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DUE DILIGENCE: LEARN FROM THE PAST, BUT LOOK TOWARD THE FUTURE

**A qualitative study of how Strategic DD could be a way to
increase M&A chances of success.**

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ABSTRACT

This paper presents an analysis on Due Diligence process as a tool to reduce the Mergers and Acquisition (M&A) risk of failure which is used by the acquirer to gather quantitative but also qualitative information about the target in the pre-merger deal, before to sign the agreement of the deal.

However, the process is sometimes unknown or underestimated since the executives sometimes want the deal to be closed as soon as possible, and neglect some critical factors which can be important to get a true vision of the target and therefore increase the chance of success of the deal in future. In the view of the enormous economic significance in M&A transactions numbers and volume, it is alarming that more of half of all transactions do not lead to the desired objectives. To investigate in this problem, some studies have emphasized Due Diligence impact to increase M&A chance of success.

Indeed, Due diligence is viewed as the only way to find out as much information as possible on the target company. It is a way to conduct a comprehensive investigation into this potential target.

In this thesis, we will focus on Financial Due Diligence which is an unavoidable way to evaluate the target to allow getting financial information, but show its limits.

That is the reason why, we will highlight the role of the Strategic Due Diligence in this paper, which fulfill the FDD limits since it allows the bidder to think strategically as each deal is unique in what its value drivers are. Finally, in this paper we concluded that the SDD is the way companies should perform the DD to increase the M&A chance of success since each deal is unique in what its value drivers are and that is what SDD is all about.

To support our paper, we have addressed two interviews with 2 financial analysts who work in audit companies located in Stockholm to gather their points of view on the subject. Moreover, both of our case studies on BNP Paribas and HP provide illustrative example on how financial and strategic Diligence can be conduct.

Key Words: Due diligence, Financial Due Diligence, M&A, Business valuation, Strategic Due Diligence.

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ABBREVIATION TABLE

<u>ABBREVIATION</u>	<u>FULL NAME</u>
DD	Due Diligence
FDD	Financial Due Diligence
SDD	Strategic Due Diligence
M&A	Merger and Acquisitions
RQs	Research Questions
BNP	Banque Nationale de Paris
HP	Hewlett-Packard

1. INTRODUCTION

In chapter one, we will present the background and the problem. Then the three research questions are highlighted as well as the purpose of our paper. Then we will point out the limitations of the research to finally provide a structural guide to the reader of our thesis.

1.1. BACKGROUND

Due to the emergence of globalization in the industries and international markets, more and more companies seek to increase revenue, search for further growth and lower cost through mergers or acquisition.

By definition, Merger is the combination of two or more companies in which the assets and liabilities of the selling firm are absorbed by the buying firm (Sherman & Hart, 2006). Although the buying firm may have a considerably different organization after the merger, it retains its original identity. Acquisition is the purchase of an asset such as a plant, a division or even the entire company (Gaughan, 2002).

For Ghaugan (2002), despite the differences between them, the terms mergers and acquisitions are sometimes used interchangeably. As a matter of fact in this thesis we will use them interchangeably.

Mergers and acquisitions have long been performed by companies in the need to seek growth to gain market shares from competitors, create economic profits, and provide returns to shareholders. It is such common practices that companies which are out of the game are likely to stay ahead from merged companies.

Although there are several obvious reasons to merge, the authors pointed out the fact that most of mergers and acquisitions would fail. Many reasons are studied to explain this trend. In fact empirical studies have treated the question and tried to understand the reason of this trend over the past decades. The term failure is understood as not achieving what was expected from the merger and acquisition.

De Florian (2007) pinpoint a study of Boston consulting group (2003) which analyzes 277 US American mergers and acquisitions between 1985 and 2000. It was then found that on the average, 64% of all mergers and acquisitions lost value at the time they were announced, and 56% of all mergers and acquisitions transactions had lost their value after 2 years.

Therefore it seemed important to seek elements which could reduce the risk of M&A failure. KPMG Study (1994), Jeffery & Herd (2004), Morrison and als (2008) pinpoint Due Diligence process in the pre-merger deal as one of they key factor to reduce the risk of M&A failure. For Kearney consulting (2004) a handful of best practices can reduce the risk and give the deal a fighting chance.

Indeed, Due Diligence which is the investigation of a potential investment is viewed as a way to prevent unnecessary harm to either party involved in a transaction.

In fact many transactions are unsuccessful because the acquirer cuts corners on due diligence-down – sizing and delegating important due diligence work. The acquirer sees in it a way to gain time, save money or spare feelings by shortening this deal phase and as a result they miss on this valuable one-time chance to explore the risks inherent in buying another company before signing on the dotted line (Lajoux 2000).

As a matter of fact, the danger in due diligence is not that companies fail to do it, but that they fail to do it well regarding to their strategy.

Since Financial Due diligence (FDD) is crucial to the success of any acquisition, it seems interesting to study and analyse how it is use to value the target. The objective of FDD is to investigate in the financial performance of the target in the past, present, but also the future and therefore give a critical point of view of the financial statements of the target.

Nevertheless, if we cannot ignored this tool to value the target, it has got some limits since it is just focus on the financial analysis of the company and forget others elements which can be primordial to the future of the M&A.

Since each deal is unique, the acquirer should considers an acquisition in the context of its industry and ask himself if the deal will be profitable in the future and therefore beneficial for his company. In order to do that, the acquirer should think strategically according to the nature of the target, but also the initial objectives wanted. Hence, Strategic Due Diligence (SDD) play a part in this process, since it allows the buyer to question itself in a critical way on how to plan the due diligence process and which area it should emphasize on to investigate in the key elements of success of the M&A. Indeed in the SDD, the company needs to assess the deal rationale by assessing the attractiveness of the M&A and its capability to realize the targeted values. Its specificity is also the fact that each deal is unique and then the due diligence scope should also be unique since the value drivers of an M&A vary from one case to another.

1.2 RESEARCH QUESTIONS

We have set up two research questions which are inter-related to draft this thesis.

They are inter-related because first we will highlight the limits of FDD to show that companies should strategically perform their due diligence in order to reduce the most the M&A risk of failure. We will try to give a framework of the way to perform FDD since it is a necessary tool to value the company.

However, relying on the financial aspect of the due diligence only which companies tend to do might be limitative to conclude the deal. That is the reason why we conclude that the strategic due diligence is a good way to perform a Due Diligence.

RQ1. What is done in a FDD to increase M&A chance of success and what are its limits?

RQ2. Why could the Strategic Due Diligence be an alternative way to overcome the limits of FDD and thus increase M&A chance of success?

1.3 PURPOSE

The purpose of this thesis is in the first time is to understand how Financial Due Diligence should be performed to play its role of reducing the M&A failure risks and what are its limits, and then to show how the Strategic Due Diligence could be used to fulfill the

Financial Due Diligence limits, and then be a better way to conduct Due Diligence process in order to increase the M&A chance of success.

