets and liabilities)
   3.2. Estimation of the future financial indicators which is the base for setting up of the cost of acquired firm (future investment and financing needs). Those factors are simultaneously the key factors for the acquisition price, including the possible premium, determination.
4. <u>Macro-factors and Business Environment</u>
   4.1. Legal environment and tax issues of the foreign country
   4.2. Environmental issues

4.3. Corporate Governance including corruption and other forms of unethical behaviour.

In the next step, the categorization is applied in the review of the practical studies stemming from mergers and acquisition advisory experts.

2.3.2 Evaluated critical factors based on practical studies

The categorized critical factors derived from academic research are compared to critical factors from practical studies. In general, the practical studies also conclude that the potential rewards from acquiring in emerging markets are undeniable, while the risk profile of cross-border acquisitions is rather higher than in domestic transactions (Poushali 2009, p. 76). Especially the overcoming of information risk is higher as the acquirer often lacks reliable information about the target company. Hence, carrying out a thorough evaluation of critical factors, risks and potential synergies in terms of finding a fair price for the target firm requires much more resources. Acquirers, being aware of that, engage mergers and acquisitions consultants on regular basis in order to make use of best practice solutions which are based on previous experience and feedbacks gained in projects with their clients (Poushali, 2009, p. 65). In this context, the analysis comprises sixteen industry reports from renowned mergers and acquisitions advisors. Those studies reflect the experience from transactions with high-level due diligence audits. The surveys reflect the experience of cross-border acquisitions from the view of acquisition executives regarding the risk field analysis. The questions answered focus on the acquisition aim, critical areas in the pre-acquisition analysis, synergy determination and related issues in the integration phase. The summary of the sixteen studies points out the risk areas or failure potentials identified in the cross-border acquisitions. Simultaneously, in order to assure comparability, the categorization from the academic evaluated factors is identical.

The methodology of the industry reports is based on survey results, where the participants are top management of the acquiring firms that conducted pre-acquisition due diligence on targets in cross-border acquisitions. Especially acquisitions in less developed markets require more thorough and time-consuming approach. In such cases, the traditional approach of acquiring in domestic markets concentrates on specific risks in the category legal and tax issues and political and macro-factors (Kroll Advisors 2012). In the focus of such audit is the inter-play between commercial and reputational issues and their implications on the potential acquisitions with respect to find reasonable decision basis. This is especially the case in jurisdictions and sectors where the government involvement in its role as a regulator, undisclosed ultimate beneficial owner in the target company, a client or a supplier, a provider of infrastructure or a competitor. Compared to the traditional view of conducting due diligence, the survey from the mergers and acquisitions experts' points to the fact that the due diligence approach needs to be suited to the dynamics of the markets, which can be summarized as follows:

- overlap between public and private sector requires combined governmental and reputational due diligence in order to uncover potential implications of harmful interconnections
- expert interpretation when information quality is low and local experts are needed to supplement the decision basis with "on-the-ground" research, and
- regulatory and political environment based on less developed legal framework may require plan scenarios for unforeseen events.

Deloitte's (2012, p. 13) industry report concluded that managing compliance and integrity-related risks in emerging markets bear more importance than in developed markets. Their results show compliance issues and integrity-related risks in acquisitions in emerging markets have increased since the beginning of the financial crisis in 2007. The survey participants underlined the need of detailed analysis to draw conclusions related to political and regulatory environment, as well as its impact on to integration and financial issues. The sub-risk factors in this category are corruption, bribery and fraud issues, changing regulatory situation as well as the implications of interaction with state-owned or state-controlled entities. Accordingly, the necessity of broadening the due diligence factors should include:

- impact of the regulatory changes on commercial success of the business,
- level of government interference or influence on the business,
- conflict of interests in the operational segment (e.g. IT systems, supply chain), and
- political influence in the steering board of the target company and corporate governance topics, e.g. bribery in this region and further compliance issues concerning related parties.

The single issues of each approach are summarized in Table 2.5 as follows:

Table 2.5 Summary of evaluated critical factors of pre-acquisition due diligence in cross-border acquisition (consultancy studies)

Evaluated Factors	**Selected Research**
1. Choice of the Strategic Partner	
Strategic Fit - strategic market position	BCG Consulting (2012); Accenture (2009); Mercer Consulting et al. (2008); GE Capital (2004); Roland Berger (2011);
Organizational and Culture Fit (operational issues, IT Compatibility)	Grant Thornton (2004); Roland Berger (2011); McKinsey (2010); Clifford Chance (2012); Baker & McKenzie (2013); Mercer Consulting et al. (2008);
Acquisition experience of the acquirer	McKinsey (2004); GE Capital (2012);
2. Business Capabilities and HR Knowledge	
Business Capabilities	BCG Consulting (2012); GE Capital (2004); Roland Berger (2011);
Technological Competence	McKinsey (2010); Ernst & Young (2012); Grant Thornton (2004); Clifford Chance (2012);
Management Resources	BCG Consulting (2012); Clifford Chance (2012); Grant Thornton (2004);
HR and Workforce Capabilities	Deloitte (2009); BCG Consulting (2012); Mercer Consulting et al. (2008); AT Kearney (2010); Grant Thornton (2004);
3. Financial Factors, Acquisition Premium	
3.1 – 3.3 Financial Issues evaluation: a) Fixed Assets b) cash-flow generation and the debt servicing capacity c) Expected capital expenditure for the acquired unit: Future financing and investment need	BCG Consulting (2012); Kroll Advisors (2012); Clifford Chance (2012); McKinsey (2004); Grant Thornton (2004);
Evaluation and acquisition price premium	BCG Consulting (2012); Clifford Chance (2012); AT Kearney (2007); McKinsey (2004);
Currency fluctuation, Asset price volatility	Clifford Chance (2012)

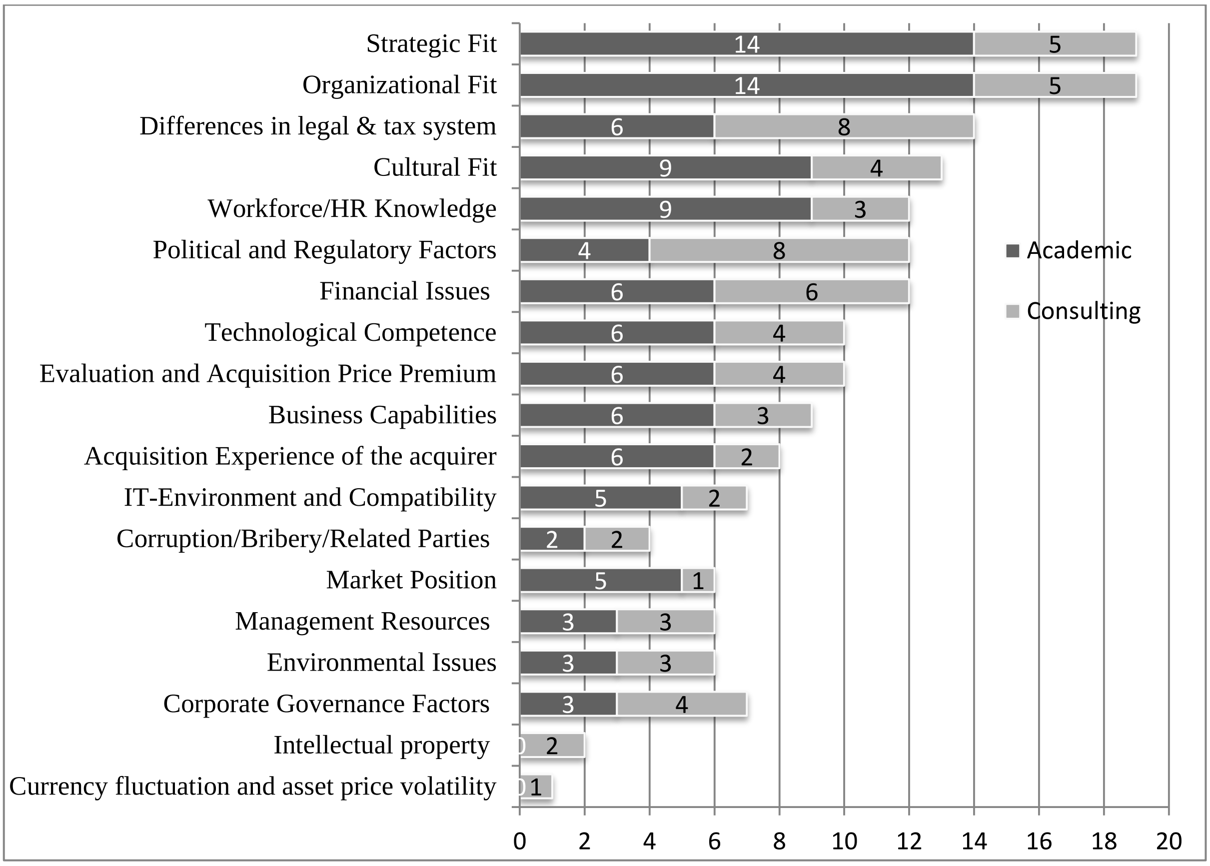
Evaluated Factors	**Selected Research**
4. Macro-Factors and Business Environment	
4.1 Macro and Political Factors (e.g. environmental issues)	Ernst & Young (2012); Kroll Advisors (2012); Clifford Chance (2012); World Bank Group Intl. Finance Corporation (2011); Deloitte (2009); Baker & McKenzie (2013); Mercer Consulting et al. (2008); Mercer Consulting et al. (2008);
4.2 Differences in legal and tax system	Ernst & Young (2012); Clifford Chance (2012); World Bank Group Intl. Finance Corporation (2009); AT Kearney (2007); Baker & McKenzie (2013); Accenture (2009); Mercer Consulting et al. (2008); Grant Thornton (2004);
4.3 Corporate Governance Factors a) Environmental Issues b) Corruption, Bribery and related parties issues	AT Kearney (2010); Deloitte (2009); Baker & McKenzie (2013); Mercer Consulting et al. (2008); Kroll Advisors (2012); Deloitte (2009);

Source: Author’s creation using literature sources in the Table 2.5

The comparison shows that most of the evaluated critical factors in the academic research are supported by the practical studies. However, the business consulting studies are more detail oriented focusing on overcoming the practical obstacles, considering the operational deal execution as the crucial success criteria identifying the potential impact on operating performance in the post-acquisition phase. In line with academic research, practical studies show that the best ingredient of successful acquisition is acquirer's strategic focus combined with acquisition that improves the market position. The second most mentioned ingredient of successful acquisition is the HR knowledge factor – which takes effects mainly in the post-integration phase. Namely, the consulting studies consider the retention of the key employees of the acquired firms as one of the crucial success factors. The third ingredient of a successful acquisition is the evaluation and determination of the acquisition price premium based on evaluated financial and synergetic effects. These effects should be mainly adapted from the due diligence findings. The fourth ingredient are intangible factors, i.e. regulatory, political changes, corporate governance, corruption and fraud, etc., which can be subsumed as the "new risks" out of increasing regulatory purpose of corporate governance. Consideration of further intangible aspect is the assessment of economic and political framework of the host country and the probability of changes in that environment which may influence the business model of the acquired entity. As the political institutions tend to be weak in emerging markets, and power often lies in the hands of elite, thus, the acquirer may face a changeable and unpredictable operating environment. Furthermore, the business consulting studies selectively warn on reputational issues, integrity risks arising from money laundering, and conflict of interest or business relationships, which are considered as critical success factor Corporate Governance. However, with growing importance of these factors, they might receive higher attention in future academic research field in the future. Considering the frequency of evaluated critical factors, the Strategic, organizational and cultural fit are the most important areas in the pre-acquisition process. Further risks are in the legal and tax area, mainly implied through differences within geographically different jurisdictions.

The risk fields local network and currency price and asset price volatility have been mentioned only once in the consulting studies. The intellectual property issue is subsumed as legal risk. The identified critical factors fit into the four categories derived from the theoretical research. The consideration of the critical factors leads to conclusion that due diligence audit should go beyond a narrow focus on risk, i.e. on law or accounting, to include the mate of risk. Simply searching for risks is too narrow concerning the requirements of an acquisition decision.

Figure 2.6 Overview of critical factors in the acquisition process sorted by frequency in the literature review



Source: Author's creation using analysis of academic and practical studies

The most decisive reasons for broad based due diligence is the quantification of synergy effects and financial impact, whereby the results of the due diligence flow into planning to determine or quantify the achievable synergy amount. A synergy-oriented pre-acquisition due diligence approach examines all possible purchasing, production, marketing, as well as, administration and distribution synergies and attempts to find a realistic assessment of the synergy potential. Also the opposite, all negative synergies are impacting issues of the evaluation that builds on a sound basis for finding the appropriate acquisition price.

2.4 Modelling the relationship between evaluated critical factors and the acquisition success in pre-acquisition due diligence

Based on previous academic and practical evaluated critical factors, the model of the thesis is derived. The leading task is development of comprehensive and integrated approach by inclusion of critical factors in the due diligence by integrating theoretical and practical results into one comprehensive model of due diligence. Based on the research from Harvey & Lusch

(1995), Price et al. (1998), Ahammad & Glaister (2013) and Gomes et al. (2013), basic research streams in the field of critical factors in the mergers and acquisitions stem for four different areas: strategic and organizational fit, financial situation and business capabilities and HR management. The practical studies supported this categorization with slightly more detailed sub-factors. Each of the four research streams contributed to the understanding of the extent of the due diligence audit. In the following, the categorization will be derived.

1. **Choice of strategic partner**

The outcome of acquisition depends on the acquirer's ability to find a target with good strategic and organizational fit (Gomes et al. 2013, p. 15; Gleich et al. 2009, p. 12). Strategic fit of the acquisition is the degree of how the target firm’s profile augments and/or complements the acquirer’s strategic orientation and thus contributes identifiable to his financial and non-financial aims (Jemison & Sitkin 1986, p. 146). The acquired firm needs need to be consistent aligned with strategic aims of the acquirer. The foundational stage of the acquisition is the development of the value creation logic, evaluation of the choice of acquisition as a means to achieve acquirer's strategic goals and sets the criteria for screening potential targets for acquisition (Carbonara & Caiazza 2009, p. 94; Perry & Herd 2004, p. 12). Ahammad & Glaister (2013) emphasize the importance of the strategic fit to have even higher impact in the context of successful cross-border acquisition. Hence, the acquiring firm needs to assess the strategic fit of the target company. Such risk assessment reveals details about the competencies of the acquiring firm to achieve additional synergy effects and values. The term organizational culture fit is often mentioned as a success factor in connection with the strategic fit so that the clear separation is seldom possible (Ahammad & Glaister 2013, p. 897; Gleich et al. 2009, p. 5; Gomes et al. 2013, p. 15).

Each organizational culture is unique with differences essentially across organizations, and it is such differences that generate integration problems, and while some authors have cautioned that similarity of “organizational cultures” does not necessarily guarantee acquisition success the assumption is that a certain cultural conformity underlies effective organization especially in mergers with high levels of integration (Kusstatscher & Cooper 2005, p. 24). Large amount of studies (Schoenberg 2004; Very & Schweiger 2001) researched how organizational fit of an acquisition impacts the transaction success. The findings are largely simiral pointing the cultural aspects as one of the most central components of the organizational fit and acquisition outcome. Employees and members of management team of a company which is in the acquisition process often face uncertainty and insecurity which may impact the overall productivity. Chatterjee et al. (1992) and Ahammad & Glaister (2013, p. 896) found that found negative relationship between the extent of organizational culture differences and the successful acquisitions. Cross-border acquisitons were impacted by such uncertainty to an even greater extent, as the cultural differences act as a determinant of performance (Very & Schweiger 2001; Schoenberg 2004). According to Schoenberg (2004) and Bruner (2006) management style is the central component of firm's organizational culture and impacts the acquisition performance. In the analysis of strategic factors, the assessment of management style compatibily is crucial. Angwin (2001) cited Hofstede's conclusions of mangement style influence on organizational culture and national culture. A detailed assessment of the cultural fit increases the understanding of the targets organizational culture and gives important directions for the integration phase which is helpful for the successful acquisition (Gomes et al. 2013, p. 18).

It can be asserted that a detailed assessment of the cultural similarity or differences in the organizational culture of the target company and the acquirer leads to better determination of the degree of change required or the degree of accommodation needed to achieve successful acquisition.

Beyond the soft fit factors, the assessment of the information systems and management audits belongs to the expanded view of due diligence needed in the pre-acquisition phase (Price et al. 1998, p. 19; Harvey et al. 1995, p.9). In line with that argumentation from Ahammad & Glaister (2013, p. 895), considering the need for evaluating informational technology (IT) prior to the acquisition as IT structure can enhance the organizational change process in the post-acquisition phase. On the other side, undetected failure can hinder efficient integration lowering synergy effects and delay the integration process in the post-acquisition phase. The acquisition experience determines the experience in handling such risky strategic plans and has positive impact on subsequent acquisitions (Haleblian et al. 2006, p. 368)

In order to attain deeper information to have a reasonable basis for evaluation and negotiation of the acquisition price, the pre-acquisition phase requires enhanced due diligence scope.

2. Business capabilities and knowledge management

The strategic motive of acquisition is durable and important feature in the mergers and acquisitions literature because of gain of business capabilities and new technological competence (Rossi et al. 2013, p. 69). Acquiring foreign existing business extends the own set of resources as knowledge base, human resources, business capabilities and an established market access and reputation (Firstbrook 2007, p. 54; Shimizu et al. 2004, p. 311; Cullinan et al. 2004, p. 5). Such resources strengthen acquirer's endowment and are complementary resources that enable leverage of existing resources (Phene et al. 2010, p. 757). Rossi et al. (2013) propose that technology driven sectors are involved in two types of acquisitions: acquisition of new technology company and acquisition of the technology as the asset of the acquired firm. Porrini (2004) found that the perspective of the acquiring firm and analysed value creation needs extensive investigation in the pre-acquisition phase. The researcher specified the main motives of such acquisitions: access to competitive technologies, implementation of a diversification process and more efficient use of organizational resources. The transfer of technological competences is achieved by understanding of research and development performance and it's transferability into acquirer's value chain.

The findings of Porrini's study (2004) show high correlation in technology driven acquisition between acquisition experience and the value creation in the post-acquisition phase. Hence, it can be proposed that the due diligence proceedings must provide detailed evaluation of the business capabilities and technological competence as complementary resources in consideration of realization of synergies, and subsequent acquisition success.

In terms of human resources and workforce capabilities (operational level), research has shown that it is essential to consider them because of their strong influence the success of transaction (Schuler & Jackson 2001, p. 243; Perry & Herd 2004, p. 13). The firm value of the target company is tied to intangible assets which include human resources and specific knowledge of skilled people. The main factor in the human resource knowledge context is the workforce including the management capabilities which can lead ambitious projects. High number of acquisitions failed because the acquirer did not identified the risk in integrating the target with very different management skills and operational processes (Perry & Herd 2004, p. 13). The management capabilities have significant effects in the integration process of the acquired unit and thus need to be involved in forming and implementing the integration (Kissin & Herrera 1990, p. 4; Perry & Herd 2004, p. 18). During the acquisition phase, they communicate and motivate the employees and the stakeholders in terms of the planned acquisition. Also in the post-acquisition phase, the role of the management capabilities is highly necessary, because the turnover rate of key employees is frequent problem resulting in poor acquisition performance (Krug 2009, p. 34; Harding et al. 2007, p. 125).

In the due diligence phase it is the time estimate the management potentials and management commitments in the target firm (Marks & Mirvis 2001, p. 90). The capabilities on operational level that will be needed in the future to complement products and services or create synergies and values need to be identified through detailed risk assessment (Price et al. 1998, p. 22). Especially firms with plans for acquiring innovation capabilities are interested around the identification and retention of intellectual capital and knowledge (Lemieux & Banks 2007, p. 1413).

Knowledge is considered as the most strategically significant resource in the organization. Knowledge management and mergers acquisitions are related as in transforming companies through organizational change and acquisitions occur. The combined knowledge creates synergy and allows the new organization to gain further competitive advantage. Thus, the acquirer's ability to create and utilize knowledge efficiently and effectively is crucial (Lemieux & Banks 2007, p. 1416).

Traditional due diligence process usually does not consider the employees skills and knowledge management in the evaluation process but in the risk oriented process the acquirer knows that the acquisition value decreases when productive employees leave or if the knowledge resources is not identified and evaluated. Porrini (2004) argues an acquirer by knowing how knowledge can be shared within the organizations is able to use the insight in the pre-acquisition decision making process in order to conduct a "knowledge due diligence". With "knowledge due diligence" reference the acquiring firm will see the ability of sharing knowledge with target firm in order to evaluate the value creation potential and under which conditions the value can be created from knowledge sharing. With knowledge due diligence reference made to an assessment that is used to see if the firm combination will be able to share their knowledge with each other within the acquisition in order to create synergies and get more effective. The pre-assessment to identify insufficiency of the target's capabilities and her leverage potential are parts of “improved due diligence” (Perry & Herd 2004, p. 13). The crucial task is the evaluation whether the acquirer can adapt and leverage the complementary capabilities to achieve synergy effects. From the resource based view, it can be asserted that acquirer's efforts in thoroughly assessing the target's resources and capabilities, enhances the possibility of successful acquisition.

3. Financial factors and acquisition premium

A substantial amount of studies have identified that payment of price premiums is one of the most significant reasons for acquisition failure (Gomes et al., 2013, p. 19). Epstein (2005) stated that most acquisition deals failed to create value due to overpayment or the high premium paid for a target firm which was influenced by the high cash-flow projections. The main item in due diligence proceedings is the assessment of the financial positions of the target firm, especially the cash flow generation, debt servicing capacity and asset evaluation etc. Beyond this critical factor fields, Price et al. (1998, p. 21) emphasizes the need for assessing the future investing and financing needs of the target company. Financial position is the basis to forecast future growth in terms of economic parameters e.g. sales volume, capital expenditure in terms of sustaining the business model and cash flow generation which are factored in the projections and value computation (Dunne et al. 2013, p. 8; Harvey & Lusch 1995, p. 18; Price et al. 1998, p. 20). The effects of forecasting unrealistic growth and cash flow generation of the target firm has serious effects on the valuation and, consequently the acquisition price (Perry & Herd 2004, p. 14). In line with this, Carbonara et al. (2009, p. 94) emphasized the positive relationship of the extended due diligence proceedings to commercial aspects (e.g. estimation of future sales volume and innovation sustainability) and financial aspects (e.g. financial stability, cash flow generation etc.) and the realistic acquisition value determination. Hence, it can be asserted that due diligence requires enhanced audit of financial aspects and acquisitions premium in order to attain deeper information for evaluation models and negotiation of the fair acquisition price.

