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James K. Sebenius

**Negotiating Cross-Border Acquisitions**

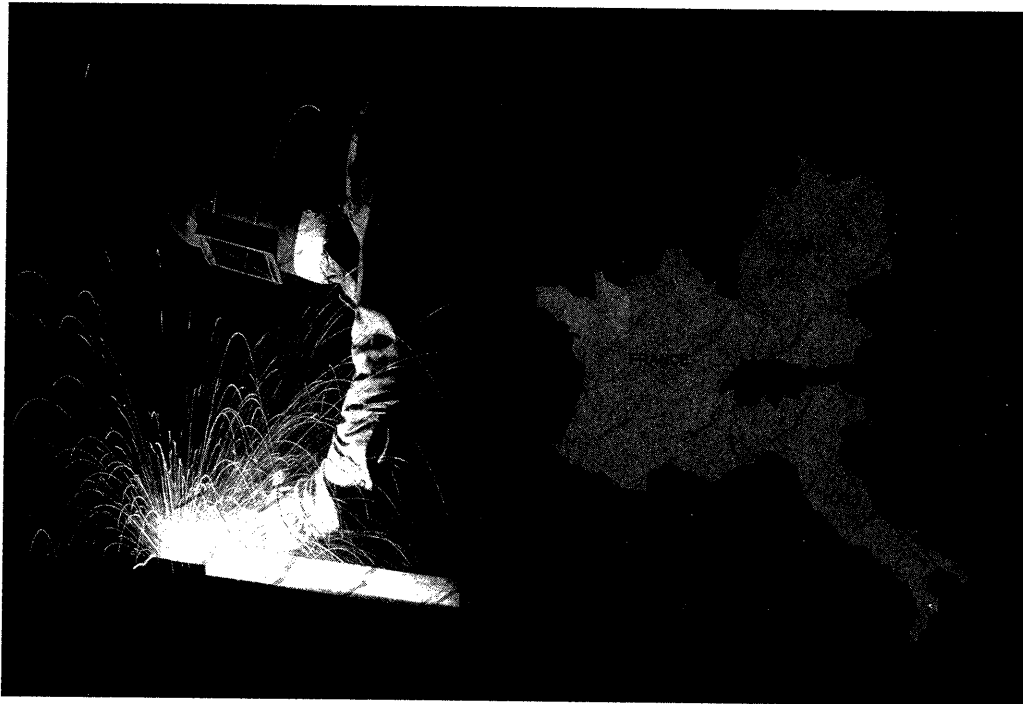
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# Case Study

## Negotiating Cross-Border Acquisitions

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James K. Sebenius



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

James K. Sebenius is the Gordon Donaldson Professor of Business Administration at the Harvard Business School.

Driven by competitive pressures for globalization and facilitated by the liberalization of markets worldwide, cross-border mergers and acquisitions grew explosively during the 1980s, paused in the early 1990s, and are again increasing. Particularly in Europe, the number of cross-border deals soared from around 400 in 1986 to almost 2,000 in 1991 — representing almost 60 percent of all deals in Europe — and are now around 1,500 annually. The value of such deals has grown proportionately more than their impressive raw numbers;<sup>1</sup> indeed, on a single remarkable day — “Mad Monday,” 13 October 1997 — more than \$120 billion in cross-border European mergers

and acquisitions were announced. While analysts have dissected many economic and financial aspects of this powerful trend, they have paid relatively little attention to the negotiating processes involved in these transactions. In this case study, I explore a sequence of acquisition negotiations by one Italian firm, Societa Metallurgica Italiana SpA (SMI), that consistently overcame seemingly insurmountable obstacles. From SMI’s skillful approach, I distill broad lessons for effectively negotiating cross-border deals.

Many companies negotiate cross-border transactions routinely, using familiar scripts for effective deal making: “map” or

enumerate and characterize the parties, assess their interests and their no-deal alternatives, envision potential agreements and the bargaining range, craft processes for both creating value and claiming it, pay attention to the sustainability of agreements, and so on.<sup>2</sup>

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

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

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

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

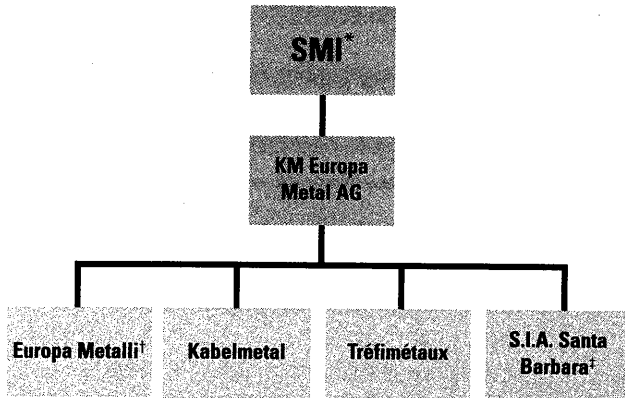
"[The] takeover bid . . . is virtually unknown in Japan, Switzerland, and Germany. Approximately a third of German companies issue registered shares which may not be sold or transferred without the express authorization of the company. What is more, the board of directors (in its capacity as legal representative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

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

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

Figure 1

## SMI Organizational Structure



\*SMI owns 77%; dispersed German shareholders hold the balance.