1.4 LIMITATIONS

We have notice that Due Diligence process have not been much subjected to attention in the literature review either because it involves usually confidential information that companies don't want to disclose to avoid the risk to lose the deal or because companies tend to ignore its real importance and analyst have only recently began to pay attention to this process. Therefore it was sometime difficult to collect information about the process.

Moreover, we had a time constraint to conduct the interviews, since we had to wait on average 2 weeks before doing each interview which was scheduled by the interviewees according to their availability.

In fact the audit companies have heavy schedule and our interview guide sent to auditors was the basis of our empirical study. But few auditors accepted to answer our interview guide because they would not have the time for it.

Moreover, from the interviews we found out that auditor where more working on the financial due diligence part and this could have influenced their responses. In fact, we think they may know more on the financial aspect of the due diligence rather than the other areas since it is the main part of their daily work.

Besides, due diligence is a sensitive topic for companies who are not willing to disclose information on this topic we where somehow constrained to focus on literature review to build our case studies.

1.5 READER'S GUIDE

Part 1. The introduction presents the framework of our topic and background associated to the subject. Then it will lead us to our main research questions.

Part 2. Here with the Methodology we justify our thesis choice but also the research methodology' tools which have been used to draft our paper and our qualitative research design approach, choice of data collection methods...

Part 3. The literature review in part 3 helps to describe the issues related to M&A and present FDD and SDD.

Part 4 In the Empirical part, we show the result of our interviews.

Part 5. Illustrative examples: BNP Paribas and HP case studies.

Part 6. Analysis and interpretation of the interviews.

Part 7. In the conclusion we will summarize our paper.

Part 8. Then we will assess the reliability and validity of our findings.

2. METHODOLOGY

In this part, we give an explanation of the choice of our subject, and which kinds of research methods we have used for the paper, as well the research approach and scientific position we have adopted, but also the collection, the research design and our data collection method.

2.1 CHOICE OF STUDY

We were interested in Due Diligence because few researches deal about due diligence and moreover the auditing profession point of view on the subject haven't yet been analyzed in a thesis.

Moreover, many surveys and studies published analyze the increase percentage of M&A failure which we found then interesting in trying to know what the main factors of this trend are. Besides, according to KPMG Study on 1994, Jeffery and Herd (2004), Nan & Als (2008), since M&A has become increasingly complex, the activities of Due Diligence have become ever more important to reduce this risk.

Then, the choice of this topic was motivated by our mutual interest in audit and financial studies since we have assisted to some courses regarding Analysis of Financial Statement and Advanced Auditing in our Master program which gave us a good basis on the audit environment and company valuation methods. Therefore our topic could be a good way to use our previous studies knowledge in analyzing an economic subject. Moreover we wanted to know more about due diligence and since few researches deal with the subject, we wanted to study a topic which is challenging and which hasn't been enough explored yet.

Then in this thesis we adopt the audit firms perspective. Our position was motivated by the fact that we needed to interview people who knew a lot on due diligence and who were familiar to the subject. Then since professionals who work in audit firms often have to work in many firms, we thought that they could have a clear view of the subject, its implications and provide us with a critical opinion supported with real facts. Since they are involved in the due diligence directly, we thought they were the right person who could give us a critical view on the subject and use their experience in their profession to justify their position.

2.2 SCIENTIFIC APPROACH

Here we will explain the choice of our approach for the thesis by summarizing first the different possible approaches in a thesis and then justify our choice in accordance to our thesis subject and purpose.

➤ **Ontological orientation**

When choosing an ontological orientation, one may choose between Objectivism and Constructionist. In an Objectivism approach, social reality exists outside of the researchers' mind. It is external to the researcher. Social phenomena and their meanings exist independent of social actors. In a constructionist approach, reality in the social world is constructed and not wholly existing out there. Social phenomena and their meanings are continually being accomplished by social factors. Reality is then a social construction. (Bell & Bryman, 2003).

According to these concepts, we took Constructionist ontological orientation because each deal is unique and we have to adapt the Due Diligence regarding the specificity of the deal and the company involved in the M&A transaction.

In performing Due Diligence, the audit company can be wholly influenced by the specific characteristic of the target.

Moreover historically, the role of due diligence has been to document the financial background of a potential candidate and compile legal information on the firm being acquired, such as corporation documentation, stockholders and potential lawsuits. But in the present environment, the scope of the due-diligence process needs to be expanded due to social factors such as: - the increased number of international acquisitions necessitates a due diligence analysis of the requirements of foreign ownership; - A mismatch of company cultures, market position, strategic direction and a myriad of other factors have caused a number of M&A to fail. (Michael, 1998) Due to the social factors which influence due diligence, the constructionism was the best orientation for our paper.

➤ Epistemological orientation

In an epistemological orientation, one may choose between Positivism and Interpretivism. In the Positivism orientation, reality exists objectively out there (Natural science view), and it is only by following the scientific method of testing hypotheses that we can get knowledge about it. This orientation is common in quantitative design and researcher tries to be neutral o the object of the study. In the interpretivism orientation, researchers need to interpret the reality as the subject matter of social science – people institutions – is fundamentally different from that of the Natural Sciences. This orientation is common in qualitative design studies. Values, norms a subjective position of the researcher and research community are vital elements in the study.

In our paper we used the interpretivism orientation which advocates that researchers need to interpret the reality. Due Diligence concept involves numerous fields such as financial, human, environmental, and it is up to the buyer to choose which fields are the most relevant to his M&A case. Then the scope of the process can vary depending on the nature of the bidder. Besides, the financial statement can be interpreted in different ways, some people would be interest in the economic profits only whereas others by the assets of the company.

➤ Induction approach

For scientific approach there are three kinds of approaches, Deduction, Induction and a mixture of them called Abduction. Deduction is a hypothesis testing theory. The theory and the hypothesis derived from it come first, and guide the process of data collection. Hypothesis is a testable proposition about the relationship between two or more event and concepts. In Abduction processes, the researcher combines both induction and deduction. The induction is an approach where the researcher infers the implications of the findings for the theory that prompted the research, and this approach is often associated with qualitative research design.

In our study, we started with observations and findings about the Due Diligence process and its impact to improve M&A success. We have raised some questions on what could be the best practices in this process to help companies involved in M&A transactions to avoid critical errors and answered both of our RQs. Then, we tried to collect qualitative data through the literature review' information to have a theoretical framework on Due

Diligence process, the interviews with audit companies helped us to have a professional perception on this process. At this stage, when reviewing the information from the interviews, we found the importance of the Financial Due Diligence and concluded to the relevance of Strategic Due Diligence which we inferred from our findings. From here, we started to investigate deeper in these two aspects, see their differences and how they could be related. Finally both of our case studies helped us to collect concrete application of these two types of Due Diligence and show us how they can be perform in reality thank to the illustrative examples of BNP -Paribas and HP-Compaq mergers. In this way, we drew our subject and theory based on the information collected which is the case in an inductive approach.