4. Macroeconomic factors and business environment

The due diligence process in cross border acquisitions bears more risks than the domestic acquisitions, as the process is being complicated by several issues that are connected to different business environment of the cross border markets. The need for considering differences in the legal and tax area has been asserted in the literature (Ahammad & Glaister 2013, p. 895; Angwin 2001, p. 33; Gomes et al. 2013, p. 20; Hitt et al. 2009, p. 8). The acquiring firm needs to consider legal and tax regulations since what may be valid in the foreign firm may not be valid for the acquiring firm. Erel et al. (2013) states that country’s tax policy, tax structure and tax incentives play important role in the cross-border acquisitions deals. Such differences in legal and institutional environment need be considered within the due diligence proceedings because they can lead to integration difficulties and induce further cost lowering the synergy effects (Feito-Ruiz & Menéndez-Requejo 2011 p. 185). Prior studies have also shown empirically that macro-economic and corporate governance arrangements affect the decision to acquire firms in cross border markets (Graham et al. 2008, p. 58; Rossi & Volpin 2004, p. 299). According to Price et al. (1998) the macro-factors include the large picture risks, especially those issues, where the company has no control over (i.e. global economy and politics, terrorism, weather-related disaster etc.). The part of due diligence is the understanding of the potential of such risks occurring and establishing precautions. The nature of the local environment and its nationality (i.e. government policies or strong unions) may have a bearing on the ability of acquirers to implement practices during post-merger integration, such as changes in salary and benefits, recruiting, turnover, and labour relations. A stronger legal and institutional environment in the target country leads to increased transaction cost for cross-border deals (Feito-Ruiz & Menéndez-Requejo, 2011, p. 186). This issue coincides with regulatory changes in countries with a strong legal and institutional environment, which may make access to markets for firms from countries with weak legal and institutional environments more difficult.

In the context of Corporate Governance and Business Environment, there are two further research works that take comprehensive look from the perspective of acquirer from emerging countries and their acquisition in developed countries. Aybar & Ficici (2009) examine the firm value of cross-border acquisitions by firms from emerging markets. Methodologically, authors performed event study and cross-sectional regression analysis of 433 acquisitions from 58 emerging market multinationals. The key findings demonstrate that acquisitions do not create value for emerging market firms. However, the research results show positive effects between enhanced corporate governance and acquiring firm’s value.

Bhagat et al. (2011, p. 262) found out that better corporate governance in the target country, such as the quality of shareholders rights and less concentrated share ownership structure, has a positive effect on the emerging market acquirer’s return in the cross-border acquisition.

Corporate Governance and Business environment are factors, particularly important for emerging economy firms because of the poor corporate governance practices that are prevalent in these economies. Poor governance practices include low disclosure requirements, a lack of proper monitoring system and underdeveloped financial markets. However, despite the well-documented implications of poor governance on firm value in the extant literature, both research works did not find strong empirical support for the above argument. However, in cross-border acquisitions in emerging countries, Corporate Governance and Business Environment must be included as critical factors of due diligence.

Determination of the latent variable Acquisition Success

Despite numerous studies about measurement of acquisition success, there is little agreement on how to exactly measure this phenomenon. Approaches vary between subjective (qualitative assessments of the synergy realization) to objective measurement methods (accounting measures, financial performance etc.). Schoenberg (2006) clearly states that use of expert informants’ subjective assessment is suitable when multiple measures of acquisition success had been considered. Manager's subjective measures can provide useful information because the manager is familiar with complete history of acquisition and decided about the acquisition.

Measuring the acquisition success with published, consolidated accounting indicators is not always appropriate, since the number and volume of the acquisition might be too small to have a significant impact on the overall performance of the acquiring firm (Zollo & Meier 2008; Schoenberg 2004). The survey participants of this dissertation are mainly global players in the automotive industry supports that consideration. Hence, subjective measurements can be utilized where objective measurements are not available. In line with that, Ahammad & Glaister (2013) argue in their study on cross-border acquisition performance against using the accounting figures as they do not noticeably affect acquirer's evaluation efforts. Application of different measurements of acquisition performance is important as the previous research showed that different types of acquisition motives lead to different relationships between the various acquisition performance constructs.

The "Acquisition Success" is described by six variables which are weighted to one composite variable, based on research from Zollo & Meier (2008) and Schoenberg (2004):

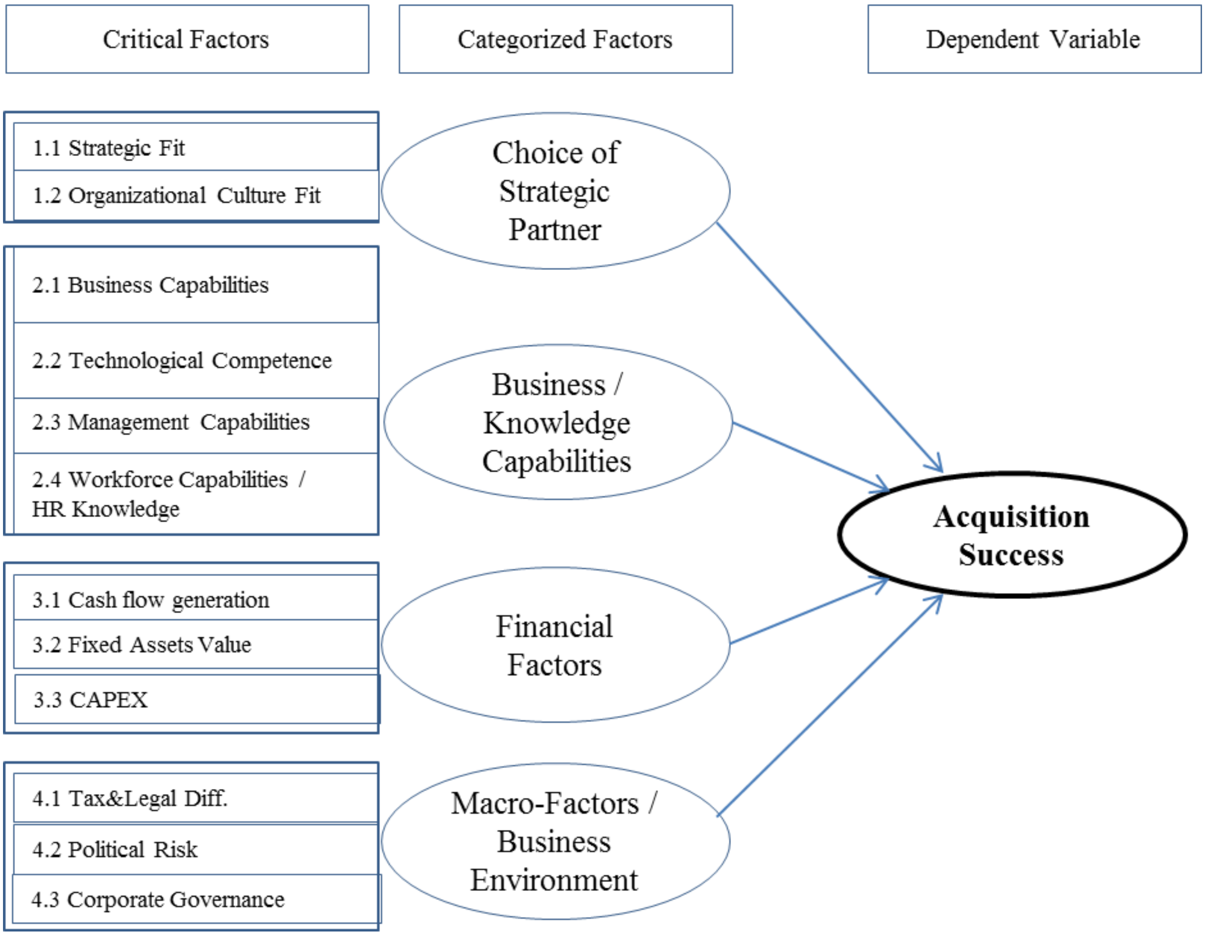
a) Profitability, Return on Investment, Cash-flow generation and debt-servicing capacity

b) Research and Development, Service and Manufacturing, Asset Utilization.

In addition to the performance measurement variables following Zollo & Meier (2008), Cartwright & Schoenberg (2006) and Das & Kapil (2012), in an attempt to avoid missed performance factors, in this dissertation the overall success and the disposal or retention of the acquired firm indicate the final acquisition success.

The research framework scheme is summarized as follows:

Figure 2.7 Research model for pre-acquisition due diligence in cross-border acquisitions



Source: Author’s creation

The model depicts the relationship between the independent variables “Choice of Strategic Partner”, “Business Capabilities and HR Knowledge”, “Financial Factors” and “Macro-Factors and Business Environment”, and the dependent variable “Acquisition Success”. “Choice of Strategic Partner” is described by the indicators “Strategic Fit”, “Organizational Culture Fit”. “Business Capabilities and HR Knowledge” are described by indicators “Business Capability”, “Technological Competence”, “Management Capabilities” and “Workforce Capabilities or HR Knowledge”.

Hence, the comprehensive model consists of “Acquisition Success” as a function of the four previously mentioned success factors.

The theoretical derivation of the critical factors in this chapter has shown the generation of a research framework with which to identify the crucial areas for pre-acquisition due diligence. Based on existing research streams, as well the critique of these streams, the previous model sets up a comprehensive framework that integrates the research fragments. The intention is to test develop the theoretical rationale for a comprehensive framework for the due diligence model, as well as to test the model. The final value of the present framework will depend significantly on empirical results. The next chapter explains the research methodology for testing the relationship between the critical factors in pre-acquisition due diligence and acquisition success.

3 Research Methodology for Testing the Relationship of Due Diligence and Acquisition Success in the European Automotive Market

The purpose of this chapter is to describe the research design and research methods. The research design consists of planning of the operations needed to collect suitable data, analyse it and to interpret them in the context of the hypotheses. The focus lies on the survey research which is applied for testing the theoretical aspects and the derived hypotheses consisting of critical factors in cross-border acquisition due diligence, according to the research model. The research methodology includes research design, operationalization of the theoretically derived critical factors, sampling, data collection and evaluation of the instruments for data collection. For the study purpose both primary and secondary data are used. For collection of primary data, survey method was used. Cross-sectional survey was used to collect quantitative information about the variables in the populations. For collection of secondary data, the data from publicly available sources was used and fitted for the research purpose of this dissertation. The research was completed by interview based confirmation of the research results by professionals in the automotive industry. The aim of the interview is to give more confidence to the quantitative data by using qualitative data (triangulation).

3.1 Empirical approach of cross-border acquisitions of German automotive firms

Primary research data is information which is collected during the research specifically for a research assignment (Hox & Boeije 2005, p. 594). As the research aim here is connected with specific, non-publicly available data, the empirical evidence of the dissertation is based on the experience of cross-border acquisitions of German automotive firms in the European automotive market.

The automotive industry has unique market characteristics, homogeneity of general market trends and heterogeneity of industry concentration in the submarket of components manufacturing. Industrial acquirers are strategically oriented rather than interested in buying and selling companies in order to achieve trade profits. A strategic buyer’s intention is long-term corporate growth by strengthening its own resources and capabilities. Hence, the search for target firms which can add value by realizing different types of synergies, including economies of scale based on complementary assets, is the focus of strategic acquisition. In line with this strategic view, the due diligence evaluates a number of factors in the pre-acquisition phase (Epstein 2005).

Unlike other industries in the production sector, the industry faces very challenging market competition, especially in the components production (Donnelly et al. 2005, p. 438). The growing consolidation takes place in the industry where size and scales, despite flexible technologies, are still significant. Donnelly et al. (2005, p. 483) takes the Renault-Nissan merger as an example of a merger that was driven by the quite complementarity in that coming together of their respective strengths allowed their weaknesses to be addressed. The merger also represents the clear example for a period of clear leadership so that the solid element of trust and mutual respect is maintained and the potential synergies can be realized. Consolidation and internationalisation of the automotive industry has started by end of last century and has led to high concentration in the value creation chain of that industry (Kang & Johansson 2001, p. 22). The acquirers expand their boundaries by acquiring new businesses along the value creation chain, i.e. vertical integration. There are two types of vertical integration (Rothenbuecher 2011). The first is a backward integration, entailing through gaining acquisition or ownership of the company, and increased control over supply operations. The second type is forward integration, entailing control over distribution and reselling operations. This may involve the purchase of a distribution system, or to set up such a system internally, where the acquired unit serves as “inner supplier”. The main disadvantage of such integration is that the supplier is bounded to a single business, even though there may be cheaper producers in the market as well. Also, by changing needs, in vertically integrated units coordination difficulties may occur. Despite all this, the cost savings, cost avoidance in the market, quality control and applied technology can be the potential benefits of the strategy. Nguyen (2013, p. 49) differs in the pricing context between upstream and downstream competition. On the one side, the pricing incentive is affected by the bargaining position of the bidder and some external contracting effects which are internalized. The reason behind it is the fact that vertical integration can increase the sum of payoffs for the integrating parties because it improves their bargaining position with independent firms and it eliminates the possibility of market structures that may be favourable to independent suppliers. Concisely put, vertical integration provides direct ownership and thus the access to adjacent capabilities, products and market share of their suppliers. This strategy adds new skills to the acquirer and reduces supplier risk in the acquirer’s value chain (Nguyen 2013, p. 23). Zhang (2013) asserted that such integration results in higher speed of new product introduction since the acquirer have access to technical expertise and specialists, and gaining larger pool of creative talent in the acquired unit. These aspects show the high focus on synergy effects, where the acquired units need to fit into the existing value chain structure and the adaptation is required.

The suppliers are under pressure to produce better and less costly equipment. The development of manufacturing industry highly depends on the supply chain. Aktas et al. (2013) argues regarding restructuring of the automotive sector due to the fact that manufactures have to produce vehicles that are better equipped, less expensive (due to economies of scale and other synergy effects) and respecting different market standards. This led to growing tendencies towards specialization and internationalization of the among suppliers either in acquiring a supplier or the customer (Macneill & Chanaron 2005; Laabs & Schiereck 2008). Additionally, in order to better serve the new markets, suppliers follow the original equipment manufacturers by establishing production sites abroad and circumvent customs. Furthermore, rising commodity prices put additional pressure to efficiency enhancement.

Laabs et al. (2011, p. 8) found mergers and acquisitions as valuable strategy to meet this challenges, as the acquirer are able to realize significant positive short-term returns as a result of synergy effects and its influence on the efficiency potential. In opposite, research shows negative long-term performance of the acquired companies, especially because the synergy effects cannot be realized and sustained. Cullinan et al. (2004, p. 78) did a survey showing the managers routinely overestimating synergy effects and underestimating difficulties of achieving them. Laabs & Schiereck (2008) have measured the long-term performance of acquirers in the automotive industry. The results indicate that acquirers were not able to sustain positive results in the long-term because the acquirers following the three-year period after closing the acquisition did not realize the planned above-average synergy potentials. The value destruction is derived by the high acquisition price, which stems from the acquisition premium. The consequences of incomplete due diligence and lack of thorough risk assessment of the target company are demonstrated also by international companies like Halliburton, DaimlerChrysler etc. which destroyed shareholder value in wake of failures in the pre-acquisition phase (Epstein 2005, p. 40). Summarizing the research findings, these are issues which need to be addressed in the due diligence proceedings in the pre-acquisition phase. Although in the research the many antecedents have been identified, it is still unclear which of them have highest role in the acquisition process (Haleblian et al. 2009, p. 489). In this dissertation, the focus lies on pre-acquisition evaluation through different assessment of critical failure and success factors within the due diligence investigation. In line with the theoretical research, the empirical evidence should identify indications in the pre-acquisition phase, i.e. due diligence proceedings. In order to generate comparable and homogenous survey results, the survey population is limited to acquisitions in the automotive sector which is divided in vehicles manufacturing and car components production by definition of German Association of the Automotive

Industry. Apart from primary data, collected secondary data was retrieved from the consolidated financial statements of the acquiring company and business intelligence database S&P Capital IQ.

Further factor in the sample is the determination of the initial motive of the acquisition. The extent and the focus of the due diligence in the pre-acquisitions phase will depend on the motive of the acquisition. In order to prove the motives of the firms in the automotive industry the following strategic motives for the international acquisition were asked. The criteria are based on the new scholars in mergers and acquisitions literature in the automotive industry (Zhu 2013; Laabs & Schiereck 2010).

3.2 Target population and the sampling approach

The empirical evidence was gained through judgement sampling, since the collection of data in the mergers and acquisitions industry is difficult because of extreme confidentiality (Applebaum et al. 2009, p. 42). The population therefore, cannot be based on randomness. The assumptions and selections made, give more specific information and better explanation of the research problem. In order to minimize errors in the generation of the sample, the data from various sources were homogenized and crosschecked. In the first step, the characteristics of this specific industry are described. Based on that, the population is derived.

3.2.1 Derivation of the population from characteristics of the German Automotive Industry

The German automotive industry has an outstanding role in terms of innovation and efficiency. In Europe, the German market has the leading role in production and sales volume. The country's skills and infrastructure combined with complete industry value chain integration, and qualified workforce create peerless automotive environment. Germany automotive market accounts for over 30 per cent of all passenger cars manufactured and almost 20 per cent of all new registrations. Worldwide, every fifth car is made by a German automotive manufacturer. Germany also boasts the largest concentration of original equipment manufacturing (OEM) plants in Europe. There are currently more than 100 manufacturing sites with, in 2013, a market share of over 50 per cent of the European automotive market. Beyond the domestic market, German automotive industry had export sales of more over EUR 200 bn in 2013 (GAAI Annual Report 2013). GTAI further underlines the importance of the automotive industry for the German economy by the fact that more than 20 per cent of the exports belong to that economic sector. As every seventh employee in Germany is engaged in the automotive industry in 2013 (GTAI Publication 2013), the population possesses representative character for the German industry at all.

In general, the automotive industry is separated in car manufacturer, original equipment manufacturer (OEM) and component suppliers (GAAI 2013; Laabs 2009). The majority of the firms from the automotive industry are members of the German Association of the Automotive Industry (GAAI). The total number of association members varies and by end of 2013, there were approx. 600 member firms. In order to achieve the most exact survey participants with companies with cross-border acquisition history, the members were matched with two leading databases in this segment: mergermarket.com and Thomson Financial DB. Hence, the population is representative for the automotive industry and its country specifics.

Concerning the motives of acquisitions in the automotive industry, there are structural changes, in supply chain partnerships and cooperation. The production relationships between OEMs and suppliers have been transformed by a number of factors e.g. increased technological pace, shorter product life cycles, modularization and assembly strategies etc. These developments led to changed cost structure, high capital intensity levels and higher competitive pressures. According to German Association of the Automotive Industry, the OEMs need to scale up the rising production by building a local supplier base establishing an enhanced supply chain, expanding the capacities and be present in the destination market (GAAI Annual Report 2013). Historically, the European market has been the most active region in terms of M&A. Diminishing sales volume and increased competitive level urge the industry to become more efficient and this implies high concentration tendencies. Suh et al. (2013) proposed in his research about consolidation led by technology sourcing and cost cutting which were key factors for cross-border acquisitions on the European continent. The typical acquirer in European automotive market has strategic motives, mainly focusing in cross-border, continental acquisitions (PWC 2013, Automotive Insights). Further, his main aim is to accomplish synergy effects in the post-acquisition phase. Given the fact that target firms in some European countries lack essential resources, financial funds or simply experience in competitive markets, the firms are vulnerable by the changing market conditions. Consequently, the main task of the acquirer's management is longer and more detailed evaluation process in the pre-acquisition phase, in order to receive clear firm profile (Ross et al. 2006, p. 125). Torborg et al. (2008, p. 34) argue, in terms of due diligence faces a lack of data details and transparency and difficulties in obtaining reliable data in the pre-acquisition phase. The challenge for acquirer's management requires an understanding of technological and managerial processes in the acquired firm's environment. Otherwise, engaging in innovation, selecting and adapting technological resources and, finally take strategic decisions might not lead to acquisition success.

Using these characteristics resulted in the following the population of automotive industry firms from European countries shown in Table 3.1.

Table 3.1 Selection criteria for cross-border acquisitions of German automotive firms in European Automotive Market

Criteria Selection	*Characteristics of the acquisitions in the period 2006 and 2013*
Industry Sector / Subsectors	Automotive Industry, Vehicle Production, Car Components
Geography	Bidder: Headquarter in Germany; Member of the German Association of the Automotive Industry (VDA) Bidders without strategic interest were excluded (e.g. financial investors, private equity firms etc.) Target firm: Headquarter in one of the European countries (EU and Non-EU membership countries; countries that became EU-members in the time period 2006 – 2013)
Deal Value	Only deal sizes above EUR 10m were considered, as this is the amount where extensive due diligence proceedings take place. Acquisitions with non-published value were excluded from the population and the sample.
Deal Status and Type	Only completed cross-border acquisitions with an acquisition stake over 50 % stake buy, signaling major ownership control of the acquirer.
No. Of Acquirers	288
thereof undisclosed bidders	75
No. Of Deals	378

Source: Source: Author's creation using Thomson Reuters Data and Mergermarket

The population of the research includes members of the GAAI is comprised of car and other vehicle-manufacturers, system and module suppliers and other car part manufacturers. Approximately 80 per cent of the GAAI members are medium-sized companies, measured by number of employees (above 250 employees with fixed employment contracts). All these firms have in common that they did at least two cross-border acquisitions, indicating a certain level of acquisition experience with an acquisition advisor and pre-acquisition proceedings. Their acquisition behavior, due diligence procedures and acquisition success reflect the current standing of merger and acquisitions in the automotive market. This population is therefore highly representative of its sector, regarding mergers and acquisitions, and therefore this research is representative as well. Having filtered the acquisitions according to the determined criteria, the sample showed a total of 378 acquisitions and volume amounting approx. EUR 42 bn. Table 3.2 summarizes deals per country with volume, indicating the geographical distribution consists as follows:

Table 3.2 Frequency of acquisitions according to geographic distribution

Country of Target Origin	**Frequency Population**	**Total Acquisition Volume Automotive Industry (EUR mill.)**	**Population in %**
France	26	2.413	5,8%
Great Britain / Ireland	15	2.592	6,2%
Austria	28	2.301	5,5%
BeNeLux	22	2.750	6,6%
Russia	27	2.792	6,7%
Switzerland	15	890	2,1%
Iberia	11	410	1,0%
Turkey	10	1.008	2,4%
Italy	19	2.695	6,5%
Scandinavia			
Sweden	12	11.969	28,8%
there of Scania-takeover 11bn EUR			
Finland	4	1.029	2,5%
Norway	7	1.626	3,9%
Denmark	14	533	1,3%
CEE			
Czech Republic	43	2.230	5,4%
Slovakia	16	920	2,2%
Croatia / Slovenia / Serbia	17	1.076	2,6%
Romania / Bulgaria	12	403	1,0%
Poland	35	2.021	4,9%
Hungary	24	1.175	2,8%
Other	21	789	1,9%
Total	**378**	**41.622**	**100%**

Source: Author’s creation using Thomson Reuters Data, Mergermarket and firm reports

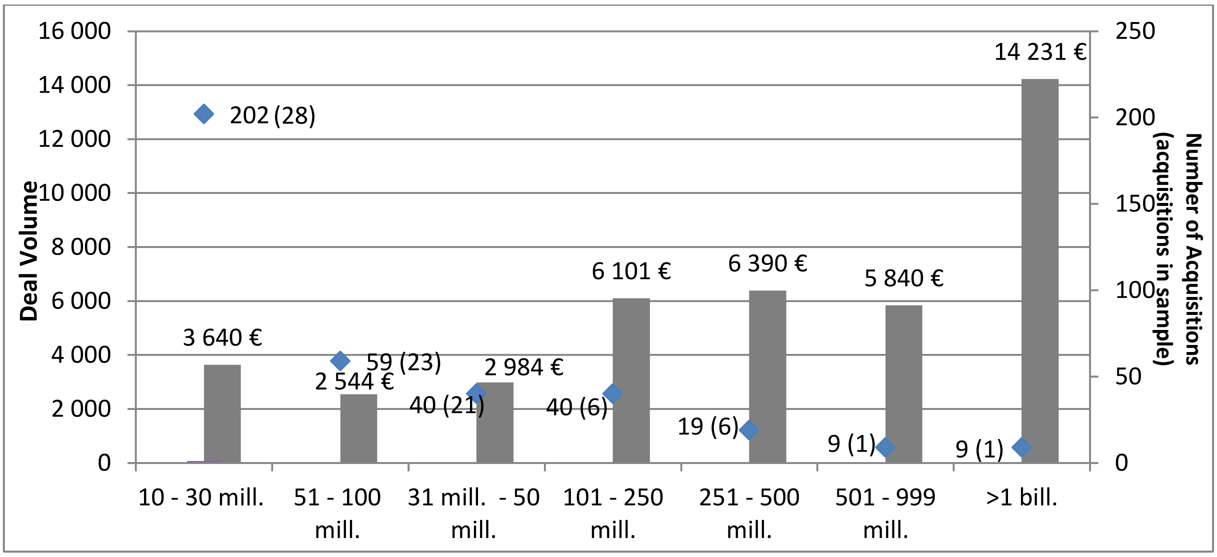
Based on the size and criteria of automotive firms with cross-border activities, the representativeness is further given by the fact that 24 of the biggest original equipment manufacturer (sorted by employee number) and automotive supplier participated in the survey (Appendix D). Hence, the sample is likely to reproduce characteristics of the whole population in miniature, with reduced number of cases.