†Includes La Metall Industriale (LMI) and other SMI subsidiaries in Italy.

‡The group's Spanish subsidiary.

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

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

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

On 5 October and 21 December 1995, I interviewed Sergio Ceccuzzi, Vorstand (management board) mem-

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

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

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

We felt that no one knew our business better than we did — from our technology to our markets to our competitors. So we decided to employ advisers in our transactions only *after* we had directly approached the people on the other side — whom we typically knew well — and had negotiated a positive conclusion, at least in principle. Afterward, of course, the bankers and lawyers could craft an appropriate financial and legal structure to support the business arrangement we had already worked

out. Often they added a great deal to the process, but we did not want to cede control of the negotiations to the merchant bankers. We wanted to call the shots until it was appropriate, nearer the end, for them to help.

## The "Delta" Acquisition

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

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

*So how did you proceed?*

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

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

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

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

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

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

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

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

## The TLM Acquisition

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

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

*How did you approach TLM?*

Initially, instead of contacting TLM's parent corporations in France (Tréfinmétaux and Pechiney), we approached TLM directly, proposing to the compa-

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

the replacement of several of their senior managers.

*So where did you go from there?*

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

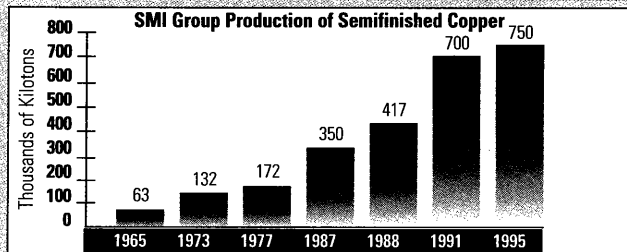
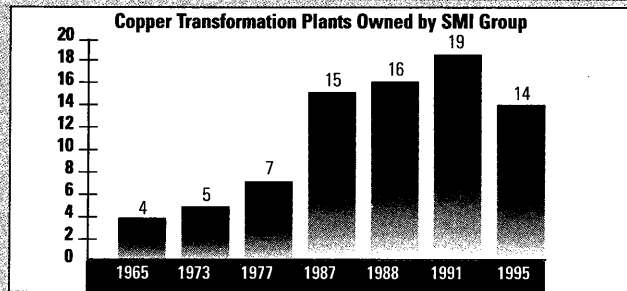
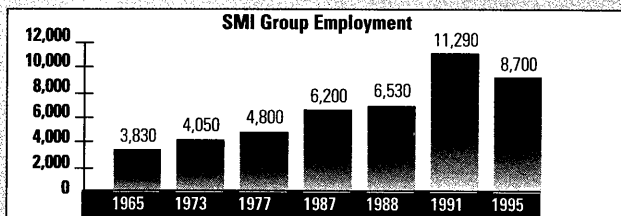
*TLM was the Italian subsidiary of Tréfinmétaux, which, in turn, was the French copper subsidiary of Pechiney?*

**SMI's Performance Record**

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

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

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



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

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

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

\*Europa Metallii includes La Metallii Industriale (LMI) and other SMI subsidiaries in Italy. Restructuring the group was effected in June 1995. Results for Europa Metallii in its subsidiary role during 1995 exist only for 1 July 1995 through 31 December 1995. Data in the table reflect an extrapolation of these results to cover the entire year.  
 †Production of semifinished copper and copper alloy products (excluding copper conductor).  
 ‡15.0% of world output.

Yes, TLM was an Italian company, controlled by Pechiney and traded on the Milan Stock Exchange. At the time, Pechiney was a private company, not yet nationalized.

*How did you talk about structuring the deal with Pechiney?*

First, because TLM was also in aluminum, we began with the presumption that TLM's aluminum operations would remain with Pechiney as part of its core business. In this way, Pechiney could remain focused on its major concern, aluminum, while still participating in a copper-oriented business with SMI.

Second, we proposed creating a new entity, a holding company called Europa Metalli SpA, to which SMI would contribute its overall operations and TLM would contribute its copper operations. Pechiney would be a passive participant with 16 percent ownership, while SMI would control 84 percent of the new company. Essentially, we completed the TLM deal on this basis.

## The Tréfinétaux Deal

*But your longer-term objective must have been to merge with Tréfinétaux, a major copper transformer in France, not merely their Italian subsidiary (TLM)?*

Yes, all along we had contemplated a merger with Tréfinétaux, but discussions went nowhere for two years. Then Pechiney, Tréfinétaux's parent, was nationalized in 1982 during the first Mitterrand administration.