2.3 RESEARCH APPROACH

To reach our purpose for this study and understand how the Due Diligence can be conduct to reduce the M&A risk, we choose a qualitative method.

Qualitative researchers are more concerned about issues of the richness, texture, and feeling of raw data because their inductive approach emphasizes on developing insights and generalizations out of the data collected (Lawrence & als 2000). In fact we though that the inductive approach will fit more our subject.

We were interested in making more research in the topic of due diligence since we found out that there were not much thesis dealing on the subject and it is not a very known process although it is in the center of M&A failure and success.

We wanted to get our information from the literature review and as well from the interviews. The interviews would then guide us in our research and have more concrete information on what is going on in reality according to auditors on Due Diligence Process.

Our first interview was held to help us understand more about due diligence in M&A , in fact we had a lot of information on the topic but still we were not sure about the relevance of our primary idea of the thesis subject. The auditor interview would help us to raise the relevant questions then and narrow our topic as a consequence.

From the literature review we managed to find school of thinking on the due diligence process with those who present generally one aspect of the due diligences as the critical success factor of the M&A.

From our point of view and after the information given by the (the first) interviews we decided to take a position and defend the SDD which we found more relevant according to us in the fact that its concept was more or less identified in the outcome of the interviews.

As a matter to fact, to answer our two research questions, we will use the literature review which partly answers in giving the theoretical view on the subject. Then, the interviews will give the professional judgments of Audit Company about FDD and SDD. Finally, our two case studies illustrate the previous parts in giving concrete example.

2.4 RESEARCH DESIGN

The research design is an important phase when writing a thesis because it helps to define the steps to follow in order to achieve the goal of the study.

The case study design is to detail and intense a single case or multi-cases. It is concerned with the complexity and particular nature of the case in question. Moreover, case studies are the preferred strategy when 'how' or 'why' questions are being posed (Yin, 2003) and since we want to show how FDD should be performed and how SDD is a way to reduce risk in M&A, we have used this design to complete our information from both our interviews. The choice of BNP Paribas Bank comes from our professional experience in this bank during one year internship in 2006, and the choice of HP Compaq is due to the recognition of the deep analysis performed in the due diligence process of the deal.

2.5 DATA COLLECTION METHOD

The choice of our data collection method was influenced by the approach of our thesis which we have explained earlier follows an inductive method.

When choosing the data collection method, one should choose among wide array methods techniques available for collecting the information for the research. Then this exercise require judicious selection of one method or more considering the factors like suitability to the problem, available resources, kind of data required to be produced and the level of precision required is necessary (Sridhar 2007).

In our paper, we decided to begin with reviewing the literature on due-diligence in order to have an idea of the subject and be able to ask in the interview the right questions to answer our research questions and raise the relevant issues. Then the interview of auditors would be a way to have a concrete idea of due diligence issues and gather information about how it is performed and how it should be done etc. However since we struggled to have other interviews, we decided to support our ideas with case studies which would be concrete examples to illustrate the information gathered from the interviews of auditors. Here we will show the different data collection methods used:

- **Literature**

To answer our two research questions, first of all we gathered information through literature review and available information in different websites, financial newspapers, and specialized books about M&A and Due Diligence. We also have used databases like Emerald. Moreover the information from literature helped us to clarify the subject, but also give us some tools to implement a process to develop our topic.

Indeed, we can get the macro information but also micro information about M&A concept and Due Diligence. First, it has helped to understand the subject and the link between Due Diligence and M&A success and secondly to propose the Strategic Due Diligence as alternative to Financial Due Diligence's limits. As a matter of fact the review of the literature allowed us to answer our research questions.

- **Interviews**

Then, we used interview as a data-collection technique which involves oral questioning of respondents, either individually or as a group. For our qualitative purposes, we needed to choose to be flexible in performing semi-structured interviews (this interview is focused on asking certain questions but with scope for the respondent to express him or herself at length) in order to limit the subject around our purpose and our topic but also to get more information if necessary throughout the interview. Semi-structured interviews are conducted with a fairly open framework which allow for focused, conversational, two-way communication. They can be used both to give and receive information. The majority of questions are created during the interview, allowing both the interviewer and the person being interviewed the flexibility to probe for details or discuss issues. Semi-structures interviewing is guided only in the sense that some form of interview guide and provides a framework for the interview (D'Arcy 1990).

When conducting the interviews, we more or less followed the questions depending on how it was going on and the information given by auditors. In fact when a relevant issue was raise, we then put more time in trying to understand its implications. As well we raise important questions when we needed more clarification from the interviewees. The interviews where then very interactive and more and exchange rather that closed questions. Nevertheless we always paid attention to ask through the interview the main questions we needed to consider to both of the interviewees.

Due Diligence is a very confidential concept in the financial market; it is hard to find some relevant information in the subject. Therefore, the most important for our purpose was to conduct interviews of quality with the right professionals who were able to answer correctly. That is the reason why it was primordial to address the interview to experienced financial analyst in famous audit companies who have performed many times Due Diligence exercises. By right professional we mean people who know about the subject and who are able to provide us with a critical reasoning. In fact the interviewees have been working on Due Diligence on a full time basis since many years. Moreover they dealt with many cases in different companies; this motivated our choice to interview auditors in the end.

- **Case studies**

Because we had limited available respondents, we finally conducted 2 case studies to illustrate our findings in the literature and from the interviews.

The first case was about a French bank BNP Paribas which seemed to be a good example of M&A success, since BNP and Paribas have merged in 1999. This case gives a perspective on conducting FDD.

Moreover, BNP Paribas is the bank leader in the M&A process and continue to acquire many others banks around the world. It seemed interesting to answer our RQ1 to draft the FDD on the group' financial core statements and thus have a concrete vision on what are the main elements in the business valuation in the evaluation of a company. Finally we will conclude with the fact that FDD has got some limits since it focus just on financial statements and forget others aspects of the company.

Then the second case study focuses on the Strategic Due Diligence process applied in Hewlett – Packard -Compaq merger as mentioned by Accenture group. This case highlight the fact that the companies have investigate in many aspect and raise the value drivers of the deal which can be relevant to increase the M&A success.

In fact the deal was well know to have set a deep and thorough exercise in the due diligence exercise which lasted almost 2 years but which was closely linked to the success of the deal. Then this case study is entitled to answer the RQ2 since their due diligence was performed in a strategic way, that is to say by following the Strategic Due Diligence process and adapting the due diligence to the specificities of the case.

However, we have not the pretension to set up entirely the FDD and SDD process for both of the companies, since the processes are very complex to understand and require lengthy investigations and obviously skills and experience. We will give a valuation based on the analysis of Balance Sheet, Income statement and Cash Flow Statement for case study 1, and a view on the SDD process for case study 2.