3.2.2 Description of the sample

The sample selection has criteria that the deal has a minimum value of EUR 10 million – in order to avoid spurious and biased results from the survey participants in wake of strategic and financial importance.

In the following Figure 3.1, total population and the number of acquisitions is shown, whereas the figures in the parenthesis indicate the number of sample cases.

Figure 3.1 Frequency and volume of population and sample cases (in EUR mill./cases)



Source: Author’s creation using Thomson Reuters Data, Mergermarket, and firm reports

With more than 200, majority of the deals are in the volume range between EUR 10 and 30 mill., 82 per cent of the participants did at least one due diligence in the pre-acquisition phase, and more 70 per cent engaged external acquisition advisor. In the parenthesis, the number of acquisitions in the research sample shows that the majority of the deals is with volume until EUR 100 mill. Further argument for considering acquisition with certain volumes is the considering of the acquirer not to avoid the cost of due diligence because of disproportionately high cost related to deal value when acquisition value is less than e.g. EUR 10 million.

The data nucleus databases mergermarket.com and Thomson Financial DB are widely used by mergers and acquisitions experts. They provide comprehensive secondary data including deal reviews, time frames, involved parties (e.g. consultants, legal adviser, etc.). This information also enables selection of completed deals. Based on this information, enquiries were made to identify the executives in the acquiring firms who were involved in the acquisitions decision and proceedings; a list of potential survey participants was assembled. Based on the results

(Table 3.3), 378 acquisitions with 288 acquirers, of which 78 undisclosed bidders and financial Investors which are excluded from the sample. In a second step, 200 executives from companies were contacted; thereof 38 were not reachable or did not respond and were eliminated. 76 participants have the policy of not participating in survey research, or empirical participants indicated that they do not have time capacities to take part in the survey. This resulted in a sample size of 85 acquirers with a total of 85 deals meaning that each survey participant evaluated one single cross-border acquisition in the European automotive market in the time period from 2006 to 2013. The sample size is limited because a) motivating top and senior management is very difficult, particularly because of their high involvement and frequent representative function of the top executive (Harzing 1997) and b) in the recent years the top executives tend to more and more decline survey participations (Cycota & Harrison 2006). Hence, the participation rate of 85 from 288 acquiring firms (> 30 per cent) can be considered as very good response rate.

Table 3.3 Development of the sample regarding number of cases and participants

Criteria Selection	*Number of Cases / Participants*
No. Of Acquirers	288
There of contacted	200
no address found/returned mail etc.	88
thereof not participating in surveys or lack of time	76
or not reachable when contacted or not answered	38
Confirmed Survey Participants	**85**

Source: Author’s creation using Thomson Reuters Data, Mergermarket and firm reports

Considering all participants in the survey, they employ approximately 80 per cent of the total employees of the German automotive industry. To underline the high representativeness of the sample, the Appendix D contains an overview of the 20 biggest car manufacturers and 20 biggest automotive parts supplier in the German automotive industry. Out of this 40 firms, 24 firms participated in the survey. The response rate of >30 per cent participation number, is significantly higher than comparable research efforts (e.g. Ahmmad et al. 2013; Mukherjee et al. 2004; Graham et al. 2008 etc), which achieved < 15 per cent. This can be explained by the relatively homogenous, industry approach motivated population, without mixing up cross-border acquisition of e.g. servicing, chemical or other non-comparable industry.

The geographical volume of the distribution of the acquisitions used in the sample deals:

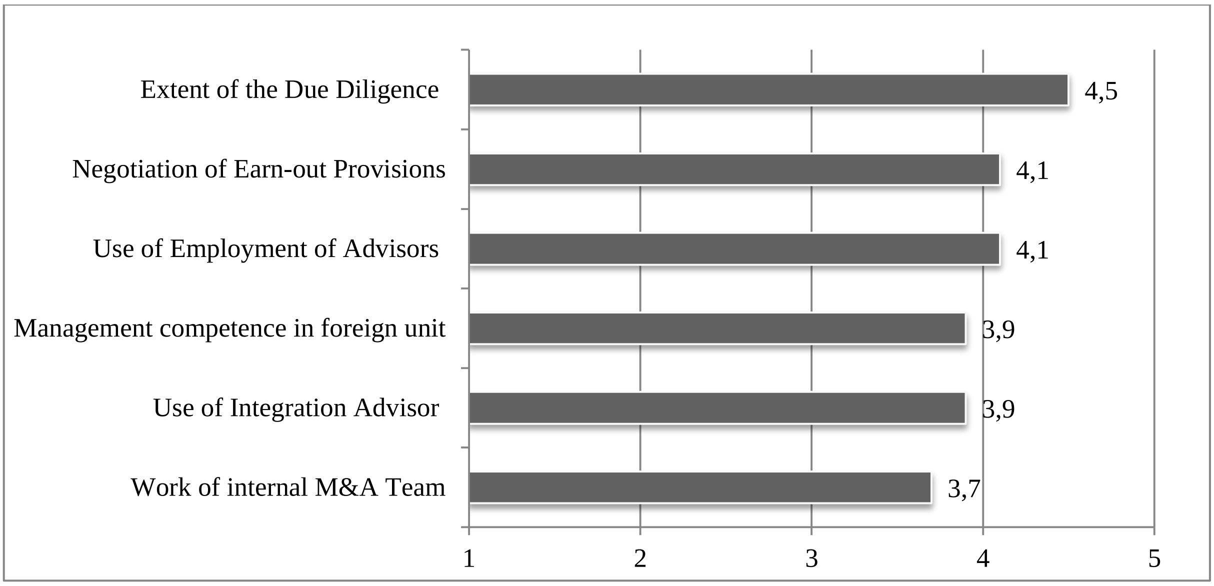
Table 3.4 Frequency of acquisitions in the sample sorted by geographic distribution

Country of Target Origin	Frequency Sample	Total Acquisition Volume- Sample (EUR mill.)
France	5	405
Great Britain / Ireland	6	1.705
Austria	6	650
BeNeLux	9	1.472
Russia	9	290
Switzerland	2	273
Iberia	4	165
Turkey	4	310
Italy	5	1.025
Scandinavia		
Sweden	5	7.770
Finland	2	300
Norway	3	171
Denmark	4	160
CEE		
Czech Republic	8	549
Slovakia	1	15
Croatia / Slovenia / Serbia	3	180
Romania / Bulgaria	2	45
Poland	6	320
Hungary	2	170
Total	**85**	**15.945**

Source: Author's creation using Thomson Data Financial, S&P Capital IQ, mergermarket.com and company reports

The subject of the research is the pre-acquisition due diligence in cross-border acquisitions. Thus, the questionnaire contained a question about the most important processual factors in order to make successful cross-border acquisition. Survey participants were asked to indicate on the Likert-Scale the importance of each factor (1-Not Important – 5 Very Important). The Figure 3.2 represents the answer choice of the survey participants, showing the clear dominance of the processual factor "Due diligence extent":

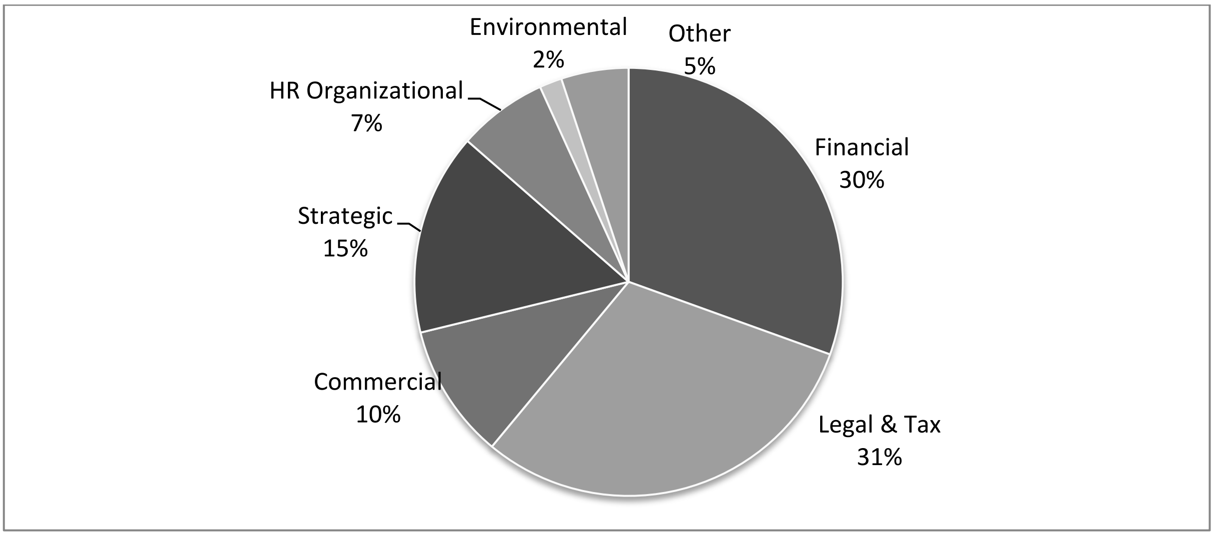
Figure 3.2 Most important factors in cross-border acquisition



Source: Author’s creation using survey results

Further information was inquired by including a question of the preferred area for engaging advisor in the due diligence process. Beyond the fact that firms perform due diligence in the pre-acquisition phase, obviously the main critical issues are expected in the Financial, Legal and tax area. However, only 30 per cent used to apply due diligence with external advisors in the cross-border acquisition process, as the Figure 3.3 shows.

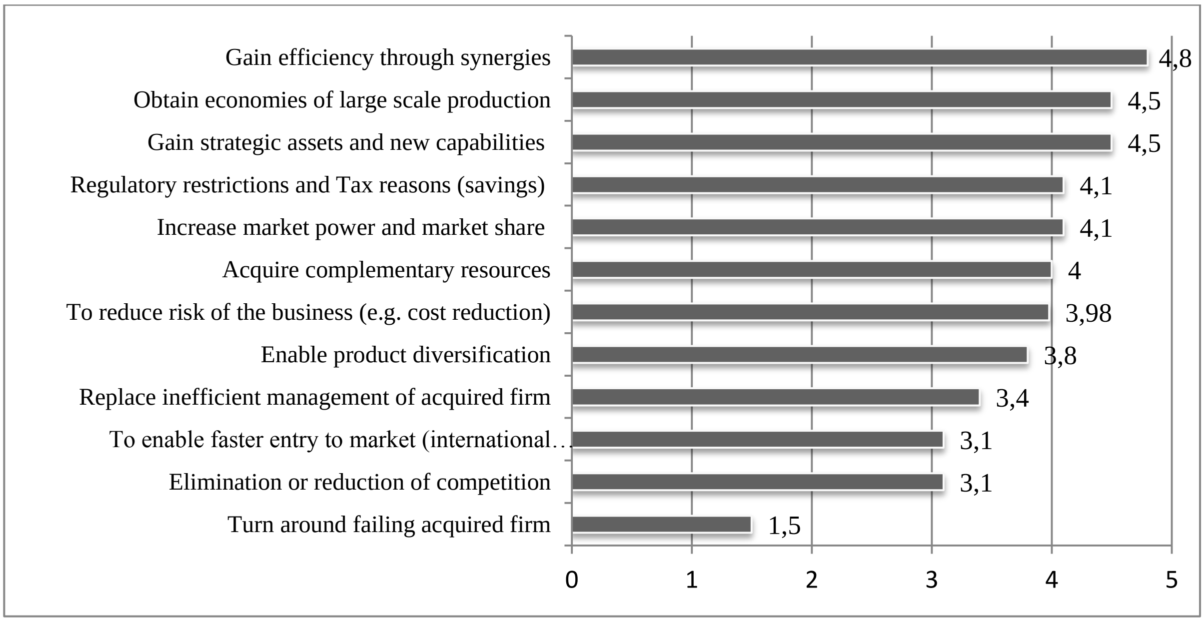
Figure 3.3 Frequency of performed due diligence type in cross-border acquisition



Source: Author’s creation using survey results

The questionnaire included the question about main motives of the acquirer, based on acquisition motives according to the research from Zhu (2013). It is the assessment of synergistically important areas, e.g. strategic and technological competence etc. are not being outsourced to external advisors. Survey participants were asked to indicate on 5-Point-Likert-Scale (1-Not Importance – 5-Very Important) strategic motives before entering the process of acquisition. The Figure 3.4 clearly shows the highest importance acquirer dedicated are those regarding the efficiency gains thorough synergies, gain of new assets and new capabilities, which is in line with scholars (Laabs & Schiereck 2010; McDonald et al. 2004).

Figure 3.4 The motives of the acquirer in the pre-acquisition phase



Source: Author, based on analysis of the survey participants

Related to this, the consideration of the synergistic criteria, operational and financial level, will be considered in conjunction with the dependent variable.

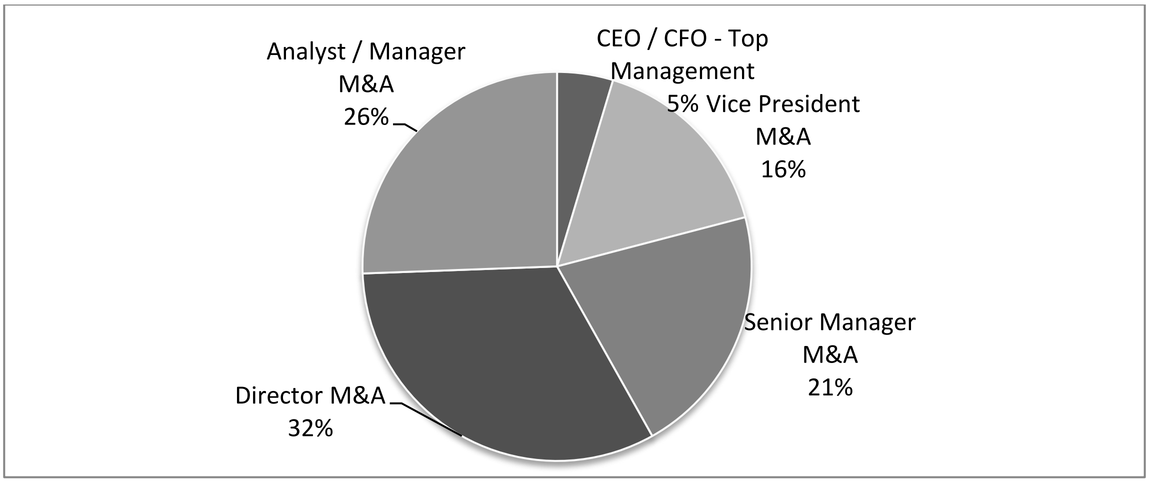
3.3 Research design and data collection strategy

Research design methods can be broken down into different basic types according to the research's fundamental objective: descriptive, causal and exploratory. The descriptive research is characterized by analysing the frequency of something, or exploring the relationship between two or more variables. Descriptive research is basically guided by the initial hypothesis. The causal research is characterized by researching cause-and-effect relationship, which are often done in the form of individual observations as they are considered as the best suited to explore cause and effect. In the exploratory research the focus lies on discovering concepts and perceptions. The descriptive part contains of the population description in terms of population and sample volume, sample participants and their acquisition experience. The second part of the research is based on cause-and-effect relationship, whereby the measures in the pre-acquisitions phase are connected with the post-acquisition success by using multiple regression analysis according to the criteria for quantitative research in the social science, basically relying on methods by Crown (1998) and Backhaus et al. (2003). It is completed by analysis of secondary data with regards to the acquisition success, which is used to complement the primary data. The quantitative analysis is based on logistic multivariate regression analysis. Most studies on mergers and acquisitions performance measure performance with corporate level data drawn from the acquirer's management. In order to research acquisition performance, the acquisition success was assessed by asking the managers to describe their perceptions of their company's performance and answer specific questions which were based on the academic research of this topic. On the basis of current research (Straub 2007; Bauer 2012; Gomes et al. 2013), the basic unit of analysis for the present dissertation are the considerations of the acquiring company.

The target informants were chosen according to the key informant survey strategy. The survey taps the knowledge and experience of those familiar with the researched subject (Campbell 1995, p. 342).

The key informants in this study were the decision-makers responsible for mergers and acquisitions from each respective company's management. Two thirds of the survey participants belong hierarchically to senior management or the top management level (more than 10 years professional experience) as shown in the Figure 3.5.

Figure 3.5 Informant position in the firm



Source: Author's analysis based on survey participants

They consisted of three groups: 1) members of the management board (Top management, vice presidents), 2) senior managers and directors in the function of head of the mergers and acquisitions department and 3) analysts and managers as project leaders of mergers and acquisitions. All of the survey participants have been actively involved in the acquisition process. They can be thus considered the most knowledgeable regarding the broad set of issues covered in the questionnaire. Three questions that would measure the informant’s degree of competence were also included. A further criterion was the willingness to answer to the questionnaire.

Following the results, the last step of data collection is a qualitative assessment by inquiring feedback from the experienced managers in the automotive industry regarding the research results. Triangulation is a powerful technique that facilitates validation of data through cross verification from two or more sources. In particular, it refers to the application and combination of several research methods in the study of the same phenomenon. In general, triangulation is often used to indicate that two (or more) methods are used in a study in order to check the results of one and the same subject (Olsen 2004).

The idea is to gain higher confidence with research result and avoid bias through the use of different methods which can lead to same result. Using triangulation for confirmatory and completeness purpose of the quantitative research, as the content of critical factors in pre-acquisition due diligence has little theoretical underpinning. Furthermore, the as a confirmatory approach, triangulation is applied to confirm if the chosen instruments was appropriate for measuring the concept of critical factors. Additionally, the confirmatory approach serves to overcome challenges related to single–method bias and thus can be applied to research results. Following the idea of triangulation, research results were presented to experts from the automotive industry.
After clear problem specification and development of an adequate research design and survey participants, the next step in the research process was the evaluation of the data collection instrument and the selection of the representative sample.

3.3.1 Criteria and evaluation of the survey instrument

The survey data was collected using cross-sectional survey using questionnaire from a sample of German automotive firms that have acquired at least twice in the cross-border, especially the European countries. As the acquisition defined criteria is the acquisition of more than 50 per cent, as this ratio leads to full control and full consolidation within the financial accounts of the acquirer. The considered time-frame is from 2006 to 2013. The questionnaire is based on topics reviewed in the mergers and acquisitions research literature and divided into three phases, replicating the acquisition process pre-acquisition phase, acquisition phase and post-acquisition phase. As most studies on mergers and acquisitions, this survey was performed under strictly confidential measures. The findings and results will be published only as aggregate summaries in which no individual survey participant's answers can be identified. Each questionnaire was coded and the list of codes and corresponding company names was accessible only to the surveyor. When the completed questionnaire returned, the company was removed from the code list. These procedures are ensured to the survey participants. Each firm was considered only once for the participation. The questionnaire consists of six content areas is separated into six sections:

1. Information about the survey participant and the acquisition circumstances,
2. Acquisition motives and external advisory support,

3.-5. The pre-acquisition, acquisition and post-acquisition phases, and

6. Acquisition performance.

The schematic overview of content areas is in the Appendix B.

In the first content area, the survey participant was asked to indicate their name, hierarchical position, the date when the survey acquisition was completed and experience in acquisition practice. Data was in the text form, and quantitatively, by number of performed acquisitions separated in domestic and cross-border acquisitions.

The second content area deals with motives by which the acquisition was driven, indicting the strategic motive and type of the planned acquisition. Correspondingly, to the acquisition type, survey participants were asked about the due diligence applied and the use of advisers in order to receive information about the pre-acquisition audit intensity and whether the acquiring company consulted external knowledge in the pre-acquisition phase. In the third content area, survey participants were asked regarding the operational steps of the pre-acquisition evaluation. The survey participants indicated the extent by which the company evaluated the factors (theoretically derived in the Sub-Chapter 2.3) prior to indicating the potential bidding price.