We had to wait ten years for an opportunity to advance this agenda. During this period, Pechiney tried to force the sale of its 16 percent stake in Europa Metalli to SMI on terms that we felt were unfair and certainly unattractive. Arbitration eventually went against Pechiney, but, as you can imagine, relationships were soured in the process.

Ultimately, a series of unforeseen events resulted in an opportunity. First, new management was installed at Pechiney. Second, Tréfinétaux began losing a great deal of money — about US \$65 million between 1985 and 1986 — causing a financial drain and a management diversion for Pechiney. Third, in 1986, Prime Minister Jacques Chirac's government came into power with a more favorable view of pri-

vatization. Of course, this was hardly a mandate for privatizing French firms by selling them to Italians!

Luigi Orlando, chairman and CEO of SMI, personally asked the new head of Pechiney about his plans for Tréfinétaux, especially given its mounting losses and Pechiney's new strategic plan. Two months later, Orlando received an answer as part of a newly clarified strategic framework for Pechiney: "On the one hand, Tréfinétaux represents 10 percent of our turnover, and we do not consider it to be of strategic value. On the other hand, if we simply divested ourselves of this activity, we would face much difficulty in obtaining political consent. Therefore, we will entertain proposals only for participation rather than for 'brutal' acquisitions. These proposals will also be evaluated by the government, whose consent will be fundamental. And Pechiney will have to play a role in the new incarnation of Tréfinétaux."

The proposal we had already prepared was compatible with his response. It provided for some Pechiney participation as long as SMI had a relative voting majority, allowing us to exercise indirect control over Tréfinétaux.

*But, if I understand correctly, Tréfinétaux management was completely against any acquisition. And wouldn't the French government have reacted negatively to any transaction that appeared to be privatization, let alone an acquisition by a private Italian firm?*

Yes, there seemed to be no point in trying to negotiate with Tréfinétaux management. And with the realities of French corporate governance, which generally give the parent company virtually absolute control over the subsidiary, it made sense to negotiate directly with the parent. So we worked very hard with Pechiney both on the deal itself and on constructing a serious industrial plan to rationalize the fragmented copper transformation industry in France and Italy. We also closely negotiated issues of management structure with Pechiney, which absorbed the employees we did not want in the new entity.

Naturally, the French government worried about the potential closure of major French operations, given likely opposition by workers and the attendant political consequences. So, following an exhaustive study, we agreed not to close certain large-scale facilities in France for three years.

*Before Pechiney would even embark on such a process, you must have had a basic price negotiation.*

Of course. We had reached agreement in principle on the basic elements of the deal, which we discussed extensively until it was obvious to everyone that the combination made eminent industrial sense.

In any new joint enterprise, we had to move beyond the general rationale of the deal to specifically value the component parts. SMI was easy to value, given its positive performance and trend, but the net worth of Tréfinétaux was another story, since it was losing money. We simply proposed valuing it at zero, having Pechiney recapitalize it to cover the losses and make a long-term, low-interest loan. Naturally, Pechiney argued vigorously in favor of a higher price, citing goodwill and the like. This was the only aspect of the deal on which we were unyielding.

*What gave you confidence that playing hardball on your pricing position would not blow the deal?*

You say "hardball." We did hold to our valuation, but our manner was extremely gentle, not strident or threatening. Having convinced Pechiney that we were the logical partner, having ascertained that it had no good alternatives but noting the difficult state of the market and worsening prospects for a stand-alone Tréfinétaux, we treated our valuation principle as a deal breaker, and Pechiney unenthusiastically concurred. But we counterbalanced this "imposition" with strong willingness to be flexible on all other dimensions of the deal.

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## **"The complex deal structure was driven by more fundamental business decisions."**

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*How did the transaction work financially?*

There were many technicalities. In essence, Pechiney would contribute Tréfinétaux to Europa Metalli following a significant restructuring. Remember, Europa Metalli was jointly owned by SMI and Pechiney. In return, Pechiney would receive a more valuable ownership position in the new larger entity along with certain control prerogatives.

Pechiney agreed to cover Tréfinétaux's losses through

1986 by means of a recapitalization to which it would be the major subscriber. In effect, it would reduce Tréfinétaux's share capital by the amount of its losses, contribute enough capital to boost the capital value of the shares up to par, and then contribute those shares to the new entity. It was a kind of "share recapitalization."

Then we constructed a formula for Europa Metalli that revalued its shares upward. In return for Pechiney's in-kind contribution (the recapitalized Tréfinétaux shares plus loan), it received more valuable shares in the new entity. Pechiney ended up with a 22 percent ownership stake in the restructured and larger Europa Metalli (EM), although its share was later reduced to 16 percent.