3. THEORY REVIEW

In chapter three, we will introduce the Due Diligence with its background about the Mergers and Acquisition concept. Indeed, we want to point out the place of this tool in this M&A concept. After the review of M&A description and motives we will insist on the cause of failures in the M&A deals. Then, we will highlight the impact of Due Diligence on the risk reduction in transactions failures. Afterward, we will go more deeply in the Due Diligence process through the analysis of Financial Due Diligence as a tool to value the target company but present also its limits. Finally we will study how the Strategic Due Diligence fulfill these limits and improve the chance of M&A success.

3.1 SCHOOL OF THOUGHT

The strategies behind the M&A have always been supported by many schools of thought which are divided into different perceptions of what the main value for the company is.

In fact, some theories promote the predominance of financial aspect as principal value in a company, while others the human resources, synergies or both as principal value. According to Haspeslagh & Jamison (1991) the theorists researching M&A can be categorized in some broad schools of thoughts:

The Capital market school took the more financial approach when researching M&A. The main objective was to see if any financial value were obtained from engaging in an M&A and who benefited from the deal. The general conclusion of this research was that the shareholders of the target company benefited financially, and the acquirer obtained none or little financial profit from the acquisition.

The Strategic school studied how the acquisition affected the individual companies involved in the process. Within this category of thoughts two focuses can be identified, one group looked at the performance of the acquisition, what synergies were captured by engaging in the M&A. The other group looked at the M&A process in itself.

We focus on these two schools of thought, which are in line with FDD and SDD.

3.2 M&A MOTIVES

The motivations of M&A are numerous and complex and have been analysed within different fields as corporate governance, industrial economics, finance, or fiscal system (Détie, 2005). Gaughan (2002) drafts the following main motives of the M&A.

3.2.1 GROWTH

Gaughan (2002) explains that one of the most fundamental motives for M&A is growth. Growth is when company grow within their own industry. Indeed, investing in growth through acquisition would create more value for the companies. In our case study on BNP Paribas a major player in the bank sector in France, the main motive to this merger was growth. In fact for the two companies, the M&A was a strategy to acquire opportunities that meet their profitability criteria and use their existing businesses and operations to expand in

the overall market. Today, the group has adopted the same strategy to merge with others firms.

3.2.2 SYNERGY

The second goal presented by Gaughan is the Synergy. It refers to the type of reaction that occurs when two substance of factor combine to produce a greater effect together than which the sum of the two operating independently could account for. Synergistic gains are created when there is a mixture of actors that will create a greater value together than otherwise could have been possible comparing the firms operation their own.

Generally synergies created through a merger will either reduce costs or increase revenue. Cost synergies can be achieved through economies of scale.

3.2.3 DIVERSIFICATION

The third goal suggested by Gaughan is the diversification which means growing outside a company's current industry. Diversification could be in the domestic market or in the cross boarder one. Yeary (2004), co-head of global M&A at Citigroup, says the cross-border M&A business is growing significantly faster than overall M&A activity, which also is expanding at a healthy pace. Bruner and Perella (2004) argue that the managers may regard the need to diversify the firm's revenue resource as the reason for mergers.

3.2.4 ECONOMIC MOTIVES

The fourth goal presented by Gaughan (2002) is more on economic motives through vertical and horizontal integration.

- Horizontal integration refers to the increase in the market share and the market power those results from acquisitions and mergers of rivals. A firm's efficiency may be increased because a big company is more able to realize economies of scale (Strategor, 2005).
- Vertical Integration refers to the merger or acquisition of companies that have a buyer-seller relationship. With the vertical mergers, the potential acquired companies can enter in the different stages of production.

3.2.5 OTHERS MOTIVES

Moreover, its exist others motives behind M&A as improved management, Research and Development, improved distribution, but also tax motives.

Knowing the motives of M&A transaction can be useful to draft the suitable Due Diligence for each deal. Indeed, knowing the future expectations between the bidder and the target allow implementing the suitable tools to achieve their goals. It might be also interesting to study the main causes of failure which can obstruct these goals.

3.3 WHY DO M&A FAIL?

Studies and analysts have allowed shoeing the main reasons why M&A fail to reach success. Globally the reasons identified appear to be the same and point out relevant reasons why M&A fail, which we will list in this part. In fact the due diligence process is supposed to overcome these causes of failure should it be well done and implemented.

“Of course the merger was a success. Neither company could have lost that much money on its own”

Steve Case, Former Chairman of the board, AOL\Time Warner.

“Capitalism is a creative destruction”

Joseph Schumpeter (1883-1950).

The value of annual global M&A transactions is estimated to be running at more than \$2.2 trillion in 1999 (Thomson Financial Securities Data). In the view of this enormous economic significance of the transaction numbers and volume, it is alarming that more of half of all transactions do not lead to the desired increase in value and higher return on investment for shareholders. A study by McKinsey (1991) concludes that 70% of M&A fails, KPMG study (1999) showed that 83% of mergers were unsuccessful in producing any business benefit as regards shareholder value. For Galpin and Herndon (2000), the expected synergies for M&A are only reached in 30 per cent of the cases. Why despite the importance of the companies involved in the deals and the amount engaged, some M&A fails?

First of all, it is important to know what failure means. For Rankine (2001), an acquisition fails if the acquired did not increase shareholder value or did not achieve the financial, commercial or strategic objectives set at the time of buying business. Moreover, we point out the fact that there is not just one reason of M&A fail, but several causes which can lead it. We have chosen the most relevant ones in the literature review to introduce the importance of Due Diligence to avoid the failures.

3.3.1 A WRONG OR POOR STRATEGY

A correct strategic analysis is essential in a company decision making about the type of acquisitions that ought to be considered, how large they should be, and how quickly they need to be achieved. Indeed, companies need to create methods of analysing drivers and understanding the relative impact of the key factors. A survey of European middle to senior management revealed that only 20 per cent were able to define the key policies of their organisation the existing level of gross profit or return and what their company planned to become over the next three years (Rankine, 2001).

Misunderstanding what is driving the market is the most basic mistake. Where companies fail to take proper account of the major forces acting on the market, then strategic choices and the acquisitions accompanying them will lead to major failure. Companies can have poor goal setting with the first difficulty will be to setting up the objectives and having high growth expectations. Rankine (2001) illustrates this case with the examples of M&A by Exxon (oil producer) with

office furniture, General Motors (auto manufacturer) with missiles or Quarter Oats (cereal manufacturer) with toys. The chances for success in a transaction increase when the acquirer company focuses on known industries and countries.

3.3.2 OVER-ESTIMATED THE POTENTIAL SYNERGIES

“There are some synergies here for sure. I don’t know where they are yet. To say that now would be an idiot’s game”

Barry Diller, commenting on QVC’s proposed strategic acquisition of CBS in 1994

An objective of an M&A described before is to increase value of the shareholder. This incremental value should come from synergies (cost reduction, sales growth), but often companies makes mistakes in the estimation of these synergies.