Further question asked about the difference of the firms prior to the acquisition and intention of supplementing the evaluated factors from the previous question. The question also aimed to emphasize the issue of the evaluation intensity of the possible synergies (types of customers, served markets, major products/services offered, operational technologies, etc.) and potential integration problems (management style, values, beliefs, culture of home countries etc.). The next questions dealt with problems they experienced and the success factors, which were crucial for overcoming the pre-acquisition problems. The indication of the intent of retaining employees through all hierarchical levels is also important to measure the workforce / technological competence transfer. In the fourth content area, the presence of possible competing bidders was asked in order to determine whether the acquirer was under stressful conditions and thus neglected certain steps in the pre-acquisition-phase because of time pressure (Price et al. 1998). The fifth content area of the questionnaire focuses on evaluated success factors applied in order to ensure successful post-acquisition integration. The questionnaire also includes the main problems experienced in the post-integration stage in order to relate them to the evaluated factors from the pre-acquisition phase.

The factor of employee retention and management appointments in the acquired firm was asked in order to determine the use of the used management competence and workforce capabilities (Schuler & Jackson 2001). The transfer of skills, separated into the planned and the achieved level, complete this content area. In the last content area of the questionnaire, the focus lies on the performance measurement, which is separated into financial indicators, synergistic indicators and overall success judgment by the responsible manager.

The main questions aimed to receive retrospective information about acquisition's success factors and if the expectations of the acquisition were met. In this context, the performance measurement factors indicate on what level the benefit occurred: on the synergistic (or on the financial (profitability, return on investment etc.), or on both levels. The questionnaire ends with subjective question about the overall success of the acquired firm as a whole for the acquiring firm. The indication was expressed on the Likert-scale 1-Not successful – 5 Very successful.

One of the crucial questions of the research study is the measurement of the variable Acquisition Success. In this research, the acquisition success will be defined according to research from Zollo & Meier (2008) and Schoenberg (2004), which consist of nine different variables. As the majority of the takeover candidates are not publicly listed, the share-based performance measures are excluded (e.g. earnings per share, share price reaction). The dependent variable Acquisition Success was measured by six success indicators, which were used to elicit responses on the 5-point Likert scale, ranging from 1 – "Expectation not met" to 5 –

“Expectation fully met”. The weight of the indicators was calculated by asking for the importance of each measure, ranging from 1 (not important) to 5 (very important). In the model, a composite measure of the acquisition success was calculated by using the weight of the type transaction success factor. Separately to the Acquisition Success Composite, in order to avoid missed success or failure performance factors, the respondents were also asked to indicate the "Overall Success" of the acquisition by indicating on the scale between 1 (not successful) to 5 (very successful). This factor had high correlation with the first subjective measure (87.5%) which was used in the subsequent analysis. The survey also contained a question concerning the sale of the acquired unit, which some researcher classify as acquisition failure (Gomes et al. 2013, Bruner 2006, Tewes 2001).

The adapted scales and questions types conform to methods used by other researchers in the field of corporate finance and business strategy research (Das & Kapil 2012). Two academic researchers in the field of international business science examined the survey instrument. Furthermore, in order to improve the understandability of the questions, three managers from the surveyed companies and two managers from the acquisition advisory side, participated in the pre-test of the survey, which also took the time and transparency factors into account. The valuable feedback from the pre-test led to certain corrections in the formulation of the questions and improvement of the of the survey instrument clarity.

3.3.2 Data collection under consideration of method bias

The data collection was separated into two phases. The first part of the survey started in 2014, when more survey participants had confirmed their participation, the questionnaire was included in an online survey tool (www.unipark.de) and the survey participants received covering letter and a link to the survey. The survey was extended in the first half of 2015, as more survey participants were engaged. Internet survey’s advantages include the audience reach worldwide, design flexibility as well as anonymity. The survey participant communicated their preference for using internet tools. In both survey periods, after four weeks, a reminder was sent out to all key informants. Some of the informants answered why they did not participate, and the major reasons supplied were internal confidentiality policy, lack of time and corporate policies against participating in surveys. In order to minimize this scarcity 1) the academic necessity was stressed, 2) the benefits of the study for the key informants was stressed and survey results were promised, 3) strict confidentiality and anonymity were assured, and 4) the time for completing questionnaire was specified with 30 minutes. Previous researches has shown that senior management members are due to high involvement seldom response to such studies. Thus, the participation rate of nearly 30 per cent of the acquiring companies can be considered very satisfactory as the topic is very sensitive on the one hand, and the relevant executives involved in international projects and thus not easy to reach, on the other side. Other studies in the mergers and acquisitions research where the response rates of the research studies clearly lie under 20 per cent (Ahammad & Glaister 2013; Aktas et al. 2013; Mukherji et al. 2013; Ahammad & Glaister 2008; Straub 2007; Schweiger 2003). Aktas et al. (2013, p. 100) emphasize, due to confidentiality and non-public availability of acquisition proceedings, research in mergers and acquisitions must usually rely on relatively small sample sizes.

The quantitative research of this dissertation is based on collected data from single participant. From each firm, a single participant provided data on independent and dependent variables. These may implicate the possibility of method bias. Several researchers have demonstrated that method bias can inflate or otherwise manipulate the estimates of the relationship between dependent and independent variables (Podsakoff et al. 2003). Such bias is serious problem as it can affect hypothesis tests, lead to incorrect perceptions and false research conclusions. In order to lessen such an effect, beyond the primary data, the secondary data was collected by checking if the acquirer sold or integrated the acquired firm. Such a disposal is classified as an unsuccessful acquisition (Schoenberg 2004). Further secondary data is the consideration of the acquirer's acquisition quality, which can be seen in the goodwill position in the balance sheet. The secondary data were drawn by research of publicly available financial statements and press releases concerning the possible disposal, and by research of database S&P Capital IQ, Mergermarket and Thomson Financial. Beyond the secondary data, following procedural measures to reduce method bias were undertaken (Podsakoff et al. 2003; MacKenzie & Podsakoff, 2012, p. 549):

a) Explanation of the academic contribution and the self-benefit for the survey participant through obtaining industry benchmark of the cross-border acquisition behavior,

b) Guaranteeing the response anonymity (coded questionnaire) and providing the survey participants with the academic contribution of the research engagement,

c) Thematically separation of the predictive variables (evaluated factors) and the dependent variable (acquisition success) in the survey instrument,

d) Statistical measures to control the effect of method bias (Harman's single factor test).

The confidentiality and anonymity were guaranteed, and the time specified that would be necessary to complete the questionnaire. The summary of the research results and findings was promised. This means that appropriate means were taken to ensure that information collected in the course of a research project about individual firms will remain confidential, and there will be no possibility to trace back information to a particular individual. For that purpose, the questionnaires were coded and not traced back.

Further criteria to avoid method bias were evaluations of the quality of the survey, i.e. to avoid misunderstanding the participants structured questions were employed and a pre-test conducted. Firstly, the confidentiality of the questionnaires does not lead to bias in the data as a result of the interaction with the survey participant. Furthermore, a question to measure participants' degree of confidence in answering the questions was also added. The identified key informants of the survey were required to have sufficient answering competence. Moreover, all participants were asked to mention the length of time they have held their responsible position. More than 75% were in the company during the period the cross-border acquisition took place and have held the position for more than six years in their current company. This supports survey participant's competence. Finally, question if participants used acquisition adviser (e.g. auditing firm, investment bank, etc.) and what kind of due diligence has been applied in referring acquisition. Financial and Legal & Tax due diligence clearly dominated, which supports the previous assertion that partial assessment of risk in the pre-acquisition phase ocurred. For the data collected, this means that the respondents apply due diligence investigation and that they are familiar with the critical factors of successful acquisition. The data collection was fitted to the research design. In order to avoid biases in the data as a result of the interaction with the subject, ethical guidelines were followed when the survey participants conducted the questionnaire. In this context the automotive industry and their management referring to the highly confidential topic of firm's acquisitions is described. In order to avoid industrial biases, the survey concentrates only on automotive industry. The data collection method chosen was based on analyses conducted on acquisitions and their volumes and quantitative and qualitative cross-sectional questionnaire. As each survey participant provided information on independent and dependent variables, there might be a problem of common method bias. Therefore, the questionnaire content reflects and/or separates the acquisition from the perspective of the three acquisition phases. Therefore, the responsible acquisition managers are familiar with the phases and can answer properly.

Following MacKenzie & Podsakoff (2012), a dispersion of the related items throughout the questionnaire, separated by unrelated buffer items, was done. In order to further minimize common method bias, the survey instrument included a large number of questions addressing different items from different perspectives and the contents of categories differed. Moreover, to reduce common method bias, the questions representing the dependent variable (acquisition success) were presented after the questions about the topics on the independent variables (evaluated factors in the pre-acquisition due diligence). Additionally, in between of these questions, there were others addressing different research fields (e.g. the achieved aims of the acquisition or whether the acquired firm was divested). According to Podsakoff et al. (2003), in order to reduce common method bias, a researcher can take provisions which lessen priming effect and consistency. In addition, Harman's single factor test can be conducted to check the critical level, which is when the variance explained by the largest factor is more than 50 per cent. The test included independent and dependent variables, with unrotated factor analysis it produced five factors. 32.1 per cent of the total variance was explained by the largest factor, indicating that the problem of common method bias does not exist (see also Table Harman's Single Factor Test – Table in Appendix F).

As the period of the study comprises acquisitions completed from 2006 until the end of 2013, because of the time lag, there might have been a problem of retrospective bias in the survey answers. In order to minimize the possibility of retrospective bias, responses concerning acquisitions from 2006 were compared to those of 2013. The Wilcoxon-test of the mean did not indicate statistically significant differences in the means of the two considered acquisition periods, indicating that there is no noteworthy retrospective bias. The non-response factor can be denied because more than 80 per cent of the automotive firms (compared by employee number) are reflected in the survey. The remainders have either low acquisition volume or no acquisition experience. Hence, it is not likely that inclusion of these automotive firms would have led to different empirical results.

4 Quantitative Analysis of Relationship between Pre-acquisition Due Diligence and Acquisition Success in Cross-border Acquisitions

In the previous chapter, the way to a representative sample with specific and homogenous characteristics was shown. This chapter is about data analysis, the interpretation of results, more exactly, the qualitative interpretation of the results in relation to the research question. The meaning and the relevance of the results are carefully assessed. By use of the triangulation method for the purpose of confirming the results, the research is completed and finally discussed in the light of current academic research results.

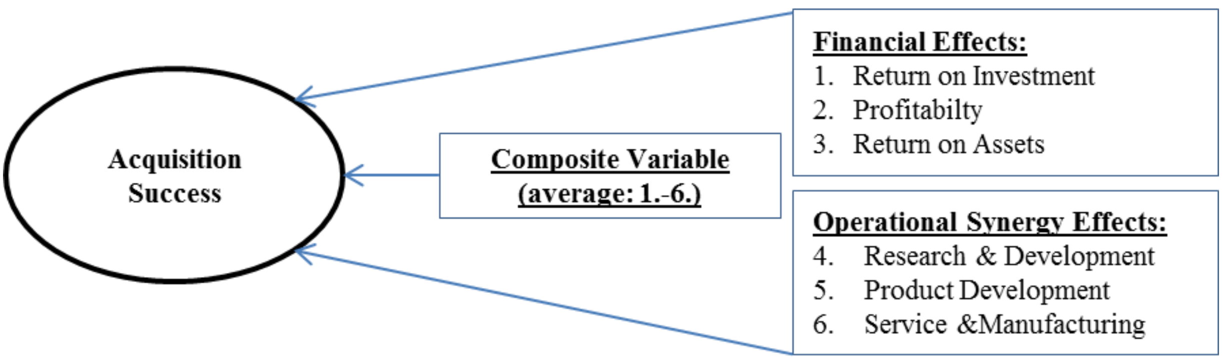
4.1 Reliability of the model variables acquisition success

Research results about the measurement of acquisition performance are mixed, indicating accounting figures can be inappropriate as the volume of the acquisition may be to small to show possible post-acquisition performance transparently. Following Schoenberg (2004), Ahammad & Glaister (2013) and the pre-test expert's suggestions, the survey participants are the better source of assessing acquisition success of cross-border acquisitions. The survey participants were asked in order to evaluate responses on a 5-Point Likert scale (1=”expectation not met” to 5=”expectation fully met”). Figure 4.1 shows the components of acquisition success. The composite variable is calculated by the formula:

$$\text{Acquisition Success}^{a} = \frac{1}{\mathrm{n}}\sum_{s=1}^{6} \text{Acquisition Success} * Ws$$

Where Acquisition Success is the type s success variable of the acquisition, W_s the weight of the type s success evaluation, and Acquisition Success is the success of acquisition a.

Figure 4.1 Measurement of acquisition success



Source: Author, based on research (Schoenberg 2004; Zollo & Maier 2008)

The composite variable has been calculated by the weight of each success evaluation. The survey participants were asked to rate the importance of each indicator using 5-Point Likert scale (1=”not important” to 5=”very important”).

As stated in 2.4, the regression analysis was run with varied acquisition success variable, where the separation supports the model approach:

a. Composite of the six dependent variables – main approach

b. Financial Synergy Effects of the acquisition (Dependent variables 1.-3.)

c. Operational Synergy Effects of the acquisition (Dependent variables 4.-6.).

This differentiation arises from the need to find out the critical factors that are the integral art of the composite variable. Splitting the model approaches results into these three categories delivers insight in the impacting areas for synergy or financially oriented acquirer. The results could be matched with results from Laabs et al. (2011) or Schoenberg (2004), indicating that successful acquisition is not necessarily directly measurable in financial terms but also in terms of operational and financial efficiency gains. The quantitative regression analysis is rounded up by comparison of the results from primary data by use of secondary retrieved dependent variable data (goodwill impairment and disposal of the acquired firm).

The first step of the distinctive approach is to prove the reliability of the dependent variable, as it consists of six different measures. The variables were examined and measured by using multiple-item scales. These scales proven on reliability of the three dependent variables using the common test of reliability, Cronbach’s Coefficient Alpha, which shows how well indicators evaluate each of the variable (Homburg & Giering 1998, p. 120). The values above 0.7 are considered as sufficient reliability, measures above 0.9 are considered as very strong reliability. For dependent variables Cronbach’s Alpha delivered high values indicating good reliability of the measurement power.

Table 4.1 Reliability of acquisition success (Cronbach’s Alpha)

	Synergy Level	**Financial Level**	**Composite Variable**
Cronbach’s alpha	0.912	0.831	0.916

Source: Calculations made by the author (on the basis of the test group (n=85)

The composite variable has Cronbach’s Alpha of 0.91 indicating high reliability. The other two variables show very good reliability level.

The evaluation of the reliability of the categories used as independent variables, the Cronbach's Alpha, was calculated and indicated an acceptable level of reliability.

Table 4.2 Reliability of the categorized variables (Cronbach's Alpha)

	Choice of Strategic Partner	Business Capabilities and HR Knowledge	Financial Factors	Macro-Factors and Business Environment
Cronbach's Alpha	0.742	0.793	0.824	0.772

Source: Calculations made by the author on the basis of the test group (n=85)

For independent variable, categorized factors, the Cronbach's Alpha delivered high values indicating good reliability of the measurement power.

4.2 Setting up of the multiple regression model and data distribution

The initial regression analysis was performed in order to test the hypotheses based on categorized critical factors on the one hand, and the individual evaluated factors on the other. The model includes twelve explanatory, observable variables and two control variables. The purpose of the test was challenging the strength of the evaluated critical factors in the pre-acquisition due diligence and their impact on dependent variable "Acquisition Success". The explanatory variables consist of evaluated critical factors as shown in the Chapter 2.3. Based on a comprehensive review of prior studies on corporate acquisition and acquisition premiums, control variables on the characteristics of the acquirer, the target, and the acquisitions themselves to rule out potentially confounding factors that could affect acquisition premiums were included. First, acquirer experience and the influence the premium paid for a target. Further control variable was if competing bidder existed in the transaction. This would put additional pressure in the price building process. Beforehand, the control variables obviously did not have impact on the Acquisition Success and they are excluded in the stepwise process of the regression analysis.

Hence, in the first step, the relationship between the joint effects of critical factors, summarized in four categories, and the acquisition success (composite variable) was tested. In the next step then the twelve individual critical success factors were tested to evaluate their impact. The intent is to test the contribution of individual critical success factors in the pre-acquisition due diligence (stepwise multiple regression with control variables can be checked in the Appendix G). In order to substantiate each hypothesis on its own, using univariate regression analysis, the relationship between the individual categorized critical factor and the acquisition success is tested. In addition, models relying on acquisition success variables, "goodwill impairment" and "Disposal of the acquired firm", both drawn from public secondary data, conclude the statistical analysis.

In the regression model the focus will be on adjusted R-square statistic instead of R-square because R-square is sensitive to the aggregation level of the data and approaches one as the number of variables in the regression approaches the sample size – irrespective of the explanatory power of the variables (Crown 1998, p. 40). The adjusted R-square corrects for the tendency of R-square to approach one as the number of explanatory variables increases.

For the sake whether to continue testing, the data was checked for abnormalities and that they are suitable for use in regression analysis. The Spearman correlation matrix indicates that the variables show only moderate correlations. The highest correlation was given between the category factors "Choice of Strategic Partner" and "Business Capabilities and HR Knowledge", as the Table 4.3 shows.

Table 4.3 Relationship between the independent critical factors (Spearman's Rho)

Indicators		Choice Strategic Partner	Bus. Capabilities and HR Knowledge	Financial Factors	Macro-Factors/ Business Environment
Choice of Strategic Partner	Correlation Coefficient	1,000	,618**	,321**	,349**
	Sig. (2-tailed)		,000	,003	,001
	N	85	85	85	85
Bus. Capabilities and HR Knowledge	Correlation Coefficient	,618**	1,000	,296**	,265*
	Sig. (2-tailed)	,000		,006	,014
	N	85	85	85	85
Financial Factors	Correlation Coefficient	,321**	,296**	1,000	,484**
	Sig. (2-tailed)	,003	,006		,000
	N	85	85	85	85
Factor Macro-Political	Correlation Coefficient	,349**	,265*	,484**	1,000
	Sig. (2-tailed)	,001	,014	,000	
	N	85	85	85	85

Note: ** Correlations are significant at the 0.01 level, * Correlations are significant at the 0.05 level.

Source: Author's creation using research results

The categorization of the evaluated critical success factors differ strongly, as they stem on the one side from the strategic management (strategic relatedness, technological competence etc.) and financial literature and law literature (e.g. Legal and Tax issues, Corporate Governance etc.). From that perspective, the interrelations shown in the Table 4.3 are acceptable and no variable need to be excluded.

Further test, Kaiser-Maier-Olkin, as the measure of sampling adequacy is 0.67, indicates that patterns of the correlations are relatively compact and, implicitly the sample results delivered adequate factor values. For these variables, the Bartlett’s Test is highly significant ($p<0.001$). Hence, the variables can be used in the regression analysis without specific adjustments.

Further test of normality is tested by the Shapiro-Wilk and Kolmogorov-Smirnov tests, with the aim to test assumption that the sample data are drawn from a normally distributed population. The focus lies on the Shapiro-Wilk test, as it is more appropriate for small sample sizes. If the significance value of the Shapiro-Wilk test is greater than 0.05, the data distribution is normal. If it is below 0.05, the data significantly deviate from a normal distribution. As the tests indicate values above 0.05 thresholds, it can be supposed that the data distribution is normal for the categories Choice of Strategic Partner, Financial factors and Macro-Factors and Business Environment. In the Appendix E, the results are presented in conjunction with visual histograms and Q-Q-Plots, which are used to verify the quantitative results shown. In a Q-Q-Plot, if the data are normally distributed, the data points will be close to the diagonal line. According to this, only the data from the factor category Business Capabilities and HR Knowledge show acceptable deviation. Other variables show normally distributed data. The skewness of the categories Choice of Strategic Partner, Financial Factors and Macro-Factors and Business Environment show negative, left skew. The Business Capabilities is also left skewed possessing very high value confirming the lack of normality distribution. Similar situation is with the kurtosis, however is the Business Capabilities positive absolute value indicating great kurtosis. The data are left-skewed and leptokurtic with respect to Business Capabilities was compared with normal distribution. Following Kline (2005) recommendations that the skew and kurtosis indices should not exceed an absolute value of 3 and 10 respectively, the data is normally distributed. Based on that, test results will stay reliable when using regression analysis.

4.2.1 Test of joint effects of critical factors on acquisition success

The base model with categorized critical factors and composite acquisition success variable is used to test the derived hypotheses. Regression model measures the explanatory power and how well observed critical factors correspond with acquisition success when included in due diligence.

F-Statistics tests whether the model – here the joint effects of all critical factors together – as a whole is significant. More concretely, do the critical factors, taken as aspects of pre-acquisition due diligence, predict acquisition success more precisely than just predicting it by use of comparing the mean values. The Table 18 shows the F-value of $p > 0.000$. The F-Statistics is well above the cut-off value for 99 per cent confidence level (5.120), indicating the high measurement reliability of the model concluding that the critical factors, as the ingredient of pre-acquisition due diligence, together predict the probability of successful acquisition. In terms of usefulness to predict outcomes of the model, the adjusted R-squared is considered as it compensates for the number of variables in the model and it will only increase if the added variables contribute significantly to the model. The adjusted R-squared indicates the critical factors can explain about 49 per cent of the variation of acquisition success.

The model's overall predictive power and the extent to which the variables in the model explain the variation in acquisition success is very good. When considering the coefficients, the unique strength effect of each critical success factor regarding the acquisition success is evaluated. In the following tables, starred predictive capability is related to the significance level (0.9 *, 0.95 ** and *** 0.99). Obviously critical factors categorized in "Business Capabilities and HR Knowledge" and "Financial Factors and Acquisition Premium" show significant impact on acquisition success. The categorized critical factor "Choice of Strategic Partner" significantly impacts acquisition success (significance level of 0.1). The estimate coefficient shows that increase by one unit would lead to 0.23 better results in acquisition success.

Table 4.4 Multiple regression analysis with categorized critical factors and acquisition success (composite variable)

	Coefficient Estimate	p-value	VIF
(Intercept)	-1.168	0.016	
Choice of Strategic Partner	0.23	0.068 *	1.8
Business Capabilities and HR Knowledge	0.513	0.000 ***	1.9
Financial Factors	0.386	0.001***	1.5
Macro-Factors and Business Environment	0.14	0.218	1.4
Adjusted R-square: 0.4897, F-statistic: 31.18 on 4 and 80 DF, p-value: 0.000			

Source: Calculations made by the author on the basis of the test group (n=85)

Digesting the results above, acquisition success in the pre-acquisition phase can be improved by including these three categories of critical factors as parts of the due diligence. Consequently, this provides support for the hypotheses H1, H2 and H3. Only the critical factors of the category "Macro-Factors and Business Environment" does not show significant contribution to the acquisition success, which leads to the rejection of the H4.

If acquisition success is considered from the operational synergies level (Table 4.5), the model shows stronger metrics: the adjusted R-squared explains 66.5 per cent of the acquisition success variation, and the F-statistics (42.64; p-value > 0.001) point to strong reliability of the model as a whole.