*How else did you propose to structure the transaction so it would be more acceptable in France, especially to the government?*

It was important to present the transaction as a restructuring of our industrial activities in Italy and France, an objective that was well served by the carefully drawn industrial plan and other features. The somewhat involved transaction structure I described should (and was) considered to be a *consequence* of a sensible business restructuring initiative in the French and Italian markets. In short, the complex deal structure was driven by more fundamental business decisions.

Moreover, Pechiney could accurately describe the transaction as a new joint activity since it would contribute Tréfinétaux's operations to an enhanced EM and boost the value of its holdings in the rationalized and much larger entity.

In the new EM, Pechiney would get three board seats and a place on the executive committee, which made decisions on any significant issues. These arrangements would last for five years and were renewable for two-year terms. If, at any time, Pechiney decided to sell or dispose of its EM stock, we would have the right of first refusal.

*Operationally, how was this plan negotiated? How did it come to be accepted, in particular, by the French government?*

In effect, SMI had to reach agreement with the French government. Yet, in line with our apolitical

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**“Once we agreed in principle and to the one tough issue — price — we operated in an atmosphere of increasing trust and collaboration.”**

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stance in Italy, we decided to undertake explicit negotiations only with Pechiney senior management, which itself negotiated with the French Ministries of Industry and the Treasury. Now Pechiney carefully apprised the two ministries of the state of the SMI-Pechiney negotiations and no doubt helped Pechiney and us understand all pertinent governmental requirements. In a very loose sense, Pechiney played a mediating role between SMI and the French government.

Formally, however, Pechiney alone presented and negotiated the plan with the French Ministries of Industry and the Treasury. SMI scrupulously stayed out of the process and steered clear of the politics. Obviously, Pechiney had an advantage in such French negotiations. Of course, the French government officials had to satisfy themselves that the industrial plan over which we had labored was indeed workable. And they paid enormous attention to the plan's operational and other details before saying *oui*.

*Could you tell more about the negotiations involved in working out these arrangements?*

After we had reached a meeting of the minds on the general nature of the transaction, two main working groups — one business and one financial — negotiated the specifics. We prepared a general draft outlining the main areas for negotiation. We divided it into six sections with a logically interdependent structure; another section related the pieces to the whole. Different people worked on different parts of the deal. Each team consisted of a senior executive, a financial executive, and a lawyer. In a sense, after initial discussions, we wrote the theme, and the two sides jointly wrote the screenplay.

We met several times, alternating between France and Italy. By fax, we exchanged innumerable versions of the evolving document, which was written in English. Lawyers played a tightly circumscribed role, formulat-

ing the appropriate legal language for the developing agreement, but they were wholly subordinate to the business people. At times, such as when a complex arbitral mechanism had to be invented, they were especially useful. And financial advisers and auditors helped us with specialized expertise. But once we agreed in principle and to the one tough issue — price — we operated in an atmosphere of increasing trust and collaboration.

*How did you deal with the former Tréfinétaux management?*

When we earlier acquired TLM — which, like SMI, was an Italian firm — SMI executives moved into the upper-level management positions; however, our view of acquisitions abroad was entirely different. In France, we were committed to using local management. Both SMI and Tréfinétaux had been founded almost a century before the transaction; each company had a long, independent tradition, and each had been the other's competitor. So we needed to evaluate both the potential loyalty of Tréfinétaux managers to the combined entity and their technical and managerial suitability. As it happened, we did not accept the existing general manager but ended up promoting a divisional manager from within Tréfinétaux. Under his direction, coordinated with our Italian activities, we executed the industrial plan. By the way, Pechiney hired the managers with whom we did not wish to work.

*When all was said and done, Pechiney remained a relatively passive, but significant participant in a restructured EM, having contributed a fair amount of capital by way of the share recapitalization?*

Yes, but for Pechiney, this was a great deal less expensive than continuing to cover the large, apparently increasing losses of Tréfinétaux. So Pechiney did well relative to the alternative of no deal at all. And not only did it have a financial stake, but it was our partner in discussing and developing a broader European strategy. This new arrangement was for them a valuable window on a larger strategic process.

*And how did the French government fare?*

The French government maintained major operations in France, at least for a while. It cut off a significant financial hemorrhage. It could accurately describe its

actions as a competitive restructuring and much-needed rationalization of Pechiney's copper activities across the French and Italian markets. French executives secured substantial representation on the board and the executive committee, together with the right to participate in strategic decisions for EM. No whole-sale disposition or sell-off of a major French asset, in particular to a private Italian firm, had occurred. And EM's holding company, SMI, did not hold an outright majority, so control could not technically be said to have been ceded upstream either.

*And how about SMI?*

Through Europa Metalli, SMI could now coordinate and control both the French and Italian activities in the copper transformation and fabrication markets. In return for this substantial increase in control — with its high potential for restructuring and market rationalization — SMI accepted the very large risk that Tréfinmétaux, even in this new setting, would continue to suffer huge losses. This risk was magnified by the agreement to maintain key French operations. All told, this was a major bet for SMI.