3.3.3 PAYING TOO MUCH

Conquering the pressure of price negotiation is a crucial skill. In the worst case, the acquirer will go bankrupt or so overextend itself as to become a takeover subject. Bad bidders usually become good targets for other companies. For Mitchell and Lehn (1990), about 40 percent of the firms that fail in the acquisition of a company become targets for other companies. The bidder has to make a realistic valuation.

3.3.4. INTEGRATION PLAN NOT DEVELOPED IN ADVANCE

Integration planning is essential in the pre-merger process. It must be planned in advance because the integration plan is integral to the valuation, implementation of the integration plan should start immediately once the takeover is completed, and decisions about integration must be made in advance if resources are to be made available and to make integration really work.

KPMG study (1999) enhances that integration project planning goes hand in hand with synergy evaluation as a key to merger success. It is critical to work out the mechanics of *how* synergies will be attained, and also how the combined business will be stabilised to preserve *current value* and ensure that one plus one does not make less than two. The survey confirms, that the chances of merger success are increased if the process of working out ‘*how*’ is started well *before* the completion of the deal. Those companies that prioritised pre deal integration project planning were 13% more likely than average to have a successful deal.

3.3.5 CULTURAL DIFFERENCE

Another criterion identified as part of relevant causes of failure is the cultural differences of two businesses combining. Culture difference refers to the way the decisions are taken in the acquirer and acquired companies, since each company has its own organizational culture with which employees identify. Indeed the companies' organizational culture may be very different and then cause poor efficient communication:

A lack of concern for the cultural factors forms a major obstacle to success of international M&A. Srilata, Schomaker and Genc (2003) suggest that cultural incompatibility between the target and acquiring firm has significant impact on why M&A operations sometimes fail to achieve the pre-defined goals. In most of transactions, the acquirer company imposes its culture to the acquired company and will put the employee with different education backgrounds, different working attitude and habit even different value together. For Habeck, Kröger, and Träm (2000) although this strategy can work sometimes, most of the times this is a perfect way of destroying value.

3.3.6 PROBLEM AREAS NOT IDENTIFIED IN DUE DILIGENCE

Due Diligence (DD) aims to ensure that the acquirer does not get any nasty surprises after taking control of business. Relying on the last audit of the target company and a chat with its management is now recognised as at best problematic or, worst, a patently disastrous route to familiarising the buyer with the potential problem it is likely to face. There are much more demanding than corporate acquirers because, as outsiders to the industry they are investing in, investors start with less basic knowledge of the markets in the first place.

There are three principal reasons why DD disappoints or fail:

- The question were not asked in the first place : when the acquirer company management is overconfident about its knowledge of the target company
- If the question were asked, satisfactory answers neither were nor obtained: the target company provide restricted answers, or claims to be bound by 'commercial confidentiality' or shelter behind a lack of effective record keeping, the risks soar.
- The deal process hampered the completion of effective DD: several deals constraints can happens as hostile acquisition, auction, time pressure, sensitivity of the seller.

It is up to the team involved in the Due Diligence to analyse, identify and resolve potential key elements necessary to avoid the M&A fail.

In this part, we have seen the different elements which can lead the M&A to fail in regard to our first RQ, but also we have shown the role of the Due Diligence. Indeed, a wrong or poor strategy, an over-estimation of the potential synergies, paying too much, an integration plan not developed in advanced, or cultural differences are the main causes of failures in a due diligence process. However there are some problem areas not identified in the due diligence by companies which also can lead to failure. Because it is all about performing well the due diligence exercise to benefit from it, which we will try to develop in the financial and strategic due diligence.

In the following part, we will demonstrate why and how Due Diligence through its objectives might reduce the percentage of failure of the M&A transactions.

3.4 DUE DILIGENCE

In this part, we will define the due diligence concept as well its place in the merger and acquisition process. We will show the different possible areas of due diligence process by showing the basic scope utilized which rely on financial and legal aspects, as well the emerged areas of due diligence over the past decades which are numerous.

3.4.1 CONCEPT AND DEFINITION OF DUE DILIGENCE

Due diligence as it applies to mergers corporate acquisition is understood to mean an investigation into the company acquired in various aspects previously defined.

The term is commonly used when it comes to mergers and acquisition processes. In other words it is simply trying to ascertain and find information which can be relevant in deciding whether or not to proceed the M&A.

In fact the idea is for the buyer to make sure that it knows what it is investing in and uncover possible relevant elements which might be critical for the M&A success and know more about what it is buying.

Because the notion of due diligence often vary between the different professionals involved, there might be different definitions of the term influenced by their own role in the process. For Schmitz (1996) due diligence is all the inquiries and investigations made by a prospective buyer in advance of the acquisition of a company to determine whether the acquisition should go ahead and upon what terms.

The due diligence can be performed by a team of people as all the aspects of business might be involved: science, technology, product development, engineering, production, marketing, sales, human resource management, legal context, liabilities etc (Angwin, 2001).

3.4.2 PLACE OF DUE DILIGENCE IN THE M&A PROCESS

Here we will describe at which stage is Due Diligence taking place in the merger and acquisition process. In fact there are 4 stages in the merger and acquisition process and stage 2 is about the due diligence process.

As described by Howson (2003), the due diligence process is composed with 4 stages, we will describe here the elements in those 4 stages using Howson's explanation as a basis.

This table illustrates the 4 stages of a merger and acquisition and due diligence is part of the second stage. We will explain in more detail what it includes:

THE ACQUISITION PROCESS

PHASE1	PHASE2	PHASE3	PHASE4
Strategic review	Heads of terms	Sale and purchase negotiation	Post-completion
Systematic search	Due diligence	Completion	
Approach			

Source: The critical stage in mergers and acquisitions , Howson (2003)

● PHASE 1:

The first stage of the acquisition is about the strategic review, the systematic search and the approach.

The strategic review is about drawing and determining the company's strategy. This is done through a deep review of strategic objectives. The acquisition first goal is in fact to answer a strategy, but the strategy needs to be defined previously and understood in advance. The following process after a clear identification of the strategy through strategic review is a systematic search for acquisition targets.

In fact, during this stage of phase 1, the company needs to identify the targets for the merger or acquisition. The company lists a certain number of criteria to consider meeting the strategy and using it as a basis for searching the right candidate. In fact, it will help identify the company which meets those criteria early settled.

The result of this process is a drawing of a list of companies who meet the most the criteria and in the mean time a ranking of those companies.

The approach is the phase were the company first get in contact with the targets in order to propose them the merger or acquisition.

● PHASE 2:

The second stage is about the heads of terms, and the due diligence. This stage comes after the success of the approach. Then through Agreement/ Head of Terms/ Letter of intent, both companies record an agreement to negotiate the purchase of a business. The document sets the conditions of the deal and elements of the deal.

Still in phase 2 comes the due diligence, which helps to understand more deeply important issues on the company which is being bought. This phase helps to plan and evaluate the post-deal integration and minimize risks which could occur.