Table 4.5 Multiple regression analysis with categorized critical factors and acquisition success (operational synergies level)

	Coefficient Estimate	**p-value**	**VIF**
(Intercept)	-2.213	0.000	
Choice of Strategic Partner	0.342	0.011 *	1.8
Business Capabilities and HR Knowledge	0.694	0.000 ***	1.9
Financial Factors	0.389	0.001 **	1.5
Macro-Factors and Business Environment	0.111	0.354	1.4
Adjusted R-squared: 0.6648, F-statistic: 42.64 on 4 and 88 DF, p-value: 0.000			

Source: Calculations made by the author (2015) on the basis of the test group (n=85)

The regression coefficients show a very strong impact of “Business Capabilities and HR Knowledge”, and good impact of “Financial Factors” and “Choice of Strategic Partner” on acquisition success as the operational synergy indicator. The significance level is highest with “Business Capabilities and HR Knowledge” and “Financial Factors” (p-value > 0.001), while the critical factor “Choice of Strategic Partner” shows weaker significance (p-value > 0.01). The variable “Macro-Factors and Business Environment” have a non-significant p-value, meaning it does not have predictive capability in the presence of the others. These results confirm H1, H2 and H3.

If the acquisition success is calculated on the financial effects level, the model again shows high adjusted R-squared, indicating that the model explains 37.3 per cent of the acquisition success variation on the financial effects level. Compared to previous results on synergy effects level, the model is not that strong, indicates however, acceptable predictive power of the stated model. The F-statistic is for Financial Factors is highly significant (p-value < 0.001), suggesting the model in this constellation predicts acquisition success, when considering acquisition success on financial effects level.

Table 4.6 Multiple regression analysis with categorized critical factors and acquisition success (financial synergy effects level)

	Coefficient Estimate	**p-value**	**VIF**
(Intercept)	-0.122	0.829	
Choice of Strategic Partner	0.119	0.424	1.8
Business Capabilities and HR Knowledge	0.332	0.023 *	1.9
Financial Factors	0.382	0.004 ***	1.5
Macro-Factors and Business Environment	0.169	0.210	1.4
Adjusted R-square: 0.3732, F-statistic: 13.51 on 4 and 80 DF, p-value: 0.000			

Source: Calculations made by the author (2015) on the basis of the test group (n=85)

The estimate coefficients of critical factors “Financial Factors and Acquisition Premium” and “Business Capabilities and HR Knowledge” indicate a positive relationship to acquisition success. This shows also that operational synergies positively contribute to financial success. The results give support to the derived hypotheses H2 and H3, even if the estimate coefficients are not as strong as in the latter two model constellations.

The multicollinearity for the latter three models is measured by the variance inflation factor (VIF). VIF provides and index that measures by how much the variance of an estimated regression is increased because of collinearity. Crown (1998) considers 5 the critical value, which indicates there are no model variables containing strongly redundant information. The values, not exceeding 2, imply absence of multicollinearity. Consequently, the chosen variables have enough distinct information for the multiple regressions to operate correctly.

4.2.2 Test of individual effects of critical factors on acquisition success

Having tested model with four categories of critical factors of pre-acquisition due diligence, the next step in the quantitative analysis is the test of the hypotheses by inclusion of single critical factors and the acquisition success. Using univariate regression analysis, the single critical factors are regressed with the dependent variable, acquisition success (composite variable). The aim is to find sets of predictors that are both statistically significant and intuitively plausible in terms of research results gained by the model approach. The results of the regressed critical factors and the acquisition success are presented in the Table 4.7.

In the univariate regression analysis, there is only one independent variable, the coefficient of the critical factor measures the strength of its relationship with the acquisition success. It is interpreted as the size of the average difference in e.g. Strategic Fit (0.782 units) that corresponds with a one-unit difference in the acquisition success. There is a positive relationship between the consideration of critical factor in due diligence, the Choice of Strategic Partner, and the acquisition success in cross-border acquisition. The significance score (p-value < 0.001) indicates that the found relationship in this sample is actually best described by a flat line. Because the relationship is significant, “Acquisition Success” can be attributed to the critical factor “Choice of Strategic Partner”.

Table 4.7 Univariate Regression Analysis – Acquisition success (composite variable)

Hypothesis 1	Estimate Coefficient	p-value
(Intercept)	0.842	0.079
Choice of Strategic Partner	0.782	0.000
R-square: 0.3438, F-statistic: 45.02 on 1 and 83 DF, p-value: 0.000		
Hypothesis 2		
	Estimate Coefficient	**p-value**
(Intercept)	0.262	0.552
Business Capabilities and HR Knowledge	0.865	0.000
R-square: 0.4642, F-statistic: 73.78 on 1 and 83 DF, p-value: 0.000		
Hypothesis 3	**Estimate Coefficient**	**p-value**
(Intercept)	0.985	0.031
Financial Factors & Acquisition Premium	0.763	0.000
R-square: 0.4483, F-statistic: 45.89 on 1 and 83 DF, p-value: 0.000		
Hypothesis 4	**Estimate Coefficient**	**p-value**
(Intercept)	1.756	0.001
Macro-Factors & Business Environment	0.616	0.000
R-square: 0.1963, F-statistic: 21.51 on 1 and 83 DF, p-value: 0.000		

Source: Calculations made by the author (2015) on the basis of the test group (n=85)

As usual for linear regression models using one independent variable, the p-value for its coefficient corresponds to the F-Statistics. Beyond the critical factor “Choice of Strategic Partner”, other critical factors show positive estimate coefficients and possess predictive capability in case of the critical factors in due diligence. They also indicate statistically significant relationship between the critical factor and the acquisition success (significance < 0.001). “Business Capabilities and HR Knowledge” has strongest predictive influence, whereby increasing this factor leads to 0.865 units enhanced acquisition success.

F-Statistics show values above the cut-off value (confidence level 0.999) in all four regressions. Thus, it can be supposed that the model as a whole predicts the dependent variable.

In terms of explanatory strength, the R-squared statistics range from 0.1963 to 0.4642, indicting the model’s overall strength and the extent to which the variables in the model explain the variation of the dependent variable acquisition success. The critical factor “Macro-Factors and Business Environment” R-squared is far lower than in other cases. Hence, even with secondary retrieved data, this critical factor is not considered necessary for the pre-acquisition due diligence. The “Business Capabilities and HR Knowledge” and “Financial Factors and Acquisition Premium” indicate very strong predictive capability, supporting the research results of the primary data.

To sum up, the results of the univariate regression analysis supports the previous results of the multiple regression analysis, which focuses on the joint effects. Table 4.8 summarizes the results of the regression analysis and relates them to the hypotheses:

Table 4.8 Summary of the regression analysis results connected to the hypotheses

	Hypotheses	Joint Effects Approach (multiple regression analysis)	Individual Approach (univariate regression analysis)
H1	The positive relationship is supposed between pre-acquisition due diligence critical factor strategic fit and organizational culture fit and the cross border acquisition success.	Confirmed	Confirmed
H2	The positive relationship is supposed between the pre-acquisition due diligence critical factors Business capabilities, technological competence and workforce capabilities and human resources and the cross border acquisition success.	Confirmed	Confirmed
H3	The positive relationship is supposed between pre-acquisition due diligence critical factors Cash-flow generation, debt servicing capability, the fixed assets evaluation and the future investment and financing need of the acquired firm, and the cross-border acquisition success.	Confirmed	Confirmed
H4	The positive relationship is supposed between the pre-acquisition due diligence critical factors Macro-factors and the business environment and the cross border acquisition success.	Rejected	Rejected

Source: Author's summary based on results from regression analysis

4.2.3 Testing the research results with secondary data

To examine determinants of the firm's goodwill impairment decisions and disposal of the acquired unit, a multivariate and linear logistical regression were estimated. The second examination of the research results was done by qualitative assessment by acquisition-experienced managers from the automotive industry. They received five propositions based on research results. This procedure belongs to the research method of triangulation, which allows qualitative assessment of the suitability of research results and, in the ideal case, confirms the results.

The following evaluations differ because the dependent variable "Acquisition success" was replaced by "Goodwill Impairment" and "Disposal of the acquired firm". The success criteria is rated by "Yes" or "No", when the variable equals one if goodwill is impaired or if the firms has been sold in the given period, and zero otherwise. The indicator variables remained the same. As the dependent variables have only two-values, 1 and 0, the multivariate logistic analysis was applied. Logistic regression is similar to a linear regression but is suited to models where the dependent variable is dichotomous. Logistic regression coefficients can be used to estimate odds ratios for each of the independent variables in the model. In the Table 4.9, the model shows strong fit with a pseudo-R-Square level that indicates more than 74 per cent of the variation of the dependent variable Goodwill impairment are explained by the categorized factors.

Table 4.9 Logistic Regression Analysis – Acquisition success (goodwill impairment)

	Estimate	**p-value**
(Intercept)	-19.944	0.002 **
Choice of Strategic Partner	3.764	0.017 *
Business Capabilities and HR Knowledge	2.858	0.017 *
Financial Factors & Acquisition Premium	-1.022	0.275
Macro-Factors & Business Environment	0.248	0.829
Pseudo-Adjusted R-Square: 0.744; F-Statistic: N/A		

Source: Calculations made by the author (2015) on the basis of the test group (n=51)

In terms of the hypotheses, H1 and H2 are confirmed. H3 cannot be confirmed – on the contrary, the result shows a negative relationship between the pre-acquisition investigation and a not-impaired goodwill value of a cross-border acquisition. H4 does not have any impact and remains in this regression analysis without impact in the acquisition process.

In the next step, the dependent variable was changed to "Disposal of the acquired firm". Table 4.10 depicts the relationship of critical factors of the pre-acquisition due diligence.

Table 4.10 Logistic regression analysis - Acquisition Success (disposal criteria)

	Estimate	**p-value**
(Intercept)	-3.113	0.26
Choice of Strategic Partner	0.434	0.533
Business Capabilities and HR Knowledge	0.705	0.269
Financial Factors & Acquisition Premium	0.084	0.888
Macro-Factors & Business Environment	-0.257	0.691
Pseudo-Adjusted R-Square: 0.11; F-Statistic: N/A		

Source: Calculations made by the author (2015) on the basis of the test group (n=85)

The logistic multivariate regression analysis with the dependent variable "Disposal of the acquired firm" has a weak adjusted pseudo R-Square, indicating that the suitability of the model for purposes of establishing the link between the explanatory variables and the dependent variable is not given. There was no relationship between the “Disposal of acquired firm” and the pre-acquisition due diligence, indicating that such disposal does not automatically mean failed acquisition. In univariate regression analysis, the results were similar. Consequently, the results where the acquisition success is evaluated by the criteria “Disposal of acquired firm” do not support the regressed critical factors with primary data.

Table 4.11 Logistic univariate regression analysis – Acquisition success based on the criteria of acquired firm goodwill impairment

Hypothesis 1	**Estimate Coefficient**	**p-value**
(Intercept)	-15.508	0.000
Choice of Strategic Partner	4.804	0.000
Pseudo-Adjusted R-Square: 0.6243; F-Statistic: N/A		
Hypothesis 2	**Estimate Coefficient**	**p-value**
(Intercept)	-11.576	0.149
Business Capabilities and HR Knowledge	3.353	0.01
Pseudo-Adjusted R-Square: 0.6109; F-Statistic: N/A		
Hypothesis 3	**Estimate Coefficient**	**p-value**
(Intercept)	-2.548	0.000
Financial Factors & Acquisitions Premium	1.132	0.000
Pseudo-Adjusted R-Square: 0.1183; F-Statistic: N/A		
Hypothesis 4	**Estimate Coefficient**	**p-value**
(Intercept)	-3.832	0.042
Macro-Factors & Business Environment	1.624	0.018
Pseudo-Adjusted R-Square: 0.1872; F-Statistic: N/A		

Source: Calculations made by the author on the basis of the test group (n=51)

The univariate regression analysis clearly supports the proposition results from the latter tests, while confirming the relationship between the three critical factors and the acquisition success measured by the goodwill impairment. The coefficient estimates show stronger values.

The first three critical factors: “Choice of Strategic Partner”, “Business Capabilities and HR Knowledge”, “Financial Factors and Acquisition Premium” have strong estimate coefficients. They possess predictive capacity as the critical factors of due diligence. They also indicate statistically significant relationship between the critical factors and the acquisition success (significance = 0.001). When considering the coefficient estimates, the strongest predictive impact, “Choice of Strategic Partner” and “Business Capabilities HR Knowledge” have whereby increasing this factor would lead to enhanced acquisition success. The estimate coefficients of the critical factors explain the variation of the acquisition success variable very good.

The F-Statistics show values above the cut-off value (confidence level 0.999) in all four regressions. It can be supposed that the model as a whole predicts the dependent variable.

The R-squared statistics range from 0.1183 to 0.6243. This demonstrates that models have reliable capacity to explain the variation of the dependent variable.

Especially the critical factors "Business Capabilities and HR Knowledge" have very strong predictive powers, as this variable accounts for nearly a half of the variation in acquisition success. In conclusion, there is support for H1, H2 and H3.

The regression analysis using the secondary derived data supports the results from previous models with primary data. The critical factors are "Business Capabilities and HR Knowledge", "Financial Factors" and the "Choice of Strategic Partner" were determined.
The last step in the in the research was the qualitative assessment by the automotive experts. Following the idea of triangulation (Olsen 2004), research results were presented to experts from the automotive industry. In front of the interview, participants were provided with research results. However, the participants did not know, that this are the final results of the study. The study included 85 survey participants from German automotive firms, all with cross-border acquisition experience in the European automotive market.

Based on the previous research results, following propositions are formulated:
The main results show that,

1. there is a need to make a broad due diligence in the pre-acquisition phase, when acquiring a company beyond the domestic borders,
2. the main critical factor of the pre-acquisition due diligence is the "Business Capabilities and HR Knowledge", basically consisting of technological competence, workforce capabilities and the management competency,
3. the second most important critical factor of the pre-acquisition due diligence is the "Financial Factors and Acquisition Premium", basically consisting of proper quantitative evaluation in order to avoid potential overpayment (reflected in the acquisition premium),
4. the third most important critical factor "Choice of Strategic Partner", basically consisting of strategic and organizational culture fit, and
5. the factor "Macro-economic and Business Environment" is not necessarily a critical factor for pre-acquisition due diligence.

The interview survey participants mostly agreed to the theses with exception of two participants, who rather include the Macro-Factors and Business Environment investigations when doing cross-border acquisition due diligence. Hence, this supports confidence with research result and avoids bias with different methods, which can lead to the same result. This results are useful for confirmatory and completeness purpose of the previous quantitative research, as the content of critical factors in pre-acquisition due diligence, as they independently reflect the experience of the cross-border acquirers. Additionally, the confirmatory approach overcomes the challenge related to single–method bias.

Table 4.12 Summary of the research results with included qualitative assessment of the research results

	Hypotheses	Joint and Individual Effects Approach (multiple regression)	Individual Approach (secondary data)	Qualitative assessment of the research results
H1	The positive relationship is supposed between the extent of the pre-acquisition due diligence factors strategic fit and organizational culture fit and the cross border acquisition success.	Confirmed	Confirmed	Managers support the proposition
H2	The positive relationship is supposed between the extent of the pre-acquisition due diligence factors business capabilities, technological competence and workforce capabilities and human resources and the cross border acquisition success.	Confirmed	Confirmed	Managers strongly support the proposition
H3	Positive relationship is supposed between pre-acquisition due diligence critical factors Cash-flow generation, debt servicing capability, the fixed assets evaluation and the future in-vestment and financing need of the acquired firm, and the cross-border acquisition success.	Confirmed	Confirmed	Managers strongly support the proposition
H4	The positive relationship is supposed between the extent of the pre-acquisition due diligence factors macro-factors and business environment and the cross border acquisition success.	Rejected	Rejected	Managers partly disagree with the rejection, indicating the critical factor is useful in the pre-acquisition due diligence.

Source: Author's summary based on research results (regression analysis, qualitative research)

Table 4.12 summarizes the results of the qualitative assessment of the research results. It shows high consistency and confirms the research findings. Hence, the high consistency of the methods used supports confidence in the overall findings.

4.3 Discussion of the major findings

The research results show stronger relationships, on both, the individual or on joint-effects levels, than comparable studies regarding cross-border acquisition success:

- Ahammad & Glaister (2013): adjusted R-square 0.34 (p-value<0.01) indicating there is solid explanatory capacity of the pre-acquisition evaluation and the transaction success in cross-border acquisitions.
- Zollo & Meier (2008, p. 70): R-square 0.32 (p-value<0.01), indicating a positive relationship between integration process performance and the overall acquisition success,
- Hayward (2002): adjusted R-square 0.462 (p-value<0.01), indicating a positive relationship between the announcement of the acquisition (pre-acquisition phase) and the positive stock price reaction,
- Zhang (2013): adjusted R-square 0.42, indicating the positive relationship between cost leader strategy and changes in the vertical integration level in the post-acquisition phase, supporting the synergy levels proposition adjusted R-square 0.413 (p-value<0.01).
- Zhu et al. (2013, p. 301): adjusted R-square 0.27 (p-value<0.01) indicating a positive relationship of tender offers premiums and cross-border acquisition success.

Compared to previous academic results, this research has stronger model capability and offers higher explanatory capacity of the critical factors of the pre-acquisition due diligence. The reason here may be the homogenous sample. Other studies possibly experience industry bias through including firms from e.g. servicing industry.

The last step in the research confirmed the research results by including six survey participants, who were asked based on research results, to comment propositions. The feedback clearly confirmed the researched results, so that practical usefulness of the study is fully given. In the automotive industry, there is an obvious need for detailed and specific pre-acquisition due diligence, including the researched critical factors.

The overall objective of the dissertation was to theoretically derive, develop and empirically confirm a comprehensive research framework that bridges the critical factors of due diligence and promotes a full understanding of the impact of due diligence in pre-acquisition phase on the acquisition success.

The first step towards this objective was the development of a comprehensive overview of critical factors derived from a review of literature and practical studies (consulting surveys) on the scope of due diligence in acquisitions in the European automotive industry. This basis served as a framework to yield the critical factors of due diligence in the pre-acquisition phase and address the problem of fragmented acquisition success factors in other studies on acquisition performance. After establishing the comprehensive framework, the proposed model was empirically tested. The research design was described by defining the research setting, data collection method, the sample frame, the sample informants, the unit analysis and the credibility of the data. The cross-sectional survey was performed using sample in the automotive industry, where the German automotive industry firms acquire in the same sector in the European region. The number of survey participants was 85, each of the participants included data on one single cross-border acquisition in the European automotive industry. According to the sample, this represents around 38 per cent of the full population's volume of acquisitions in the European automotive industry. There was no non-response bias in the present research, as the participation was ensured prior to sending the survey participation link. The reliability of the survey instrument was supplemented by pre-testing the questionnaire with experts from the automotive industry, acquisition advisory and academic researchers with research projects on the subject of acquisition. The reliability of the retrieved data was tested and resulted in strong reliability with a Cronbach's Alpha of greater than 0.8 for all categories in the research. Content validity of the survey instrument was ensured by a detailed review of the literature, empirical findings and pre-testing with experts from academic and entrepreneurial areas. The univariate and multiple regression analysis was then used to test the derived hypotheses and individual factors with respect to the model reliability and predictive ability of the evaluated critical factors in the pre-acquisition due diligence. Having finished the empirical tests with primary data, the preliminary research results were tested by inclusion of secondary data. Using logistic multivariate regression analysis, the acquisition success measurement was based on goodwill impairment and disposal of the acquired firm. The empirical research was completed by inclusion of qualitative data assessment, where experts from the automotive industry received propositions based on research results for comment.

Next, the hypotheses and the influence of the individual critical factors are discussed according to their rejection or acceptance and put into context with current state of academic research concerning the success and failure factors of cross-border acquisitions. Table 4.13 summarizes the gained results. The starred predictive capacity is related to the significance level from 0.9 * (weak predictive capacity), 0.95 ** (good predictive capacity) and *** 0.99 (very good predictive capacity).

Table 4.13 Evaluated Factors and the Hypotheses

Hypotheses	Critical Factors – Individual	Predictive Capability
H1. Choice of Strategic Partner	1.1 Strategic Fit	*
	1.2 Organizational Culture Fit	n.s.
	Critical Factors – Individual	**Predictive Capability**
H2. Business Capabilities Knowledge Management	2.1 Business Capabilities	**
	2.2 Technological Competence	**
	2.3 Management Competence	n.s
	2.4 Workforce/HR Knowledge	**
	Critical Factors – Individual	**Predictive Capability**
H3. Financial Factors and Acquisition Premium	3.1 Cash flow generation and debt servicing capacity	***
	3.2 Fixed assets value	n.s.
	3.3 Future financing and investment needs	***
	Critical Factors - Individual	**Predictive Capability**
H4. Macro-Factors and Business Environment	4.1 Legal & Tax Issues	n.s.
	4.2 Macro-Factors and Business Environment	*
	4.3 Corporate Governance	n.s.

*** acceptable predictive capability ** good predictive capability *** high predictive capability**

Source: Author's summary based on results from regression analysis

The "Choice of Strategic Partner" integrates the most relevant indicators from an academic perspective: the acquisition performance derived from the strategic and organizational management view. In line with prior research (e.g. Gomes et al. 2013; McDonald et al. 2005 etc.) pre-acquisition investigation of strategic relatedness (e.g. market position), especially influences on the synergy effects level. Hence, this common significant factor in academic research also applies to acquisitions in the European automotive industry.

Morosini et al. (1998) tested using firm and industry level variables the relationship between national cultural distance and cross-border acquisition performance. The clear finding was the necessity of including organizational culture fit into cross-border acquisition decision-making. The acquisitions where there was a high cohesiveness of organizational culture fit was given, show potential to enhance the combined firm's performance over time. Gomes et al. (2013) state in their research that proves of the identification of the organizational culture fit and the overall acquisition outcome is positive. However, newer research, Ahammad et al. (2015) found that differences on organizational culture level encourage firms to transfer knowledge-based resources in the combined firm. The problem stems from overemphasizing what in the pre-acquisition stage and its relation to the post-acquisition stage. Hence, the statistical non-significance of this indicator variable points to less attention in terms of pre-acquisition due diligence.

The second derived hypothesis was formulated to integrate the most relevant factors of acquisition success as derived from the Business Capabilities and HR Knowledge. The individual components were operational business capabilities, technological competence and workforce capabilities and human resources. The skills of business and technological capabilities of the workforce, the crucial elements for the realization of operational synergistic value in the value chain of automotive industry, stay clearly in focus. An acquiring firm needs qualified evaluating experts in order to prove the suitability of the target firm's resources. Laabs & Schiereck (2010, p. 86) showed that lack of experience in evaluating such skills negatively impacts long term acquisition success, confirming the critical characteristics of this factor. The researcher measured the long-term success of acquisitions in the automotive supply industry and corresponding evaluation thorough capital markets in the time-period 1981 and 2007. Interestingly, the results show only experienced acquirers were able to achieve efficiency gains and economies of scale.