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**“We spent much time finding ways to integrate the entities psychologically, while signaling to the French that we genuinely valued them.”**

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*Thinking back to the Tréfinmétaux managers, whose objections were overridden in the process, what steps did you take afterward to make them effective, committed managers in the new Italian-French enterprise?*

During the negotiations, the Tréfinmétaux managers' behavior was Pechiney's problem. And, as you recall, we did remove some managers at the completion of the acquisition for business reasons, though we acted very quickly to complete any bloodletting. We did not drag out the process. Then we had a *French* company that had to coordinate an industrial plan with its Italian shareholder. We introduced Italian managers into the process, although this was mainly at the board level rather than the operating level. Indeed, the managing director of Europa Metalli was responsible for essential cooperation and coordination of these two different companies with different managements.

We spent much time finding ways to integrate the entities psychologically, while signaling to the French that we genuinely valued them. For example, we combined some crucial advanced R&D activities and put them fully in French hands. And we staged events at which managers from the two companies were able to get to know each other better. For example, we had a strategic management consultant conduct an interactive seminar — on the logic of *our* joint Italian-French strategy — so the two sides could get to know each other personally. In 1993, however, we changed the management structure dramatically so we were no longer *coordinating* activities but actively *managing* them.

*How were you doing that?*

In late 1992, when I assumed responsibility for the group's industrial activities, Europe was in a recession. Early the following year, to enable EM to cope better with the recession and to strengthen SMI's hand in running the company, we created an informal management structure. A main feature was an executive board, which I currently chair. The board is made up of one French and two Italian members. Each is directly or vertically responsible for an international division (tubes, rods, or bars). We also internationalized various staff functions (MIS, financial systems, administrative systems, procurement, and so on) and assigned responsibility for these horizontal functions to board members.

While this informal structure confers no legal authority on board members — I cannot even sign a binding letter in my capacity as chairman — it has the advantage of being well-recognized and accepted within the French and Italian entities, while allowing each to maintain its formal identity as a distinct, local firm. But *de facto* authority and responsibility are assigned carefully to those board members whose skills match critical needs. And the structure has worked very well, going far beyond coordination to active management. By virtually any measure, the combined and restructured Italian-French operations have exceeded expectations in the five years following the transaction by overcoming, with remarkable resilience, the difficulties imposed by the recession of the early 1990s.

### **Lessons from the Tréfinmétaux Deal**

*If I were drawing lessons from this negotiating experience, I would first note how long the process took*

*from conception to realization. It was preceded by absolute clarity about SMI's strategic objectives, which endured over time. The industrial logic of the ultimate combination — rationalized French and Italian cop-per transformation activities — was powerful and can be seen as the engine behind the various moves.*

Yes, so far, so good. But logic was not enough. Almost ten years elapsed before a combination of circumstances — a privatized Pechiney, new management, large Tréfinmétaux losses — seemed to ripen the situation for new initiatives. And “ripeness” was hardly sufficient; conceptualizing and structuring the deal took considerable effort to overcome the barriers.

*Second, it appears that after SMI executives conceptualized the plan, and events became more promising, there were at least three hurdles: Pechiney management, the French government, and Tréfinmétaux management. Under the right terms, Pechiney could rid itself of a problem division that the French company had acquired almost incidentally, that was separate from the company's core strategy, and that was losing money. Any proposed deal, whatever its merits, could be blocked by either or both the French government and Tréfinmétaux management.*

*The essence of SMI's negotiating strategy involved a sequential approach, by which SMI sought first to build a deal-favoring coalition in a series of deliberate, incremental steps and then to draw in, or ultimately subdue, any parties that might obstruct an agreement. You perceived that the possibility of a natural coalition between senior Pechiney management and SMI executives arose, given the right price; this would be the deal-driving coalition.*

*You orchestrated a carefully planned sequence of coalition-building events: first, SMI dealt with Pechiney to cement an alliance; next, Pechiney worked alone with the French government to address governmental concerns and ensure acceptance of the SMI-Pechiney plan; and finally, all three allied players confronted Tréfinmétaux management with an irresistible fait accompli. As long as Tréfinmétaux managers did not take sufficient initiative to convince the relevant ministries (or allies in the parent company or even key union players) to block the deal, the game was over for them.*

*So another major lesson seems to be the importance of*

*mapping and assessing the critical parties and then sequencing your negotiating efforts appropriately and retaining the initiative. And not incidental, I suppose, was the fact that an analogous approach had worked a decade before in the TLM transaction.*

*Third is the closely related lesson that, in multiparty negotiations, it is helpful to divide the other players into at least three groups: (1) unconditional allies, (2) those who will become allies if you can solve their problems and meet their interests, and (3) more or less unconditional opponents. Each group must be dealt with differently and often sequentially. Pechiney's senior management fell into the second category once a price was agreed on; the relevant French ministries were also in the second category but with more complex interests to address; and Tréfinmétaux management, at least during the process, was in the third.*