● PHASE 3:

The stage 3 is about the sale and purchase negotiation and the completion. In fact, at this stage the due diligence process is already done and the idea is to conclude the deal and since the buyer has all the elements on hand he can then proceed to negotiations considering the elements it has on the acquired company. This could be negotiating the price according to findings in the due diligence or seek protections etc, Then the completion process is about signing definitely the documents which established conditions.

- **PHASE 4:**

The stage 4 is about the post completion stage, where it is about making the return from the new acquisition which justifies the price paid. The due diligence process is important for this stage, because it is entitled to give a view on the post-completion plan and draw it.

3.4.3 DUE DILIGENCE SCOPE

In this area we will expose the different due diligence exercises. In fact the due diligence can cover different topics and a list of fields have emerged over the past decades which have widen its scope. We will describe the basic scope of due diligence mostly of financial and legal aspect, followed by some of the emerging elements.

In this area we will expose the different due diligence area. In fact the due diligence can cover different topics and a list of area has expanded its scope over the past years. We will concentrate on the most common due diligence area.

3.4.3.1 BASIC DUE DILIGENCE SCOPE

The basic due diligence scope is composed of the financial and the legal aspect mainly. Moreover historically, the role of due diligence has been to document the financial background of a potential candidate and compile legal information on the firm being acquired, such as incorporation documentation, stockholders and potential lawsuits (Harvey, 1998).

- In the financial due diligence, the focus is on the validation of historical information, the review of management and systems. The goal is to confirm underlying profit and provide a basis for valuation.
- In the Legal due diligence, the focus is on contractual agreements mainly and the goal is to uncover warranties and indemnities as well as validate all existing contracts, sale and purchase agreements.

3.4.3.2 EMERGED ELEMENTS

Here is some other due diligence areas which have emerged during the last decades. Even though the most commonly applied due diligence prior to conducting a merger and acquisition are the Financial and Legal aspects, the due diligence process may concern various other fields such as legal, environmental, commercial, corporate culture, systems/IT, pension, fiscal, insurance, human resources, and various other aspects.

In fact experts have begun to re-examine the traditional due-diligence process of the past several decades to determine how to enhance its value. The complexity of M&A transactions, the financial instruments used in the transactions and increased government regulation have stimulated a renewed interest in due diligence (*Harvey, 1998*)

- **The Commercial due diligence** is based on the investigation of market dynamics, the target's competitive position and commercial prospects. The goal is to assess the sustainability of future profits and formulate the strategy for the combined business.

- **The Human resources and culture** due diligence goal is to make up the workforce, the terms and conditions of employment, the level commitment and motivation as well as the organizational culture. The goal is to uncover any employment liabilities, assess the potential human resources costs and risks of doing the deal, prioritizing the HR issues that need to be dealt with during integration, assess cultural fit, costing and planning the post-deal HR changes (Howson, 2003).
- **Environmental due diligence** can be defined as the systematic identification of environmental risks and liabilities associated with an organization's properties and operations. In fact there is an increasingly stringent movement of the regulatory framework in many developed countries towards the 'polluter pays' principle, with greater emphasis now being placed on environmental issues across all industries in order to manage potential risks associated with poor environmental performance or impact on the natural environment. It is all about assessing the environmental risk associated with a merger and acquisition (Reuvid & Young, 2005).
- **Pension due diligence** may be performed if the purchaser is acquiring the pension scheme as part of the transaction. Purchasers will not want to have to make large, one-off contributions to the scheme, the biggest concern, therefore, will be funding deficits (Howson, 2003). The idea is to minimize the risk of underfunding due to the various pension plans and plan valuations.
- **Insurance due diligence** investigates in the present, future and most importantly past exposures of the business. The structure and cost of the existing program (Howson, 2003).

3.5 FINANCIAL DUE DILIGENCE

Since we want to show the importance of the FDD in the success or failure of the deals, our goal in this section is to analyse which elements are primordial and have to be taken into account when the different actors of the M&A teams perform the deals.

As we mentioned before, certain reasons explaining the failure of M&A are the over-estimation of the potential synergies, or paid too much. The acquired company is not interesting if the total business does not reflect the price paid. For Gaughan (2002), the acquirer needs to ascertain the value of the target to determine the proper offering price and whether the target company meets the acquirer's financial standard.

Of course both sides in a M&A transaction will have different ideas about the worth of a target company: the seller will tend to value the company at as high of a price as possible, while the buyer will try to get the lowest price that he can. The current financial actuality is led by the proposal of acquisition of Yahoo! by Microsoft. Jerry Yang, the CEO of Yahoo! Who requested \$ 53 billion or \$37 per share, whereas the executive management of Microsoft led by Steve Ballmer walked away from a proposal to acquire Yahoo for \$47.5 billion, or \$33 per share (Le Figaro Economique, 2008).

Glen (2005) demonstrates that before acquiring a company, an audit of the target company should be done in order to collect valuable information relating some issues as value and quality of the receivables, litigation problems. In this part we are going to demonstrate how

FDD could be done to reduce the M&A failure through the business valuation of the target thanks to various financial instruments plebiscite by the literature review or the interviews addressed. Our objective in this part is to express a framework of the FDD process in order to give some theoretical answers for the RQ1.

3.5.1 OVERVIEW

One purpose of FDD is to confirm the existence of assets, liabilities and equity in the balance sheet, and to determine the financial health of the company based on the income statement. Statement of Cash Flow enables the merger' analyst to access the firm ability to generate future cash flow that may be used to service the debt that might result from a merger (Gaughan 2002). We will demonstrate in the BNP Paribas' case study how the data collected from these three statements are used by FDD to investigate on the company.

Now, we are going to show with which financial ratio, the financial analyst is able to calculate and evaluate a business, thus to provide financial key elements to the M&A success.

3.5.2 VALUATION

We will try to present in this part some financial instruments and ratios as a basic model that may be used by the financial analysts to evaluate a business. We have not the pretension to claim that this framework is a perfect one; but we try to present and analyze main elements which have to taken into account in the business valuation given by some authors in our literature reviewed on the subject or by interviewees.

The valuation of the target is a key element in the FDD process, because it allows the acquired to get information about the value of the target in order to evaluate and pay the 'good' price as well.

Investors in a company that are aiming to take over another one must determine whether the purchase will be beneficial to them. In order to do so, they must ask themselves how much the company being acquired is really worth (Investopedia).

Fist of all, it seems relevant to know clearly what value means. There are different concepts of value for Harvard Business School Press (2001):

- Intrinsic value: Is the net present value of expected future cash flow independently from any acquisition
- Market value: The market can add a premium to the intrinsic value to reflect the possibility that a company should make an offer to acquire the company.
- Purchase price: Is the price that a bidder company thinks it will have to pay in order to be accepted by the shareholders of the target company.
- Synergy value: The synergy value is the net present value of the cash flow that will result from the improvements that are made when the two companies are combined.