The importance of employee capabilities and business capabilities, as critical factors contributing to the success of acquisitions, the findings of the prior research have been confirmed (e.g. Shimizu et al. 2004; Perry & Hard 2004; Harding & Rouse 2007; Krug 2009 etc.). Especially the high significance of human resources factors supports prior research findings in that firms acquiring innovation capabilities are keen to identify intellectual capital and knowledge (Lemieux & Banks 2007, p. 1413). The critical factor concerned the management competence has been proven non-significant, which is partially contrary to prior research suggesting an important management role in the post integration phase (Kissin & Herrera 1990; Pery & Herd 2004, p. 18). Newer research supports focussing more on Business Capabilities than on capabilities on the management level (e.g. Lemieux & Banks 2007, p. 1413; Rossi et al. 2013, p. 72), which is inline with present research results on the cross-border acquisitions in the automotive industry.

The third hypothesis was formulated to integrate the most relevant determinants of acquisition success from the financial field, more exactly cash-flow generation and debt servicing capability, the fixed assets evaluation and the future investment and financing need of the acquired firm. The assessment of cash-flow generation capability, future investment needs in new technologies, and the growth of the acquired firm are shown to be critical factors for the pre-acquisition due diligence. In line with the academic and practical research, the findings strongly point out the problem of valuation of the target firm by systematic evaluation of tangible and intangible assets in the balance sheet and the income statement. The cash flow builds the basis for evaluation methods and the more exact the estimate value is, the more precise the acquisition price can be calculated. The results from the automotive industry mostly agree with academic research (e.g. Hitt et al. 2009; Epstein 2005) which indicate importance of fair acquisition price where synergy and financial effects value build the critical factors in due diligence. Future financing needs in the pre-acquisition due diligence have had strong predictive impact on the acquisition success implying acquirer's predictive capacity in becoming productive firm combination.

The acquisitions premium needs to be amortized in justifiable time period and the expected future investments prolong the timeframe to create value, which mostly depends on successful post-integration results (Kim et al. 2011, p. 27; Hitt et al. 2009, Perry & Hard 2004). Hence, the research findings support previous scholars where the estimated synergy and financial value influences the acquisition premium, making it a critical factor of the due diligence.

Finally, the fourth derived hypothesis was formulated to integrate the most relevant determinants of acquisition field from the perspective of macro factors and the overall business, including the tax and legal aspects, business environment, and corporate governance aspects, as critical factors of pre-acquisition due diligence. As the research results showed, acquirers from the automotive industry do not consider Legal & Tax and Corporate Governance issues as critical factors for successful acquisition in the European automotive industry. Low significance is given to the individual evaluation of Macro-Factors and Political Risk showing acceptable impact. This supports the prior research findings (e.g. Feito-Ruiz & Menéndez-Requejo 2011, p. 185; Graham et al. 2008, p. 62). Also the recent suggestions of the scholars (Zhu et al 2013, p. 289) about examining institutional characteristics (e.g. political interventions, institutional frameworks, currency policy etc.) are supported. The factor Corporate Governance (e.g. Corruption and Bribery issues) has no influence, despite recent research findings that unethical behaviour negatively impacts cross-border acquisitions (Malhotra et al. 2010; Knecht & Calenbuhr 2007, p. 427; Rossi & Volpin 2004).

The rejection of the proposition may be accounted to similarity of the jurisdictions, where the acquisition target is headquartered. The sample considered acquisitions that took place within the European countries. Taking into account the studies the context of Corporate Governance and Business Environment from the perspective of acquirer from emerging countries and their acquisition in developed countries, neglecting them is wrong. Aybar & Ficici's (2009) and Bhagat et al.'s (2011, p. 262) key findings demonstrate positive effects between enhanced corporate governance and acquiring firm's value.

In sum, based on the research results, Macro-Factors and Business Environment has a subordinated role in cross-border acquisitions of German firms in the European automotive industry.

Summarized, three derived hypotheses and eight individual critical factors indicated positive and in some cases even significant to strongly significant effects on acquisition success, confirming, and the hypothesis of expanding the due diligence by these critical factors. Consequently, expanded due diligence in the pre-acquisition phase of a cross-border acquisition positively influences the acquisition success.

The results of the model using Goodwill Impairment as the dependent variable confirmed H1, H2 and H3. The model using Disposal of the acquired firms did not show any relationship. This conforms to Schoenberg's findings (2004), which pointed out that divestment may also signal profitable sale or successful restructuring measures in response to corporate strategy. The importance of several evaluated critical factors is proven, especially indicating two category levels that can pave the way for acquisition success: Business Capabilities and Knowledge Management and Financial Factors and Acquisition Premium and Choice of Strategic Partner. They are critical factors of the pre-acquisition due diligence. From the perspective of the acquirer itself, this finding matches with the indicated strongest acquisition success factor named: due diligence extent (Figure 3.2). Based on the above results, the necessity of pre-acquisition due diligence in cross-border acquisition can be asserted. Beyond the derived hypotheses, it can be deducted that successful acquisition requires comprehensive due diligence, which considers critical factors.

Table 4.14 Comprehended overview of hypotheses based on research results

Hypotheses		**Predictive Capability**
	Due diligence in the pre-acquisition phase	
H1.	Choice of Strategic Partner	**
H2.	Business Capabilities and Knowledge Management	***
H3.	Financial Factors and Acquisition Premium	***
H4.	Macroeconomic Factors and Business Environment	rejected
*** acceptable predictive capability ** good predictive capability *** high predictive capability**		

Source: Author's summary based on research results

As the research results show, acquirer needs consistent and scalable process for assessing typical risks and opportunities in the cross-border markets. The findings provide reasonable support for the underlying exploratory learning theory, that acquiring target specific knowledge helps balancing information asymmetry. The suggestion is clear: the more information the acquiring firm obtains and the more she learns about the target. The learning occurs through assessment of critical factors in pre-acquisition due diligence the better will be cross-border acquisition.

Extension of the due diligence critical factors beyond traditional due diligence elements means the move to the next level of performing due diligence. In other words, the results of the quantitative analysis suggest that due diligence factors require more an enhancing than replacing traditional due diligence activities. From the author’s perspective, the due diligence will become longer but also more forward-looking and more post-merger oriented. However, each acquisition has its own “personality” and thus, the applicability of the expanded due diligence process may vary from situation to situation.

Conclusions and Suggestions and Managerial Implications

I. Conclusions and Suggestions

In the past decades, mergers and acquisitions have been intensively researched through the lenses of strategic management, corporate finance, behavioural finance etc. Despite the intense effort, the made progress is little as the high failure of acquisitions outcomes demonstrate.

- A comprehensive theoretical literature review in the field of acquisition risk and critical factors – both success and failure reasons – identified the need for a new approach to the pre-acquisition due diligence.

- Moreover, numerous research studies of mergers and acquisitions is fragmented and only partly informed each other. The fragmented research lacks unifying theories that approach the whole acquisition process on the one hand, and in-depth research (e.g. due diligence critical factors) on the other. The topic of this dissertation established a vital link between research and practice, mainly by deeply exploring the critical factors of due diligence in the pre-acquisition phase.

- The thesis' theoretical framework, paired with practical insight, led to twelve specific critical factors of due diligence. Initially, they are categorized into: "Choice of Strategic Partner", "Business Capabilities and HR Knowledge", "Financial Factors" and "Macroeconomic Factors and Business Environment". The model delineates these twelve critical factors, based on their implications for pre-acquisition due diligence in cross-border acquisition.

- The results of the tested model indicate "Business Capabilities and HR Knowledge", "Financial Factors and Acquisition Premium" and "Choice of Strategic Partner" are critical factors of pre-acquisition due diligence. They possess predictive capability for successful acquisition when incorporated in due diligence. The crucial finding of the research is the assessment of synergy effects through including specific critical factors. Business Capabilities and knowledge transfer are the main asset in the achievement of operational synergy values. "Financial Factors" strongly impact acquisition success in the achievement of financial synergy effects.

- With regard to the German automotive industry, the focus on synergy value acquisition shows that automotive firms tend to expand the value chain and gain more control over technology development and other capabilities. The strategic focus of the German automotive firms is to capture capable contributors in the manufacturing chain and increase the technological knowledge of the overall firm.

- The experienced acquirers examine critical factors in the pre-acquisition phase. However, because of the nature of the automotive industry, "Macro-Factors and Business Environment" (e.g. tax and legal obstacles etc.) did not show significant relationship with cross-border acquisition success.

- Goodwill impairment (retrieved from the financial statements) was used as the dependent variable and supported the research results with acquisition success (composite variable from primary data). The results pointed to a positive relationship between Goodwill impairment and the critical factors of pre-acquisition due diligence. Very strong relationships were seen with "Choice of Strategic Partner" and "Business Capabilities and HR Knowledge".

- The research results were presented to managers with acquisition experience in the automotive industry. The industry experts have confirmed the findings of this research work.

- The research provides the link between two theories: organizational exploratory learning and information asymmetry. The acquirer evaluates and offers an acquisition price on the basis of existing knowledge (information asymmetry), gained through various information search processes in the pre-acquisition phase (exploratory learning). On practical basis, it has been proven that by means of a comprehensive due diligence in the pre-acquisition phase, successful acquisition is more probable than without.

- Solely focussing on financial, legal and tax issues, according to the traditional due diligence view, is too narrow and can lead to acquisition failure. Thus, it can be suggested to investigate the target firm with comprehensive pre-acquisition due diligence. The change from the traditional methods of performing due diligence to a broader approach includes evaluation of critical factors business capabilities, technological competence and human resources' knowledge, strategic relatedness, and cash flow oriented parameters.

- The acquirers need to develop a due diligence process that is guided by specific critical success criteria, e.g. technological competence i.e. technical capability of the workforce of the target firm.

- “Macro-factors and Business Environment” is not necessarily a critical factor for the European automotive industry. However, based on research that states corporate governance aspects, the acquiring firms are recommended to put excessive efforts into it in the pre-acquisition phase. Namely, research results that take comprehensive look from the perspective of acquirer from emerging countries and their acquisition in developed countries, show positive relationship between value creating acquisitions and corporate governance aspects in the developed countries.

- The results of the due diligence must be a part in the determination of an achievable synergy amount. The due diligence and the synergy assessment findings should build the basis of a fair bidding price for the acquirer.

II. Managerial Implications

- The contributed empirically proven model delineates critical factors of the pre-acquisition analysis of acquisition candidates. These critical factors need to be incorporated in the strategic planning of automotive firms that wish to engage in cross-border acquisitions in the automotive market.

- The most important asset of cross-border acquisition is business capabilities and human resources’ knowledge transfer. They lead to achievement of operational synergy values in the post-acquisition phase. Hence, their inclusion in the decision-making process would be of crucial importance.

- The second most important critical factors are financial factors, more concretely the acquired firm’s future cash flow projections. Decision-makers must devise evaluation parameters that evaluate these aspects in order to determine a fair acquisition price. The financial issues include cash-flow generation ability, future investment and financing needs, and debt servicing capacity.

- Finally, in order to maintain long term competitiveness, management is responsible for development of acquiring skills, i.e. selecting, evaluating, doing due diligence and integrating acquisitions etc. The determination of appropriate acquisition premium and the strategic suitability largely depends on acquirer's skills, expertise and experience from prior acquisitions.

III. Future Research implications

Regarding future academic research on this theme, researcher could use multiple simultaneous ways of measuring both, the theoretical and empirical natures of acquisition performance problems. Future research could work on current fragmentation of the topic, especially in the form of different critical success factors in cross-border acquisitions. Various perspectives have to be taken in mind to the multidisciplinary nature of the mergers and acquisitions research. The focus could be laid on improved comprehension of the effects essential to acquisition performance. The future research could examine the possibility of quantification of the critical factors, risk indicators or even new perspectives establishing their importance regarding acquisition performance, also beyond the specific automotive industry indicators.

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Appendix

A Survey Questions

QUESTIONNAIRE FOR GERMAN ACQUIRING COMPANY

This survey is confidential and the findings will be published only as aggregate summaries in which no individual's answers can be identified. Each questionnaire is coded and the list of codes and corresponding company names is accessible only to the surveyor. When you return your completed questionnaire your company will be removed from the code list and you will not be contacted again.

A. BACKGROUND INFORMATION

A1. Position of the respondent (Job Title): ………………………………………………………………..

A2. What was the nationality of the foreign acquired company? Nationality:……………………...

A3. When was the acquisition completed, which you were referring to in this survey? Month: ……..……………. **Year**: ………………..…….

A4. Please give the number of acquisitions made by your company 2006 - 2013:

a) in cross-border markets ………………… b) in domestic markets …………………

A5. Do you engage professional consultant in order to receive more broadly results in the due diligence phase?

A6. What kind of due diligence do you usually perform in the cross-border acquisitions:

a) Financial …………………

b) Legal & Tax …………………

c) Commercial/Marketing …………………

d) Organizational Culture …………………

e) Strategic …………………

f) Operational …………………

g) Other, please specify …………………

B. THE ACQUISITION

In this section the focus is general information on the overall context of the acquisition.

B1. Please indicate the attitude of the acquired firm's board towards the acquisition, at the time of the purchase negotiations. *Please circle the appropriate number on the scale below.*

No Resistance To Being Acquired (Willing seller)		Some Resistance To Being Acquired		Major Resistance To Being Acquired (Unwilling Seller)
1	2	3	4	5

B2. Were any other companies actively interested in purchasing the acquired firm at the time of your bid?

Please tick.

No [ ]

Yes [ ]

C. MOTIVES FOR INTERNATIONAL ACQUISITION

1. How important were the following strategic motives for the international acquisition? *Please circle your answer.*

		No importance				Very important
a.	To enable faster entry to market	1	2	3	4	5
b.	To facilitate international expansion	1	2	3	4	5
c.	To enable presence in new markets	1	2	3	4	5
d.	Enable the overcoming of regulatory restrictions	1	2	3	4	5
e.	Increase market share	1	2	3	4	5
f.	Increase market power	1	2	3	4	5
g.	Gain efficiency through synergies	1	2	3	4	5
h.	Gain strategic assets	1	2	3	4	5
i.	Gain new capabilities	1	2	3	4	5
j.	Obtain economies of large scale production	1	2	3	4	5
k.	Obtain non-manufacturing scale economies	1	2	3	4	5
l.	Enable product diversification	1	2	3	4	5
m.	Acquire complementary resources	1	2	3	4	5
n.	Redeploy assets to the acquisition	1	2	3	4	5
o.	Tax reasons (savings)	1	2	3	4	5
p.	Replace inefficient management of acquired firm	1	2	3	4	5
q.	Elimination or reduction of competition	1	2	3	4	5
r.	Turn around failing acquired firm	1	2	3	4	5
s.	Cost reduction	1	2	3	4	5
t.	To reduce risk of the business	1	2	3	4	5
u.	Other (Please specify)………………………........	1	2	3	4	5

D. PRE – ACQUISITION PHASE

1. Please indicate the extent to which your company evaluated the following factors relating to the acquired firm.

Please circle your answer.

		Very little evaluation				Very thorough evaluation
a)	The strategic relatedness between your company and the acquired firm	1	2	3	4	5
b)	The degree of cultural relatedness between your company and the acquired firm	1	2	3	4	5
c)	The degree of organizational relatedness between your company and the acquired firm	1	2	3	4	5
d)	The acquired firm's market position	1	2	3	4	5
e)	The acquired firm's technological competence	1	2	3	4	5
f)	The acquired firm's business competence	1	2	3	4	5
g)	The acquired firm's management capability	1	2	3	4	5
h)	The capability of the acquired firm's workforce	1	2	3	4	5
i)	The effectiveness of the acquired firm's HRM policies	1	2	3	4	5
j)	The degree of the acquired firm's cash flow generating capability	1	2	3	4	5
k)	The acquired firm's fixed asset value	1	2	3	4	5
l)	The future financing needs of the acquired firm	1	2	3	4	5
m)	The future investment needs of the acquired firm	1	2	3	4	5
n)	The extent of the debt of the acquired firm	1	2	3	4	5
o)	The future interest payments of the acquired firm	1	2	3	4	5
p)	The degree of compatibility of the IT systems of both firms	1	2	3	4	5
q)	The differences in the legal system between the Germany and the acquired firm's home nation	1	2	3	4	5
r)	The degree adaption to international Corporate Governance guidelines (e.g. addressing ethical issues as bribery, corruption etc.) of the acquired firm's home nation	1	2	3	4	5

2. Please indicate how different the acquired firm was to your firm, in the following areas, <u>before the acquisition</u>.

Please circle your answer.

		Very similar				Very different
a)	General management styles	1	2	3	4	5
b)	Values, beliefs and philosophies	1	2	3	4	5
c)	Reward and evaluation systems	1	2	3	4	5
d)	Types of distribution channels	1	2	3	4	5
e)	Culture of home countries	1	2	3	4	5
f)	Types of customers	1	2	3	4	5
g)	Major products/services offered	1	2	3	4	5
h)	Production and operations technologies	1	2	3	4	5
i)	Approach to risk taking	1	2	3	4	5
j)	Geographic markets served	1	2	3	4	5

3. In your view how important are the following factors in leading to a <u>successful acquisition deal</u>.

Please circle your answer.

		No importance			Very important	
a)	Determining the appropriate price to be paid for the acquired firm	1	2	3	4	5
b)	Accurately forecasting the acquired firm's cash flows	1	2	3	4	5
c)	Identifying anticipated synergies between your firm and the acquired firm	1	2	3	4	5
d)	Avoiding hostile takeover	1	2	3	4	5
e)	Deciding appropriate method of payment (e.g., cash or stock)	1	2	3	4	5
f)	Conducting effective due diligence	1	2	3	4	5
g)	Negotiating effectively with the acquired firm	1	2	3	4	5
h)	Obtaining advice from external advisors (e.g., investment bank)	1	2	3	4	5
i)	Anticipating reaction of the major shareholders of the acquired firm	1	2	3	4	5
j)	Broad involvement throughout of the acquired firm's key personnel in the negotiation of the acquisition	1	2	3	4	5
k)	Others (please specify)...................................	1	2	3	4	5

4. **Please indicate the extent to which you experienced the following <u>problems</u> in the <u>pre-acquisition phase</u>?**

Please circle your answer.

		No problem				Major problem
a)	Identifying acceptable firm	1	2	3	4	5
b)	Collecting information about the acquired firm	1	2	3	4	5
c)	Ensuring reliability of the information collected	1	2	3	4	5
d)	Effectively structuring a deal	1	2	3	4	5
e)	Assembling teams to conduct the acquisition process	1	2	3	4	5
f)	Understanding different cultures	1	2	3	4	5
g)	Understanding different management styles	1	2	3	4	5
h)	Understanding acquired firm's legal systems	1	2	3	4	5
i)	Understanding acquired firm's tax systems	1	2	3	4	5
j)	Understanding local environmental regulations	1	2	3	4	5
k)	Understanding currency control regulations	1	2	3	4	5
l)	Dealing with a different accounting systems	1	2	3	4	5
m)	Asset Evaluation	1	2	3	4	5
n)	Estimation of future investment needs	1	2	3	4	5
o)	Determination of the acquisition price	1	2	3	4	5
p)	Negotiating with the acquired firm	1	2	3	4	5
q)	Determination of the technological competence	1	2	3	4	5
r)	Increased personal pressure to conclude the deal	1	2	3	4	5
s)	Maintaining the confidentiality of the negotiation	1	2	3	4	5
t)	Others (please specify)...................................	1	2	3	4	5

5. **<u>At the time of the acquisition</u>, please indicate how important it was for your firm to <u>retain employees of the acquired firm</u> in the following categories?** *Please circle your answer.*

		Not important				Extremely important
a)	Top management	1	2	3	4	5
b)	Middle management	1	2	3	4	5

c)	Research and development	1	2	3	4	5
d)	Manufacturing and operations	1	2	3	4	5
e)	Marketing, sales and distribution	1	2	3	4	5
f)	Finance, legal and other staff	1	2	3	4	5

6. For each of the factors given below please indicate the extent to which the following were successful in overcoming the pre-acquisition problems. *Please circle your answer, if not applicable please use N/A.*

			Very Successful				Not Successful
a)	Employment of advisors from acquired firm's country in providing reliable information	N/A	1	2	3	4	5
b)	Integration of external advisor with internal acquisition team	N/A	1	2	3	4	5
c)	Assembling the right team for the pre-acquisition phase	N/A	1	2	3	4	5
d)	Relying upon the acquired firm's management while entering a new country	N/A	1	2	3	4	5
e)	Creating a specific foreign country Merger & Acquisition group	N/A	1	2	3	4	5
f)	Conducting thorough due diligence	N/A	1	2	3	4	5
g)	Negotiating earn-out provisions with seller (i.e., tie the price to future performance)	N/A	1	2	3	4	5
h)	Others (please specify).....................	N/A	1	2	3	4	5

E. THE POST – ACQUISITION PHASE

1. In your view how important are the following factors in leading to successful post-acquisition integration?

Please circle your answer.

		Not important				Very important
a)	Establishing a post-acquisition strategy early in the process	1	2	3	4	5
b)	Injecting new management people into the acquired firm immediately	1	2	3	4	5
c)	Providing sufficient resources for post-acquisition integration	1	2	3	4	5
d)	Identifying the value drivers of the acquisition and focus on these	1	2	3	4	5
e)	Identifying and retaining key employees and managers of the acquired firm	1	2	3	4	5
f)	Dealing with the people you are not retaining firmly, fairly and quickly	1	2	3	4	5
g)	Managing acquired firm’s employee resistance	1	2	3	4	5
h)	Establishing new performance appraisal programmes	1	2	3	4	5
i)	Establishing new training and development programmes	1	2	3	4	5
j)	Moving rapidly as planned	1	2	3	4	5
k)	Establishing a sense of unity between the two firms	1	2	3	4	5
l)	Organizing cultural awareness workshops	1	2	3	4	5
m)	Assimilating the acquirer’s cultural systems (i.e., values, norms) into the acquired firm’s culture	1	2	3	4	5
n)	Forming an integration team consisting of managers from the acquiring and acquired firms	1	2	3	4	5
o)	Developing a formal integration plan by top management teams of both companies	1	2	3	4	5
p)	Fostering involvement of acquired company employees during the integration process	1	2	3	4	5
q)	Establishing an effective communication strategy to keep the acquired employees well informed	1	2	3	4	5
r)	Others (Please specify)……………………………..	1	2	3	4	5

2. To what extent did your company face the following problems during the integration stage?

Please circle your answer.