*The fourth lesson is the way you structure a deal, which, while advancing your own interests, must be as responsive as possible to other players' real interests and constituencies to maximize the chances of agreement. Deal structure can be important not merely for legal, financial, and tax purposes but, in some cases, as a powerful and positive signal to key players or audiences that their interests are being met. Further, the right deal structure enables key players to give an acceptable, even attractive, account of the deal to their constituents in a way that maximizes the chances of acceptance.*

*The final lesson is that once the deal is done, the negotiation does not stop. There must be an ongoing, intensive process to ensure that the original rationale for pursuing the deal remains viable and that the negotiated arrangement continues to generate value.*

Your “lessons” very nicely capture our experience.

*In 1988, two years after the Tréfinmétaux deal, you were quoted as saying, “We succeeded in restructuring our industry with minimum cash outflow, achieving an important position in Europe, and we are now among the three global leaders. We obtained these results with the consent of other firms and the local governments involved in the deal. We can say that we are satisfied. We must now continue to focus our efforts on the managerial and industrial implementation of the plan in order to ensure the group's further development. Once we have achieved further industri-*

*al consolidation through new organizational initiatives and investments, we can proceed to negotiate new agreements." Where did you turn next?*

## The Kabelmetal AG Deal

During 1989, there were rumors in the market that Kabelmetal AG, a division of the Munich-based MAN conglomerate — which was involved in businesses ranging from the production of lorries and precision machinery to the fabrication of copper and copper alloy products — might no longer be considered a core business of the group. In our highly capital-intensive business, size offers a potentially decisive competitive advantage. Kabelmetal, our major German competitor, had a turnover of about \$900 million, making it roughly comparable to our combined Italian-French operations. Through the links our parent holding company had with Allianz, a major MAN shareholder, we set up a meeting to explore MAN's interest in a possible sale. When we reached an agreement in principle on a sale, however, we stopped negotiating with MAN altogether and moved to a second phase of the acquisition.

*I'm confused. Why did you stop negotiating with MAN after merely reaching an agreement in principle to sell?*

There was another aspect of our provisional deal with MAN, which was that MAN would resume negotiations with us only *after* we had reached an agreement with the Vorstand members of Kabelmetal that a sale was in their interest and that they approved going forward. Then we would resume negotiations at the shareholder level. So it was a three-step process — MAN, the Kabelmetal Vorstand, then MAN — to complete the deal, within which we agreed that a *no* at any stage would terminate the negotiations.

*Why did you give such veto power to the Vorstand?*

Virtually everyone involved asked that question. You must realize that the Vorstand had *de facto* veto power anyway. The realities of German corporate governance are very different from those in France and a number of other European countries.

One element that is particularly nettlesome for would-be acquirers is the management structure of publicly held stock corporations. Each public company in Germany has a supervisory board — half elect-

ed by shareholders and half elected by employees — and a Vorstand or executive management board. Vorstand members are appointed by the supervisory board, typically for five-year terms. Realistically, if an acquisition of a German company is to succeed, it must be endorsed by the Vorstand.

Vorstand members cannot be removed from office unless a court of law proves just cause; typically, Vorstand members remain firmly entrenched for at least the duration of their five-year appointments. Furthermore, it is common for half the members of the supervisory board to be employee representatives inclined to select Vorstand members sympathetic to labor. In pursuing a merger or other combination, a buyer must work cooperatively with an entrenched management that is likely to be protective of workers' interests.

Another caveat: in Germany, a number of publicly traded companies have begun to enforce strict limits on the voting power that any one shareholder can hold. German law allows firms to add provisions to their articles of incorporation that restrict a shareholder's voting power to less than 5 percent of the total — regardless of the number of shares owned. This is essentially an antitakeover measure. Given a firm's ability to invoke such severe limits on outside control, an acquisition in Germany often makes sense only if the buyer's objectives are consistent with those of management; if there is any misunderstanding between buyer and Vorstand, the purchase is bound to be disappointing.

So if it does not sanction a deal, a German Vorstand can cause an acquirer endless problems and effectively poison a transaction. In my view, this was one key factor that doomed Pirelli's effort to acquire Continental. While Pirelli had shareholder support and ample financing, Continental management staunchly opposed the deal and ultimately thwarted it. With effort, a supervisory board could replace a recalcitrant Vorstand, but such a step would be radical in Germany and would result in grave problems.

In our case, rather than pursuing the kind of forceful power play we used with Tréfinétaux, we felt we had to persuade Vorstand members that the combination was in their interest. And, rather than let them assert their power, we preemptively acknowledged it and moved to sell the Vorstand on our vision for the combined entity in the new Europe of 1992.