Then, we are providing some tools to build our framework with the calculation of some data like P/E ratio, Discount Cash Flow.

- ❖ P/E ratio or the 'multiple method'

The Price-earnings (P/E) reflect the amount an investor is willing to pay for the firm's earning on per share basic (Gaughan 2002). The P/E is sometimes referred to as the "multiple", because it shows how much investors are willing to pay per dollar of earnings. In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E. indeed, a higher P/E ratio indicate that the investors have a greater degree of confidence in the firm's future prospect. A valuation ratio of a company's current share price compared to its per-share earnings is calculated as (Investopedia):

$$= \frac{\text{Market Value per Share}}{\text{Earnings per Share (EPS)}}$$

For example, if a company is currently trading at \$43 a share and earnings over the last 12 months were \$1.95 per share, the P/E ratio for the stock would be 22.05 (\$43/\$1.95).

With the use of the P/E ratio, an acquiring company makes an offer that is a multiple of the earnings of the target company. Looking at the P/E for all the stocks within the same industry group will give the acquiring company good guidance for what the target's P/E multiple should be.

However, it should not be used as the only or main valuation method in an acquisition, due to the external factor which influence its calculation. First of all, it is necessary to examine public companies in the same industry in order to compare their P/E ratio. It would not be useful for investors using the P/E ratio as a basis for their investment to compare the P/E of a technology company (high P/E) to a utility company (low P/E) as each industry has much different growth prospects.

P/E is basically only useful when the companies analyzed is public because access to key numbers are essential, both for the individual calculations, but also to be able to compare. In case of a hostile deal for instance, the buyer can have more difficulties to get accounting information useful to calculate the P/E ratio.

❖ Discount Cash Flow method

Discounted Cash Flow (DCF) is a valuation method used to estimate the attractiveness of an investment opportunity (Investopedia). A study of Kaplan & Ruback (1995) reinforces the superiority of the DCF valuation to other valuation methods. DCF analysis uses future free cash flow projections and discounts them (most often using the weighted average cost of capital or WACC) to arrive at a present value, which is used to evaluate the potential for investment.

If the value arrived at through DCF analysis is higher than the current cost of the investment, the opportunity may be great. That is the reason why DCF it is the most trusted and utilized valuation method (Weston and Weaver, 2001). The calculation of DCF is:

$$DCF = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \dots + \frac{CF_n}{(1+r)^n}$$

CF = Cash Flow

r = discount rate (WACC)

To calculate the DCF, we need to follow some steps:

1) Determine the time period that is expected to generate these cash flows. It is usually the period when is expected to keep the company's competitive advantage.

2) Estimate the free cash flows, which are the amount of cash generated before financing.

The definition of Free Cash Flow which has already been calculated previously can be summarized by this formula:

$$\begin{aligned} & \text{NET INCOME} \\ & - \text{DEPRECIATION / AMORTIZATION} \\ & - \text{CAPITAL EXPENDITURES (amount spend to acquire physical asset)} \\ & - \text{CHANGE IN WORKING} \\ & = \text{FCF} \end{aligned}$$

By calculating FCF it is assured that the CF generated is available to the providers of capital both equity and capital. However, the free cash flow is not a measure of value creation from selling products. It is just a dividend of excess cash from operating activities to the financing ones.

3) Estimate the terminal value, which is the expected amount of money that the company is expected to be worth at the end of this period.

4) Determine a company's weighted average costs of capital (WACC) for the investment.

WACC is the average of the costs of these sources of financing: common stock, preferred stock, bonds and any other long-term debt; each of which is weighted by its respective use in the given situation (Investopedia). See in appendix the calculation of WACC

Despite the complexity of the calculations involved, the purpose of DCF analysis is just to estimate the money you'd receive from an investment and to adjust for the time value of money. DCF models are powerful, but they do have shortcomings.

To resume, the previous financial tools are relevant to investigate in the present but also past and future expectation of the target. The P/E ratio is a good valuation method, which can easily be applied and it is useful as a valuation method for a target company. Moreover, the use of this ratio is also a future-oriented approach because the bidders are willing to know about the firm's future earning, not just its current earnings. As a key valuation tool in pre-merger process, DCF determines a company's current value according to its estimated future cash flows. Moreover, this method can be used in the valuation of the public firms but also closely held firm.

3.6 STRATEGIC DUE DILIGENCE

In our study we want to emphasize on the strategic due diligence as a concept which may reduce the risk of M&A failure rate. In this part we will define what is meant by strategic due diligence. In fact companies have long focus their attention on financial and legal aspects of the due diligence as mentioned above, hoping that it would help them to reach success. Despite their effort, it seems that still it is not enough to cover a due diligence scope and avoid a company to fail in the post acquisition phase.

3.6.1 DEFINITION

The strategic due diligence is presented as going far beyond financial due diligence. It is a way of performing a due diligence and increases the chances for the merger to succeed.

According to Accenture, buyers must look ahead and measure the target company against the vision it aims to achieve. Such strategic due diligence investigations range from

immediate post-merger integration issues, the anticipated reaction of customers and competitors to the longer-term impact on the industry.

The strategic due diligence is a complex exercise which emphasize on analyzing if the deal will work and is worth it. It takes into account the deal specificities and concentrates on investigating on what is considered to make the deal work.

In Sikora article (2007), Due Diligence is considered to be more thorough than ever especially since the Sarbanes-Oxley law of 2002.

Also it advises the seller of a business to take time to understand very well a business before concluding an M&A deal. In fact it is supported by a kpmg study which found that 46% of corporate divestors and 25% of private equity sellers thought they did not maximize value in selling and often that means the seller cashed out too fast without understanding the business as well as the buyer.

It is said that Deals are getting bigger, and more cross-border transactions are getting done. That combination forces the buyer to take on more risk at the very time the Sarbanes-Oxley law, enacted in 2002, is holding corporate boards and executives accountable if they don't exercise adequate care when they pursue strategic initiatives. Boards are demanding more rigor in deal analysis, and investors, already skeptical of M&A because of a long history of value-crunching transactions, are ratcheting up pressures for strong performance. (Siroka 2007)

Also Tom Flaherty which is the senior vice president in the energy and utilities practice at Booz Allen Hamilton Inc., highlight the fact that the due diligence exercise has evolved and tend to focus now more on analyzing if the business can be run effectively rather than trying to show that the numbers are realistic and it witnesses the strategic approach which is more and more adopted when performing due diligence.

Similarly, Jeff Gell, who heads M&A in the Americas at Boston Consulting Group, says, "You want to make sure that the economics of what you are acquiring are right, that it makes strategic sense and that there are no massive surprises that are going to bite you after the fact."

In a study dealing with value creation in M&A, it is found that among the reason why some acquisition did not create value is the fact that:

- managers of the acquiring company did not understand the target company at the time of the acquisition.