		No problem				Major problem
a)	Acquired firm employees' resistance to change	1	2	3	4	5
b)	Pressure to address too many issues at the same time	1	2	3	4	5
c)	Unrealistic assessment of business turnaround	1	2	3	4	5
d)	Lack of available management for new enterprise	1	2	3	4	5
e)	Conflict of expectations with the acquired firm's management	1	2	3	4	5
f)	Ambiguity of power/authority in the acquired firm	1	2	3	4	5
g)	Relative dominance of one firm	1	2	3	4	5
h)	Dealing with poor quality of acquired firm's management	1	2	3	4	5
i)	Managing cultural differences between the firms	1	2	3	4	5
j)	Combining different organizational structures	1	2	3	4	5
k)	Controlling future expenditures of the acquired firm	1	2	3	4	5
l)	Dealing with unions of the acquired firm	1	2	3	4	5
m)	Difficulties in implementing sophisticated procedures and techniques	1	2	3	4	5
n)	Difficulties in integration planning and execution	1	2	3	4	5
o)	Others (please specify)…………………….	1	2	3	4	5

3. What was the extent of your firm's acquisition experience at the time of this acquisition?

No experience				Great experience
1	2	3	4	5
1	2	3	4	5

4. Please indicate the extent to which the following <u>incentives</u> were offered <u>to encourage</u> employees of the acquired firm to stay with the company. *Please circle your answer.*

		No extent				Great extent
a)	Short-run incentives (e.g. a large bonus payable after the expiration of a certain period of time)	1	2	3	4	5
b)	Long-term contracts	1	2	3	4	5
c)	Stock options	1	2	3	4	5
d)	Performance bonuses	1	2	3	4	5

7. Are any of the following <u>positions</u> (or their equivalent) held by <u>people from your company</u> in the acquired firm (i.e. appointed by the acquiring company from among acquiring company staff <u>or</u> from new staff appointed by the acquiring company)? *Please tick.*

		Yes	No
1.	CEO	[ ]	[ ]
2.	Finance director	[ ]	[ ]
3.	Operations director	[ ]	[ ]
4.	Sales and marketing director	[ ]	[ ]
5.	R&D director	[ ]	[ ]
6.	HRM	[ ]	[ ]
7.	Other reporting directly to the CEO (Please specify) ………………………	[ ]	[ ]

8. **<u>Transfer of skills:</u> For each of the activities given below please indicate the extent to which benefits based on <u>transferring skills</u> have been:**

   (i) **Actively sought** since the time of acquisition (by circling to the appropriate number on the left hand scale)

   (ii) **Actually achieved** as of now (by circling the appropriate number on the right hand scale)

   (The direction of skills transfer may be either from your company to the acquired firm or vice-versa)

<u>ACTIVELY SOUGHT</u>						**<u>ACTUALLY ACHIEVED</u>**				
No Skills Transfer		**Some Skills Transfer**		**Significant Skills Transfer**	**<u>Functional Areas</u>**	**No Skills Transfer**		**Some Skills Transfer**		**Significant Skills Transfer**
1	2	3	4	5	Research and Development	1	2	3	4	5
1	2	3	4	5	Product and Service design	1	2	3	4	5
1	2	3	4	5	Purchasing / Supplier relation	1	2	3	4	5
1	2	3	4	5	Service / Manufacturing operations	1	2	3	4	5
1	2	3	4	5	Marketing and Sales	1	2	3	4	5
1	2	3	4	5	Distribution / Outlets	1	2	3	4	5
1	2	3	4	5	Customer Service	1	2	3	4	5
					<u>Administrative Areas</u>					
1	2	3	4	5	Strategic Planning	1	2	3	4	5
1	2	3	4	5	Financial Reporting	1	2	3	4	5
1	2	3	4	5	Investment Appraisal	1	2	3	4	5
1	2	3	4	5	Personnel / HRM	1	2	3	4	5
					<u>Others (Please specify):</u>					
1	2	3	4	5	………………………………………..	1	2	3	4	5

9. **Combining of activities:** **For each of the activities given below please indicate the extent to which benefits based on combining activities have been:**

(i) **Actively sought** since the time of acquisition (by circling to the appropriate number on the left hand scale)

(ii) **Actually achieved** as of now (by circling the appropriate number on the right hand scale)

[Examples of activities that might be combined include R&D (e.g. moving to single R&D laboratory), operations (e.g. sharing production facilities), sales (e.g. adopting a single sales force) etc.]

ACTIVELY SOUGHT						**ACTUALLY ACHIEVED**				
No Activities Combined		**Some Activities Combined**		**Significant Activities Combined**	**Functional Areas**	**No Activities Combined**		**Some Activities Combined**		**Significant Activities Combined**
1	2	3	4	5	Research and Development	1	2	3	4	5
1	2	3	4	5	Product and Service design	1	2	3	4	5
1	2	3	4	5	Purchasing / Supplier relation	1	2	3	4	5
1	2	3	4	5	Service / Manufacturing operations	1	2	3	4	5
1	2	3	4	5	Marketing and Sales	1	2	3	4	5
1	2	3	4	5	Distribution / Outlets	1	2	3	4	5
1	2	3	4	5	Customer Service	1	2	3	4	5
					Administrative Areas					
1	2	3	4	5	Strategic Planning	1	2	3	4	5
1	2	3	4	5	Financial Reporting	1	2	3	4	5
1	2	3	4	5	Investment Appraisal	1	2	3	4	5
1	2	3	4	5	Personnel / HRM	1	2	3	4	5

F. ACQUISITION PERFORMANCE

1. Has the acquired firm been divested? *Please tick.*

☐ **Yes** ☐ **No**

2. Please indicate the extent to which the following factors have influenced the success of the acquisition.

Please circle your answer.

		No influence			Significant influence	
a)	Leadership	1	2	3	4	5
b)	Well planned communication	1	2	3	4	5
c)	Early management of "me issues"	1	2	3	4	5
d)	Cultural compatibility	1	2	3	4	5
e)	Clear strategic vision and fit	1	2	3	4	5
f)	Deal structure (e.g. price paid and type of financing)	1	2	3	4	5
g)	Due diligence	1	2	3	4	5
h)	Appropriate level of integration	1	2	3	4	5
i)	Support and commitment from senior managers	1	2	3	4	5
j)	Others (please specify) ………………………….	1	2	3	4	5

3. For each of the <u>performance</u> measures relating to the acquisition given below, please indicate the <u>degree of importance</u> attached to the measure at the time of the acquisition? *Please circle your answer.*

		Not important				Very important
1.	Profitability	1	2	3	4	5
2.	Return on Investment	1	2	3	4	5
3.	Asset Utilization	1	2	3	4	5
4.	Synergy gain in R&D	1	2	3	4	5
5.	Synergy gain in Product/ Service design	1	2	3	4	5
6.	Efficiency Gain in Service/					

	Manufacturing Operations	1	2	3	4	5

4. **For each of the following categories of <u>performance</u>, to what extent has the acquisition performance <u>met initial expectations</u>.** *Please circle your answer.*

		Expectation Not met				**No initial Expectations Fully met**
1.	Profitability	1	2	3	4	5
2.	Return on Investment	1	2	3	4	5
3.	Asset Utilization	1	2	3	4	5
4.	Synergy gain in R&D	1	2	3	4	5
5.	Synergy gain in Product/Service design	1	2	3	4	5
6.	Synergy gain in Service/Manufacturing Operations	1	2	3	4	5

5. **<u>Overall</u>, how <u>successful</u> has the acquisition been for your company**? *Please circle your answer*

Not successful				**Very successful**
1	2	3	4	5

G. OTHER COMMENTS

If you have any other comments you wish to make about the management of acquired firms, or wish to explore any question in more detail, please do so below.

H. SURVEY FEEDBACK

We will be pleased to send you a summary of the results from this survey. If you would like to receive a summary please provide your details below.

……………………………………………….

THANK YOU FOR YOUR TIME IN COMPLETING THIS QUESTIONNAIRE

B Content Areas of the Questionnaire (Survey Instrument)

Content Area	Content	Data Type / Scale Type
Cover Letter	• Purpose and objectives of the study • Estimated time frame for the questionnaire • Safeguarding measures of data confidentiality and anonymity of participants by providing coded questionnaires	n/a
1. Information about the survey participant and the acquisition circumstances	• Firm Name/Hierarchical position • Number of Acquisitions (cross-border/domestic) • When was the acquisition, the survey participant refers to in the questionnaire (2006-2013)?	• string / free text • Numeric • Date
2. Motives for the acquisition; Engaged advisors and advisory fields	• Importance of the strategic motives of the acquisition • Engagement of professional acquisition advisor (control variable) • Kind of due diligence engaged in cross-border acquisitions	• 5-Point Likert scale (No importance – Very Important) • Yes / No - Criteria • Qualitative
3. Pre-Acquisition Phase	• Evaluation of critical success factors in the pre-acquisition phase • Main difference between the target and the acquiring firm • Success-Factors and problematic areas of the acquisition	• 5-Point Likert scale (No importance – Very Important)
4. Acquisition Phase	• Competing bidder in the pre-acquisition phase (control variable)	• Numeric
5. Post-Acquisition Phase	• Factors, which led to successful post-acquisition integration • Main problems during the integration phase • Retention of key employees and management positions • The grade of skill transfer – planne/achieved measurement • The grade of activities combination (synergistic effects) – planned/achieve measurements	• 5-Point Likert scale • Scale with transition indicators actively Sought /Achieved
6. Acquisition Performance	• Divestment of the acquired firm: Yes / No • Acquisition success factors – retrograde approach • Performance measurement indicators • Performance in accordance with expected acquisition results	• Yes / No - Criteria • 5-Point Likert scale (Most - least important)

Source: Author

Questions – Confirmation of the Research Results (triangulation):

In front of the interview, participants were provided with research results. However, the participants did not know, that this are the final results of the study. Five further acquisition-experienced decision maker from the automotive industry reflected their opinion in phone interview.

The study included 85 survey participants from German automotive firms, all with cross-border acquisition experience in the European market.

The main results show that,

1. there is a need to make broad due diligence in the pre-acquisition phase, when acquiring company beyond the domestic borders,

2. the main critical factor of the pre-acquisition due diligence is the Business Capabilities and HR Knowledge, basically consisting of technological competence, workforce capabilities and the management competence,

3. the second most important critical factor of the pre-acquisition due diligence is the Financial Factors and Acquisition Premium, basically consisting of proper quantitative evaluation in order to avoid potential overpayment (reflected in the acquisition premium),

4. the third important critical factor Choice of Strategic Partner, basically consisting of strategic and organizational culture fit, and

5. the Macro-economic and Business Environment is not necessarily a critical factor for pre-acquisition due diligence.

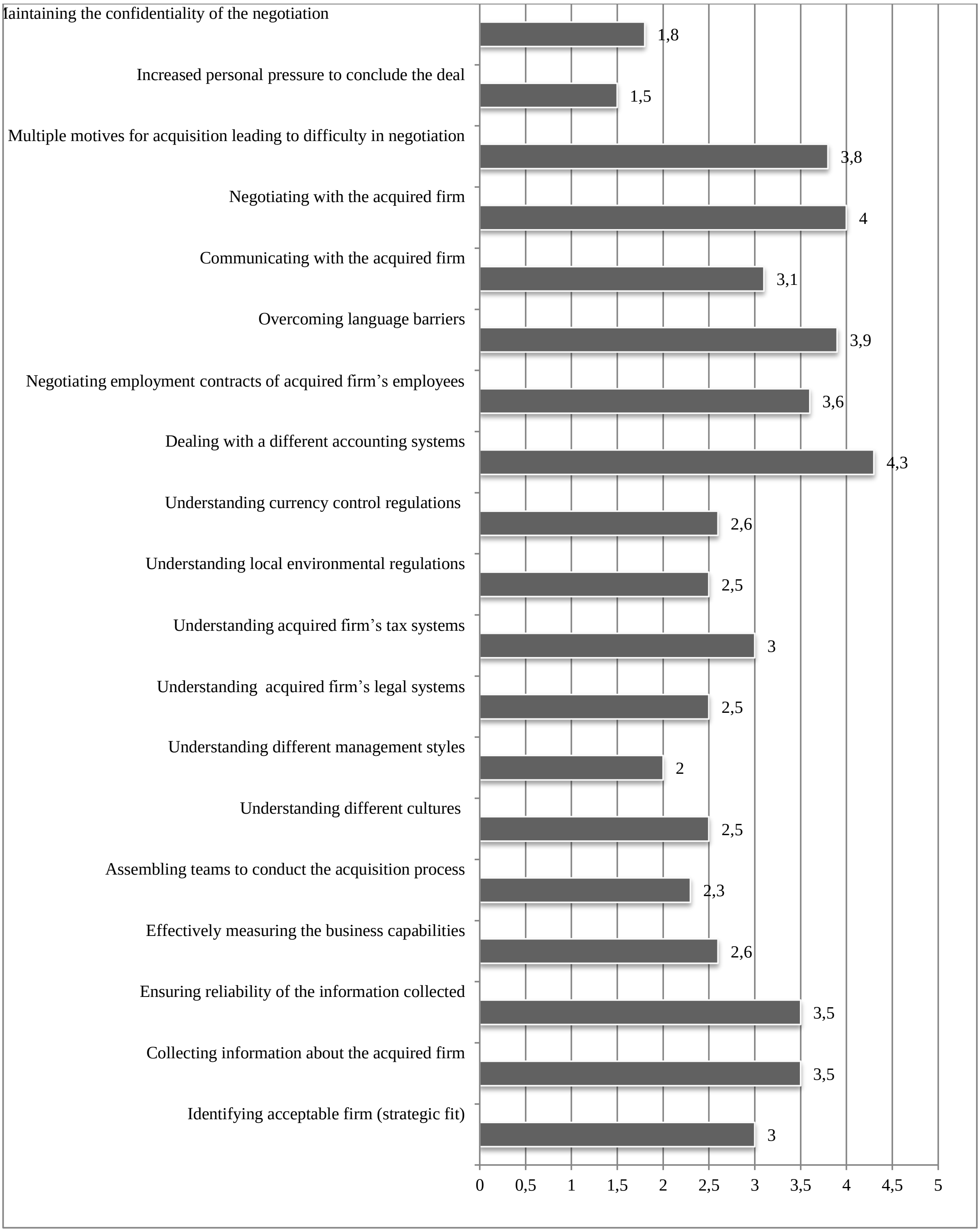
Do you agree with these statements? Please comment each of the five statements.

Statement **Participant**	**1**	**2**	**3**	**4**	**5**	**Comment / Feedback**
1	Agree	Agree	Agree	Agree	Agree	The research endeavor seems very logical. As technology-driven firm, we are always welcoming suitable employees and servicers with specific skills in relevant matter. Business capabilities and technological competence are really in focus of value chain-enhancing cross-border acquisitions.
2	Agree	Agree	Agree	Agree	Do not agree	Due diligence is the cornerstone to make safe acquisitions in cross-border acquisitions. Our firm's target in the past year was long-term contractor. So we were aware of their business capabilities and the workforce knowledge in the product segment they were active. It was necessary to investigate the financial statements and determine appropriate price and payment conditions (earn-out clause). The macro-economic environment is not really of a matter in the pre-acquisition phase. We know that country's market and political conditions and, hence, do not need to investigate them in case of acquisition.
3	Agree	Agree	Agree	Agree	Agree	We had been in the position to evaluate the target firm as we had been working for years with them. The main asset the acquisition target brought us was the expertise in construction and the maintenance of high quality standards at reasonable cost. Due diligence was done in terms of financial items in order to determine the price and contract issues. Investigation was done by one local and one global auditor.
4	Agree	Agree	Agree	Agree	Agree	The due diligence proceedings are common in our industry and there are specialized servicer with certain expertise in assessing the possible risks and chances. The input from the pre-acquisiton due diligence is crucial in the deal-closing phase. Findings are mostly a part of the acquisition contract.
5	Agree	Agree	Agree	Agree	Do Not Agree	Truly agree to the first four propositions, the last one is not really the experience we did. Our experience is very similar with the results presented. However, the inclusion of the macro-economic situation and political relatedness of the management is valuable asset. In the specific deal, we have engaged external due diligence servicer for Legal & Tax and Financial issues. There was also environmental due diligence - an appraisal in terms of the building and the land where the production facilities of the acquisition target is located.
Statement Participant	1	2	3	4	5	Comment / Feedback

6	Agree	Agree	Agree	Agree	Agree	Truly agree to the first four propositions and partly to the last one. In the specific deal, we have engaged external due diligence servicer for Legal & Tax and Financial issues. In general, the inclusion of the macro-economic situation and political relatedness of the management is not a deal-breaker.

Source: Author, based on results of the feedback of experts from automotive industry

C The Main Problems in the Cross-border Acquisition Process



D Top 20 List of Automotive Firms in the German Association Automotive Industry

-	Original Equipment Manufacturer	Employees (Germany)	Sample		Automotive Supplier (German HQ)	Employees (Germany)	Sample
1	Volkswagen	102.050	x	1	Bosch	107.285	x
2	Mercedes Benz	96.000	x	2	ZF Friedrichshafen	42.000	x
3	BMW	91.250	x	3	Schaeffler	32.000	x
4	Audi AG	44.700	x	4	Hella KGaA	22.000	x
5	MAN	32.309	x	5	Draexlmaier	21.000	x
6	Ford	23.400		6	Benteler Automobiltech.ik	18.000	x
7	Opel	22.600	x	7	Mahle / Behr	17.400	x
8	Porsche	22.300		8	Brose Fahrzeugteile	15.200	x
9	Neoplan	7.600		9	Continental	14.000	x
10	Humboldt-Deutz	4.020	x	10	Webasto SE	9.796	
11	Fendt	2.700		11	Knorr Bremse	8.900	x
12	Brandt Fahr-zeugbau	2.100	x	12	Eberspaecher Holding	6.500	x
13	Iveco Magirus	1.995		13	KSPG	6.400	
14	Knaus-Tabbert	1.200		14	Leopold Kostal	4.220	
15	Dethleffs	770		15	Leoni	4.200	x
16	AC Automotive	750		16	BASF SE (Automotive)	3.600	x
17	Hymer	750	x	17	Infineon Technologies	3.300	
18	EvoBus Setra	260		18	TrelleborgVibracoustic	2.200	x
19	Wiesmann	110		19	Kautex Textron	300	
20	Contrac-Cobus	70		20	HBPO Module	220	

Source: German Association Automotive Industry (2013)

E Statistical Analysis – Categorized Factors

Pearson Correlation – Categorized Factors

		Factor Strategic Fit	Factor Bus. Capabilities	Factor Financial	Factor Macro-Political
Factor Strategic Fit	Pearson Correlation	1	,651**	,318**	,353**
	Sig. (2-tailed)		,000	,003	,001
	N	85	85	85	85
Factor Bus. Capabilities	Pearson Correlation	,651**	1	,417**	,356**
	Sig. (2-tailed)	,000		,000	,001
	N	85	85	85	85
Factor Financial	Pearson Correlation	,318**	,417**	1	,503**
	Sig. (2-tailed)	,003	,000		,000
	N	85	85	85	85
Factor Macro-Political	Pearson Correlation	,353**	,356**	,503**	1
	Sig. (2-tailed)	,001	,001	,000	
	N	85	85	85	85

**. Correlation is significant at the 0.01 level (2-tailed)

Spearman's Rho – Categorized Factors

Spearman's Rho		Factor Strategic Fit	Factor Bus. Capabilities	Factor Financial	Factor Macro-Political
Factor Strategic Fit	Correlation Coefficient	1,000	,618**	,321**	,349**
	Sig. (2-tailed)		,000	,003	,001
	N	85	85	85	85
Factor Bus. Capabilities	Correlation Coefficient	,618**	1,000	,296**	,265*
	Sig. (2-tailed)	,000		,006	,014
	N	85	85	85	85
Factor Financial	Correlation Coefficient	,321**	,296**	1,000	,484**
	Sig. (2-tailed)	,003	,006		,000
	N	85	85	85	85
Factor Macro-Political	Correlation Coefficient	,349**	,265*	,484**	1,000
	Sig. (2-tailed)	,001	,014	,000	
	N	85	85	85	85

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Skewness and Kurtosis

Descriptive Statistics

	N	Mean	Std. Deviation	Variance	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Factor Strategic Fit	85	3,946	,6187	,383	-,122	,261	-,542	,517
Factor Bus. Capabilities	85	4,245	,6551	,429	-1,316	,261	1,784	,517
Factor Financial	85	3,844	,6551	,429	-,283	,261	-,357	,517
Factor Macro-Political	85	3,455	,6467	,418	-,032	,261	-,303	,517
Valid N (listwise)	85							