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**“National cultural differences might have mattered a great deal, had we, as potential Italian owners, not taken pains to be very flexible.”**

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*That must have taken some effort. It seems that a German management team with an essentially passive shareholding parent would resist being acquired by a smaller Italian competitor with what promised to be a very involved owner.*

Indeed, the Kabelmetal managers were skeptical and highly reluctant at the outset. They had been largely autonomous under MAN ownership. And Kabelmetal had a proud, successful history after its founding in 1860, more than twenty-five years before either SMI or Tréfinmétaux. So we needed to paint a larger vision of where we could go together. We had to offer Kabelmetal a major place in this more expansive vision, a more significant role in Europe, I might add, than their current situation permitted. We pointed to our successful combination and restructuring of the Italian and French operation, which, of course, Kabelmetal management had followed closely. We assured them that, not only would we keep the present Vorstand — assuming their results continued to be positive — but, as we integrated our French, German, and Italian operations, they would have a leading role in management of the combination.

Instead of focusing on the loss of autonomy that Kabelmetal would suffer, relative to its current passive ownership, we urged the managers to consider the advantages of being a controlling shareholder that knew the business intimately and was absolutely committed to becoming one of the strongest competitors in Europe. Unspoken was the obvious threat: if they said no, we would soon be attacking them more aggressively in the marketplace. By saying yes, they would both eliminate us as a competitor and be poised to reap major competitive advantages from the scale that the combination would confer.

This was not merely a self-interested group of German managers trying to preserve their autonomy, power, and position. While the MAN group owned 77 percent of Kabelmetal AG, the minority shareholders were widely dispersed. Both legally, as fiducia-

ries, and personally, the Vorstand wanted to do what was best for all their shareholders and would continue to keep the interests of their minority owners in mind even if we bought MAN's holdings.

*How much did national cultural differences matter?*

They might have mattered a great deal, had we, as potential Italian owners, not taken pains to be very flexible. Incidentally, that was true with the Tréfinmétaux acquisition as well. While there were certainly stylistic and managerial differences between us, our commitment to locally managed firms made a difference. Moreover, we were all in the same business, had been for years, and were committed to being so. Rather than speaking German, French, or Italian, we all spoke “copper transformation” as a first business language. And we all shared a strategic vision of the central importance of efficiently structured size for competitive success in our industry. As a result of this agreement with the Vorstand on the guiding principles and shared vision for a combined entity, we completed the acquisition in December 1990 for some \$349 million.

*What about the more detailed operating aspects?*

We avoided detailed operating plans in the early stages. It would have been a major mistake to begin an itemized assessment of how we would combine our operations, who would be cut, who would take the lead on which responsibilities, and the like. That would only cause fear and potential organizational backlash. So we kept the discussions quiet, mainly at the top management level, and focused on guiding principles and shared vision. Later, when the deal was announced, we launched an implementation plan in line with agreed-on principles. Even after the deal was done, we still had to work with and persuade the Vorstand members on new initiatives rather than imperiously issue orders.

*How has it worked out?*

Quite well. Our management choices with Kabelmetal closely paralleled our experiences with Tréfinmétaux. We started with board-level coordination and have recently moved to group-level management with the same sort of structure: a Vorstand with each board member directly responsible for management of an international division plus horizontal international staff functions (MIS, financial and administrative sys-

tems, procurement, technology development, and so on). We simply scaled up the management structure we had put in place in 1993 for the French-Italian operations.

In 1992 and 1993, the recession hit our French and Italian operations especially hard, and we needed to accelerate their restructuring. Our overall results during the first few years were boosted by strong German performance, which made it easier for Kabelmetal to become central to the group sooner. Recently, we radically simplified the legal and industrial structure of the French-Italian-German operations (including a smaller Spanish joint venture). We increased the share capital of Kabelmetal by DM 189 million (US \$135 million), from a par value of DM 135 million (US \$96.4 million) to a par value of DM 325 million (US \$232.1 million). With respect to its 77 percent share of the capital increase, SMI contributed in kind all its copper and copper alloy fabricating subsidiaries. SMI's German partners, to account for their 23 percent share of the capital infusion, issued a stock offering, raising DM 43.5 million (US \$31.1 million) in cash.

The recapitalized company, rechristened KM Europa Metal AG, became the new holding company for the group. Whereas previously Kabelmetal's minority shareholders had owned 23 percent of a single subsidiary within the group, after the recapitalization, they controlled 23 percent of the holding company that owned *all* the group's subsidiaries. Consequently, Kabelmetal was given an enhanced managerial and industrial role. (Debt remaining from the 1990 Kabelmetal acquisition continued to reside with SMI. To expedite debt repayment, SMI issued new shares of stock and undertook a systematic sale of nonessential fixed assets.)

Ironically, in terms of profit, the Italian and French entities had traded places with Kabelmetal and were now the most profitable within the group. The seven-person Vorstand of KM Europa Metal AG, incidentally, had three German members, three Italian, and one French, though selection was based on merit, not on a U.N.-like criterion of geographic balance.

Following these domestic and cross-border acquisitions, and after significant restructuring, consolidation, and debt reduction, we have become one of the most important European competitors in semifinished copper and copper alloy products. With only 2.3

times the number of employees it had in 1965, the SMI group in 1995 produced more than eleven times its 1965 tonnage in fourteen plants across Europe, with annual turnover in excess of US \$3 billion, a profit upswing of about US \$100 million compared to 1993, and every indication that the positive trend is continuing. The group's return on equity is now 9.2 percent. Our next challenge is to further boost profitability, which is too low. But we are now making all decisions with the consolidated balance sheet in mind.

### **Lessons from the Kabelmetal AG Deal**

*I see many of the same negotiating lessons we distilled from your Delta, TLM, and Tréfinmétaux experiences, though applied here very differently.*

*Again, the driving logic was industrial. The time horizon was protracted, requiring discipline to adhere to a consistent, long-term strategy. You had to distinguish among the various parties on the other side and understand as thoroughly as possible each player's interests — MAN and Kabelmetal's Vorstand — from that player's perspective. Understanding their interests and the no-deal alternatives needed a detailed assessment of national political, economic, and corporate governance practices — which differ sharply between France and Germany, and between either of these countries and Italy.*

*With the assessment, you had to discern potential allies and blockers and develop an approach, proposals, and a sequence to meet each player's interests better than the no-deal alternatives. Then you had to persuade each party of the possible value in embracing rather than undermining a proposed combination. Once the deal was done, in order to maximize and sustain its potential value, you needed to create a structure in which the parties kept negotiating their common interests productively.*

I would say that you have captured the approach exactly.

*Thank you and good luck with your operating results and your next deal.*

### **Successful Negotiating across Borders**

My advice, distilled from my interviews with Ceccuzzi, builds on general principles of effective negotiations and SMI's experiences. Its applicability goes far beyond cross-border transactions.

1. Be very clear about the industrial and strategic logic behind your proposed acquisition and the genuine value it will create.

2. Take the long view. Be prepared to be patient, perhaps for years, as circumstances ripen the potential for the deal (unless your own forcing actions can hasten this result without undue risk of escalation). Then, act decisively but be careful not to stimulate an emotional counterreaction.

3. Well before any potential transactions, become familiar with the industry and establish good personal relationships; draw on these assets to develop the deal.

4. As with any deal, prepare by mapping the likely players, the interests that your approach will evoke, the players' no-deal alternatives, and their likely positions vis-à-vis your approach.

5. In creating the player map, factor in the procedures of corporate governance in the target company's country and the relevant characteristics of the political economy.<sup>5</sup> In particular, assess which parties are likely to be involved and which are likely to be motivated and able to block a deal or make it more costly. If you are not deeply familiar with governance and the local political economy, find advisers who are.

6. With the *individual* player map provisionally in place, assess potential alignments in the coalition, delineating:

- Those likely to favor the deal — especially the potential deal-driving coalition or the entity with the most significant stake in success — ideally cutting across organizational boundaries and perhaps including stakeholders outside either the acquiring firm or the target. Distinguish between the likely unconditional allies and those who would be allies if you address their concerns.
- Potential blocking coalitions — opponents that may individually or as a group have the power to stop the

deal. Distinguish between those with objections you can meet and those who may be unconditionally opposed.

- Patterns of influence or deference among the other players, in particular, whether one group will defer to another or if one group's position will determine or influence another's.

7. Customize your approach to each group; maximize chances of success by carefully sequencing negotiations and making explicit choices about the nature of your persuasive emphasis at each point. Think carefully about when you will meet with others separately and in larger groups.

8. Decide on a strategy for dealing with potential deal blockers. Should you try to meet their interests to convert them into supporters? Should you sidestep them, play them off against each other, or simply try to overcome them directly or with the help of other parties that either are influential with would-be blockers or can override them?

9. Focus on how *they* are likely to see things, not on how *you* think they should see them. Where possible, craft your approach so it offers value and a vision in their terms, yet in a manner that accomplishes your objectives. Imagine and help to give them a story they can tell themselves, peers, families, and constituents about why they *should* favor the deal.

10. Craft a deal structure not only for legal, financial, organizational, and tax purposes, but also for key audiences and constituencies whose interests you are taking into account. Especially in politically salient deals, pay attention to the messages conveyed by your approach and the structure of the deal.

11. Retain the initiative in negotiating cross-border deals; don't be blindsided by the other party.

12. Act to ensure the sustainability of the deal, remembering that once the deal is done, negotiation does not stop.

## References

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■ 1. For a discussion of the statistics in this introduction, see, for example, European Commission Directorate General for Economic and Financial Affairs, "Mergers and Acquisitions," in *European Economy: Supplement A, Economic Trends*, Supplement A, number 3