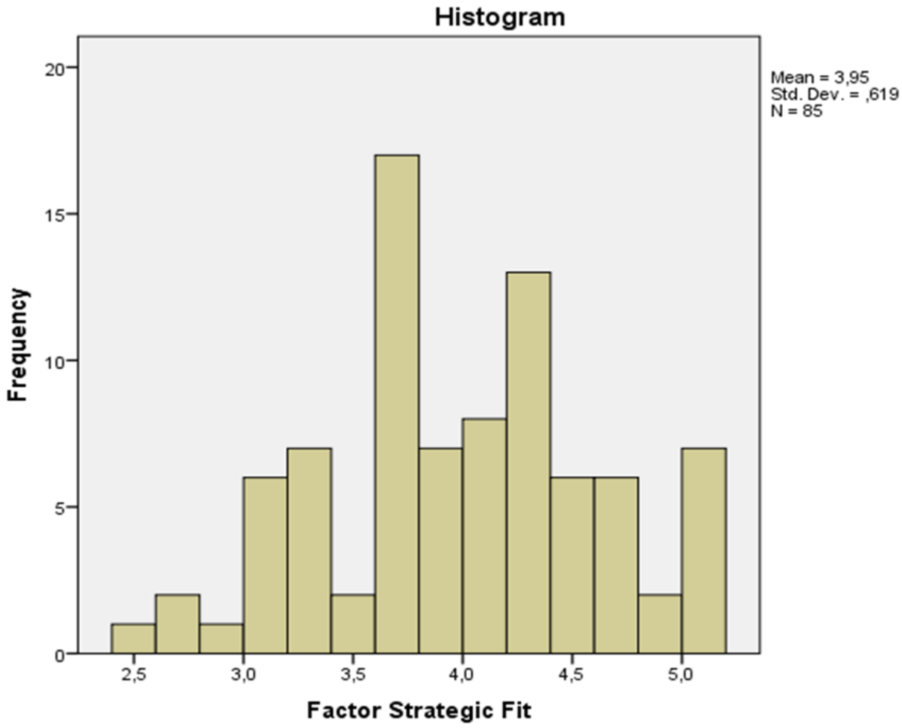
Normality Test – Categorized Factors

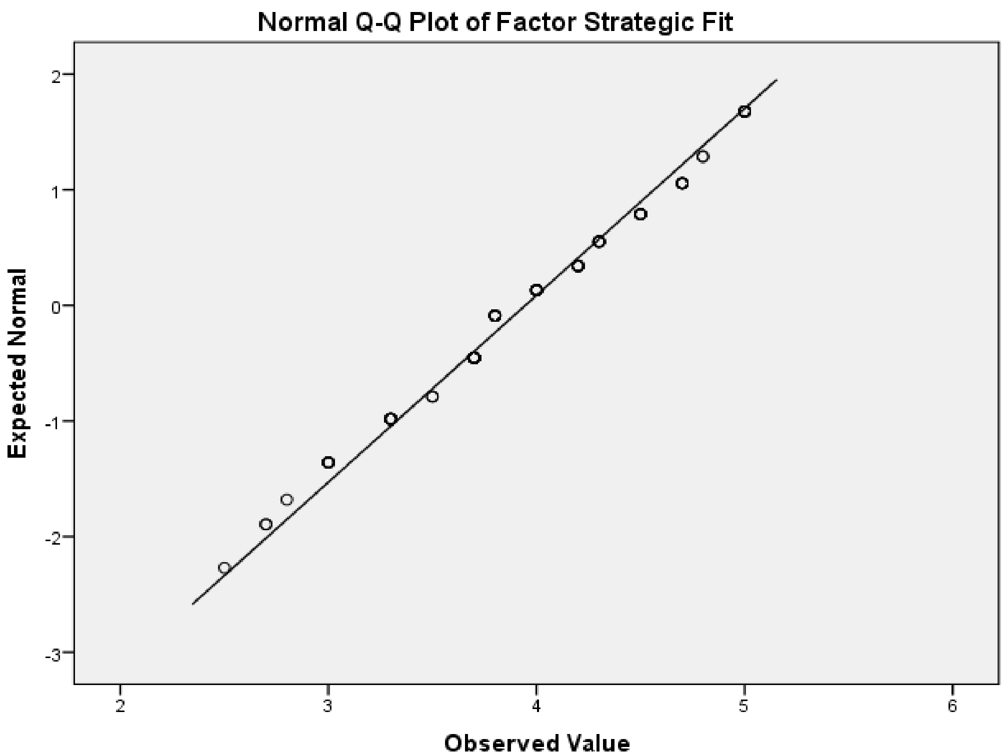
	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Factor Strategic Fit	,122	85	,003	,967	85	,029
Factor Bus. Capabilities	,190	85	,000	,877	85	,000
Factor Financial	,159	85	,000	,967	85	,026
Factor Macro-Political	,118	85	,005	,976	85	,121

a. Lilliefors Significance Correction

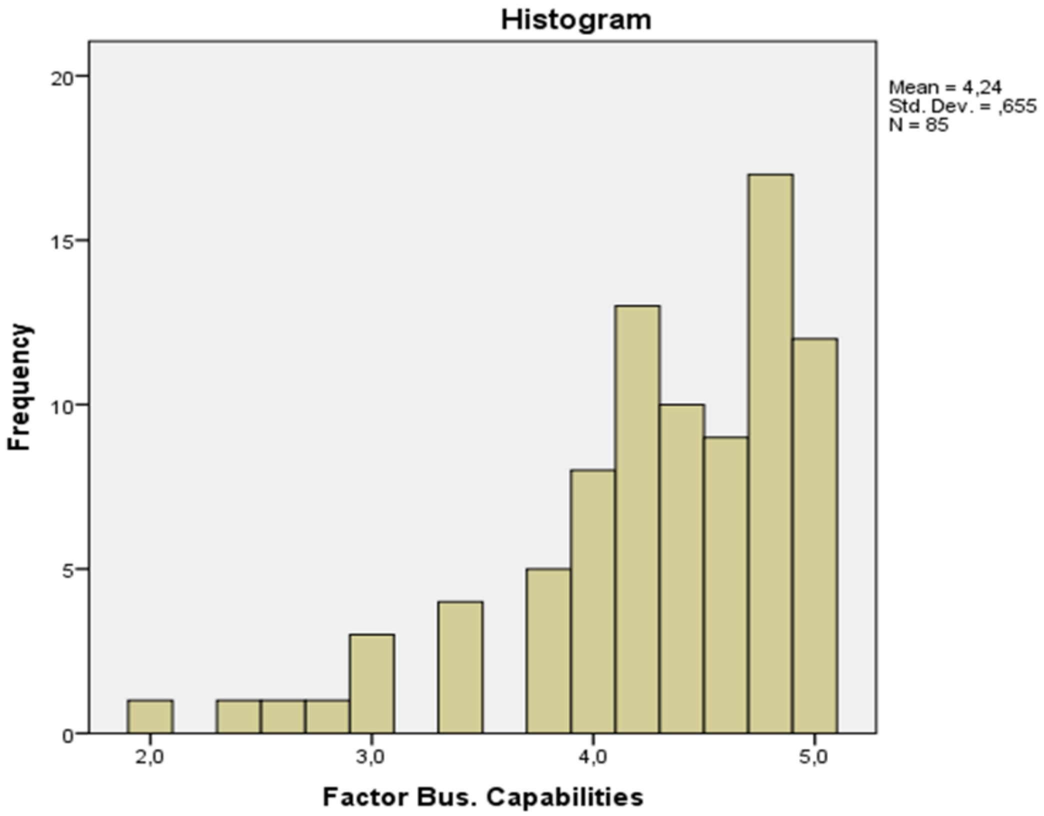
<u>Plots – Categorized Factors</u>

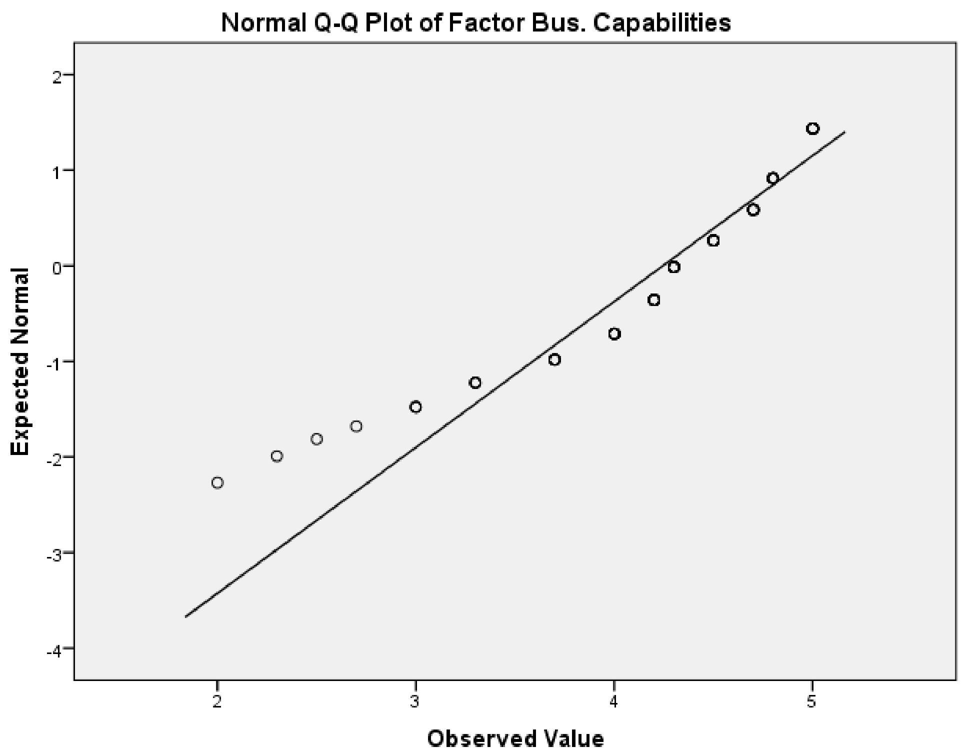
1) Choice of Strategic Partner



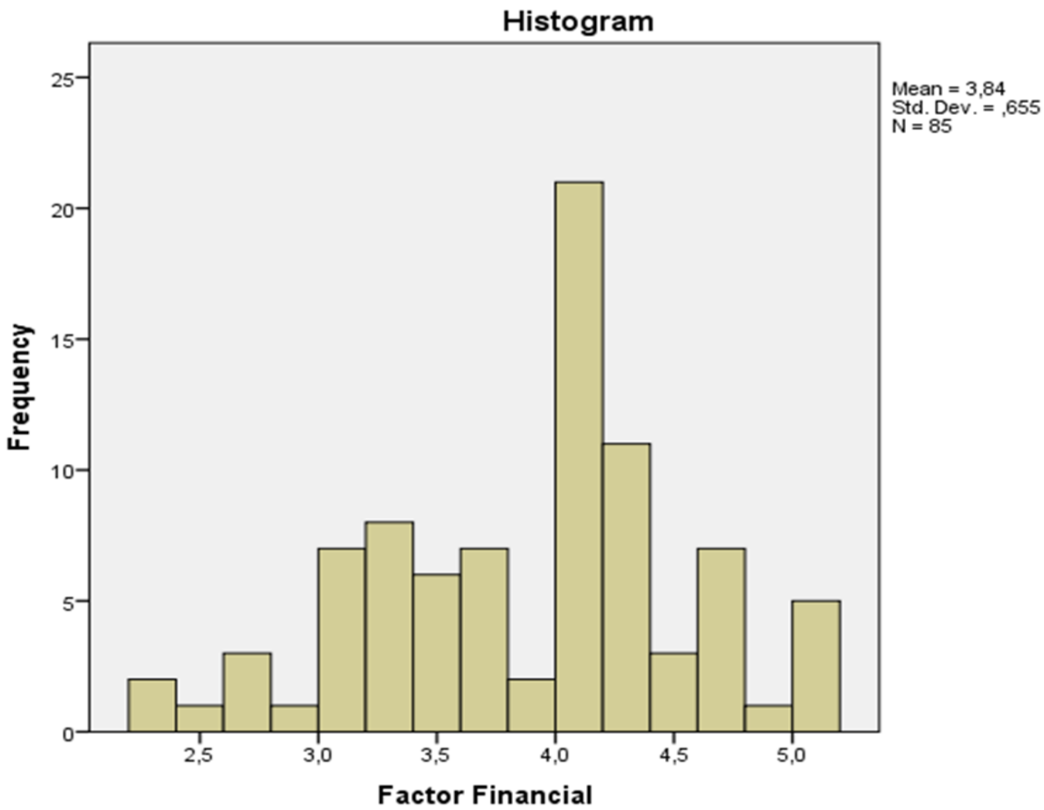


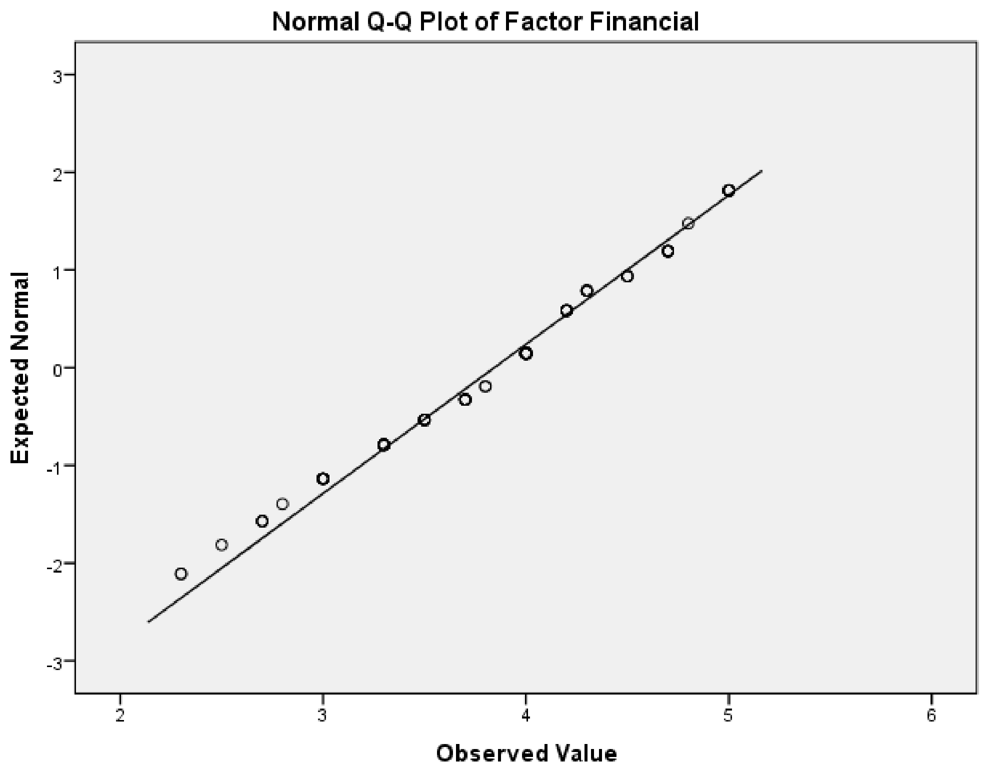
2) Business Capabilities and HR Knowledge



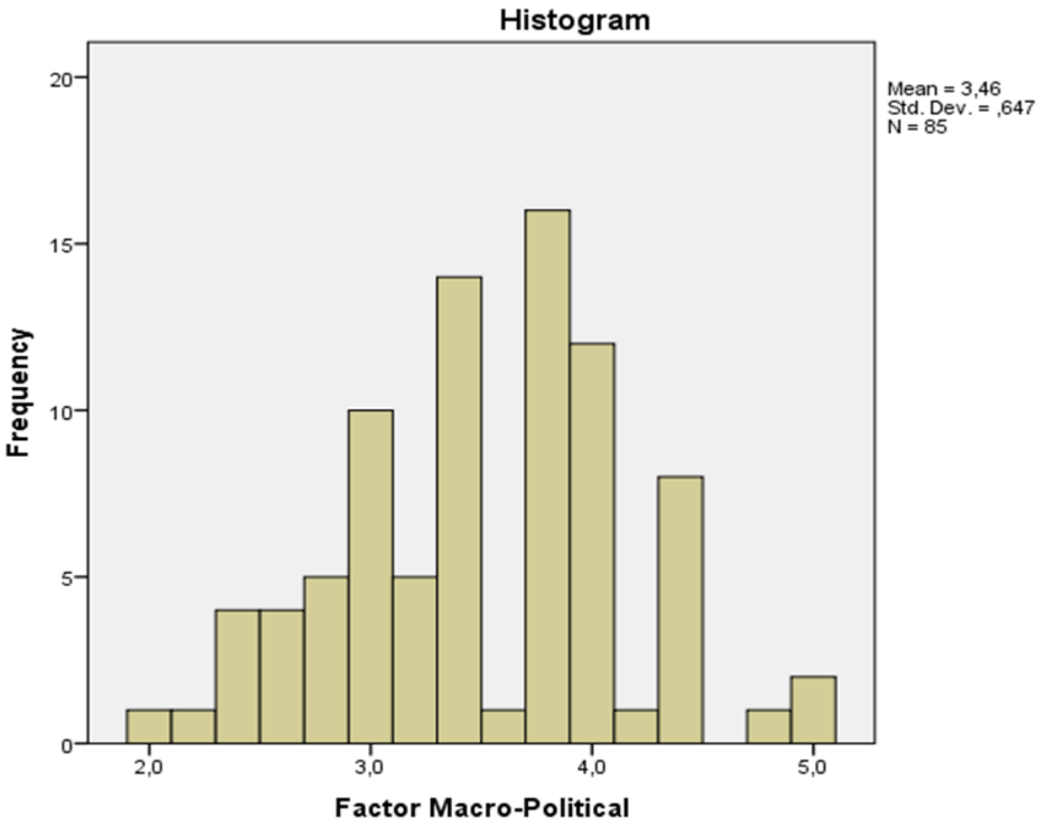


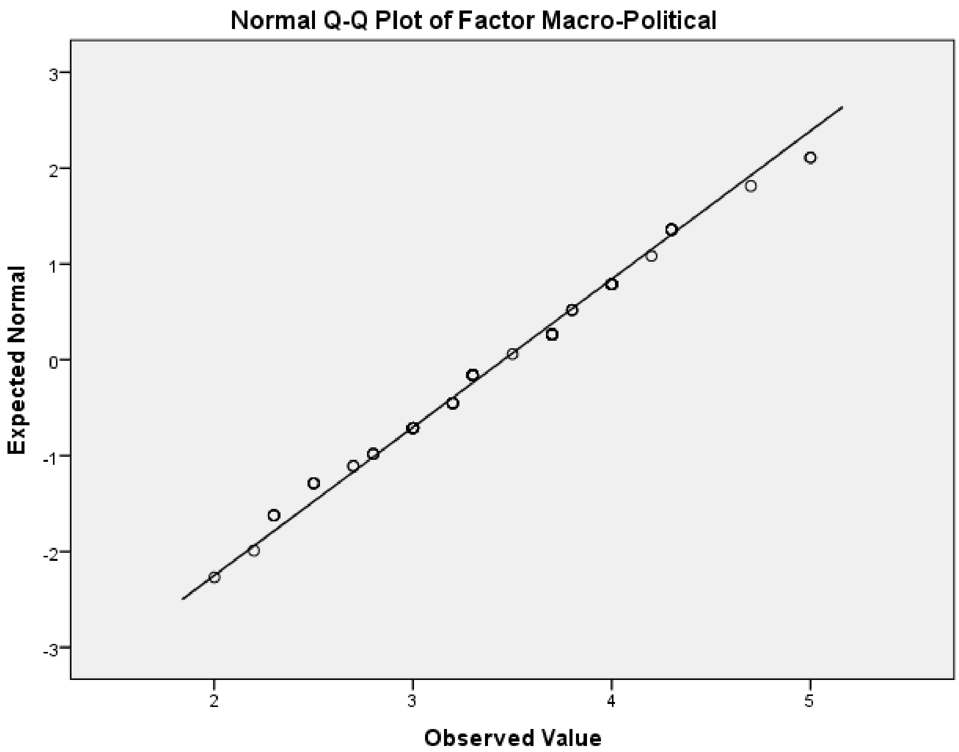
3) Financial Factors / Acquisition Premium





4) Macro-Factors and Business Environment





Factor Analysis:

KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		,668
Bartlett's Test of Sphericity	Approx. Chi-Square	90,000
	df	6
	Sig.	,000

Communalities

	Initial
Factor Strategic Fit	1,000
Factor Bus. Capabilities	1,000
Factor Financial	1,000
Factor Macro-Political	1,000

Extraction Method: Principal Component Analysis.

Total Variance Explained

	Initial Eigenvalues		
Component	Total	% of Variance	Cumulative %
1	2,304	57,600	57,600
2	,854	21,347	78,946
3	,511	12,772	91,719
4	,331	8,281	100,000

Extraction Method: Principal Component Analysis.

Rotated Component Analysis – Only one variable was extracted, so that there is no solution to be extracted (Varimax-Rotation).

F Test on Common Method Bias

Harman’s single factor Test – Common method bias

Total Variance Explained

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	4,094	32,119	32,119	4,094	32,119	32,119
2	1,829	16,245	50,363			
3	1,182	10,851	60,214			
4	1,013	8,445	67,659			
5	,840	7,002	74,661			
6	,700	5,830	80,491			
7	,596	4,970	85,460			
8	,465	3,874	89,335			
9	,399	3,326	92,661			
10	,341	2,838	95,499			
11	,286	2,386	97,885			
12	,254	2,115	100,000			

Extraction Method: Principal Component Analysis.

G Test of the relationship critical factors and acquisition success

Subsequently, the twelve critical factors, as the ingredients of the categorized evaluated factors in the previous model, will be considered individually. The purpose is the determination of single due diligence factors with highest impact on acquisition success. The initial model in below has adjusted R-square value of 50 per cent, showing high explanatory power of the variation of the acquisition success. The Business Capabilities and Workforce Capabilities show significance in the current model. The F-statistics is greatly above the tabulated F-value indicating significant F-Value for the regression equation.

Individual evaluated factors – Acquisition Success (composite variable)

	Coefficient Estimate	p-value	VIF
(Intercept)	-1.289	0.028*	
Investment Advisor (v2)	-0.023	0.878	1.4
Competing Bidder (v14)	-0.019	0.889	1.4
Strategic Fit (v15)	0.06	0.626	2.2
Organizational Culture Fit (v16)	-0.033	0.714	1.9
Business Capabilities (v17)	0.265	0.022*	2.2
Technological Competence (v18)	0.178	0.148	3.2
Management Competence (v19)	0.038	0.744	2.5
Workforce Capabilities (v20)	0.23	0.031*	1.8
CF & Debt Servicing (v21)	0.232	0.106	3.1
Fixed Assets (v22)	0.052	0.617	1.9
Future Financing Needs (v23)	0.067	0.589	2.9
Legal & Tax (v24)	0.131	0.321	2.4
Political / Macro Factors (v25)	0.156	0.176	2.2
Corporate Governance (v26)	-0.092	0.337	1.7
Adjusted R-square: 0.5009, F-statistic: 10.03 on 14 and 70 DF, p-value: 0.000			

Source: Calculations made by the author (2015) on the basis of the test group (n=85)

Using stepwise multiple regressions in order to receive more adequate model, in the next step, five explanatory variables are kept. The model possesses strong explanatory power with 53 per cent of the explained variation in the acquisition success by the individual critical issues in the pre-acquisition due diligence. The significance level is acceptable for Technological Competence and Business Capabilities (0.9) and very high for the Work-force Capabilitites and Cash-flow generation ability and debt servicing capacity (sig. > 0.95).

Model with individual critical factors variables

	Coefficient Estimate	p-value	VIF
(Intercept)	-1.148	0.011 *	
Business Capabilities	0.238	0.014 *	1.6
Technological Competence	0.188	0.010 **	2.3
Workforce Capabilities	0.268	0.004 **	1.4
CF & Debt Servicing	0.344	0.000 ***	1.4
Macro-Factors and Business Environment	0.204	0.022 *	1.4
Adjusted R-square: 0.5307, F-statistic: 29.69 on 5 and 79 DF, p-value: 0.000			

Source: Calculations made by the author (2015) on the basis of the test group (n=85)

The Workforce Capabilities, Technological Competence and Business Capabilities show only slightly weaker impact on the dependent variable.

The F-Statistics for Workforce Capabilities and Cash-flow & Debt Servicing Capabilities is significant suggesting that these variables are very important predictors of the acquisition success in the pre-acquisition phase. Business Capabilities, Technological Competence and Macro-Factors and Business Environment show predictive importance on the acquisition success in the pre-acquisition phase (p-value < 0.05). The result shows that independent variables from each category have at least one variable with influence to the acquisition success.

In sum, the model suggests that acquirer who put strong focus on Business Capabilities, Technological Competence, Workforce Capabilities, Future Financing Needs, Cash flow and Debt Servicing ability, and Macroeconomic factors may positively influence successful acquisition.