- the acquirer imposed an inappropriate organizational design on the target as part of the post-acquisition integration process;

The study was based on interviews done with managers and internal performance data. It relied on information from Cooper Industries' acquisition of Cameron Iron Works in 1989 and Premark's acquisition of Florida Tile (formally known as Sikes Corporation) in 1990. Both case didn't seem to have create value overall.

The study which was done through interviews with managers and internally generated performance data analyzed the reason why these acquisition were followed with negative outcomes.

The main reasons of negative outcomes which were found from the interview with Cooper Cameron managers was that not enough time was spent on operating and strategic management issue.

In fact the acquiring company Coopers didn't take enough into account the specificities of the acquired company Cameron for whom a centralized organizational design and incentives was not appropriated. In fact the management system at Cameron was not efficient. This highlights the importance of understanding the target company in order to avoid crucial issues. Here particularly, the organizational design was inappropriate.

For Premark's acquisition of Florida Tile, some issues not addressed earlier could have affected the acquisition outcome. In fact the acquiring company didn't made enough analysis on the acquired company to try to know if the deal would work. The deal suffered from a lack of coherence between both companies in term of market. Premark and Florida Tile were not on the same market segment and the synergies opportunities were not well assessed before the deal was concluded.

This deal shows the importance to know the target company in the pre-deal phase in order to assess in a proper way the potential value created from the deal otherwise the outcomes will be totally divergent from the expectations.

3.6.2 STRATEGIC DUE DILIGENCE MODEL

Whereas financial and legal due diligence ascertain the potential value of a deal and concern buying the company "at the right price," strategic due diligence explores whether that potential is realistic. It tests the strategic rationale behind a proposed transaction with two broad questions which helps to uncover the potential value of a deal (Adolph, 2006) :

- Is the deal commercially attractive?
- Are we capable of realizing the targeted value?

This table illustrate the main points to consider under each question when evaluating the deal rationale:

	Is the deal commercially attractive?	Are we capable of realizing the targeted value?
FOCUS EXERCISE	<ul style="list-style-type: none"> - External Inquiry - Assessment of commercial attractiveness through identification of drivers of earnings - Calculation of competitive position of combined company - Assessment of impact on customers, competitors and overall market dynamics 	<ul style="list-style-type: none"> - Internal focus - Hard internal examination of whether the targeted value of the deal can be realized - Assessment of associated risks in term of customer and competitive responses, technology issues, and cultural challenges followed by assessment of ability to manage those risks - Test of company capability of realizing projected synergies

Source: Gerard Adolph 'Strategic due diligence a foundation for mergers and acquisitions success' (2006).

Explanation of the table: this table illustrate how the strategic due diligence is performed by identifying the deal rationale through 2 broad questions. The main idea is performing internal and external inquiries by going far beyond financial due diligence aspect only.

In we see that the company through the external inquiry question himself on the future outcome the deal would realize and the deal attractiveness and impact on customers. Through the internal inquiry, the company assesses if it can with its internal resources realize the targeted value and as well assesses its risks associated with different areas which will help him to strategically draw its due diligence should one or more areas be relevant for the success of the deal. Also the ability to realize the synergies is assessed.

3.6.3 STRATEGIC DUE DILIGENCE: A UNIQUE EXERCISE

According to Adolph (2006), strategic due diligence ensure that no transaction are treated the same way, each deal has its own value drivers, and thus the composition of each due diligence team must change. Executives should determine which areas of the organization will produce value in the merger, and draw members of the team from those areas. Companies much then tailor their process to the issues and potential integration challenges of each specific deal.

Furthermore, for Rosenbloom (2002), every transaction is unique and requires a customized approach. Executives should determine which areas of the organization will produce value in the merger, and draw members of the due diligence team from those areas.

4. EMPIRICAL PART

In this chapter, the empirical method is presented. Our research method, the way we conducted our interviews will be explained. The interviews revealing that even if financial Due Diligence is very important to lead M&A success, it might not be enough. In fact the company may face the necessity to look beyond the basic scope and widen the required information. It has to uncover what drives value which can help gain comfort of dynamic of project.

4.1 OUR RESEARCH METHOD

To build our paper, we decided to contact the main audit companies which are among the big4 with principally Deloitte, KPMG, PWC and Ernst & Young and we tried to be in contact with the head of the Transaction services or alternatively someone who have been working since few years on due diligence to be able to have a clear opinion on the subject. In fact the Transaction service of an audit company mainly deals with corporate advises and private equity firms on how to use transactions more effectively to reach their business goals. As well it helps clients to understand the markets, assess the impact of regulatory changes, screen acquisition or alliance candidates, prepare for divestures and uncover hidden opportunities, risks and deal issues whether the objective is to diversify, enter new markets, reduce costs, exit businesses, or raise capital). More specifically, it deals with due diligence issues and companies in the process as an advisor and in making the necessary reports. We tried to request interviews in France and Sweden but finally we managed to have 2 interviews in Sweden mainly from Pricewaterhousecoopers after having tried many contacts. We really analyzed the relevance of the answer and experience of the person interviewed. In fact, the quality mattered more for us than the quantity.

Our questionnaire consisted of 24 questions and was divided into 4 parts.

In the first part, we asked general question to the financial analyst about their position and role in the audit company.

Moreover we evaluated the experience of our interviewees since seniors are more able to find credible or relevant information about how a FDD is performed rather than a junior financial analyst.

In the second part, we asked questions on the auditor role in the due diligence process. The idea was to evaluate their main working skills.

The third part was about a depth analysis of the questions inspired by the literature review we found on the topic such as the link between due diligence and mergers failures.

Part four included questions concerning the process itself and a critic on the component of the due diligence process from the basic financial aspect to the emerging fields over time such as environmental due diligence, commercial, strategic due diligence.

Few of our questions were drawn as closed questions to have the confirmation of our understanding of the subject However, for the need of our qualitative method most of the questions were open-ended questions which allow the respondent to have more the possibility to answer on its own way.

Since we wanted to gather information from French and Swedish audit companies, the questionnaires have been submitted in French and English and as well each e-mail request sent to audit company offices. As we mentioned before, we haven't receive any response from French audit company, which limits our study to Swedish auditors.

Before the interview:

Before each interview we prepared ourselves so that both of us could take advantage of the interview and listen to the answers. We also were taking notes of the answers or relevant information the interviewees could raise.

First we tried to contact a certain number of potential interviewee mainly auditing companies in France and Sweden which are among the Big4 with principally PWC, Deloitte, KPMG, and Ernst & Young. Then we tried to be in contact with the head in the Transaction services or alternatively someone who have been working since a couple of years on due diligence process to be able to have a clear opinion on the subject. As we mentioned previously, the transaction service is the department which work on the M&A transaction to perform Due Diligence. We mainly found the addresses from Internet or sometimes through contact with previous teachers in the auditing field. Moreover, we draw a table with all the contact we would like to reach first. We then call the listed phone numbers and exposed them our request for interview. Most of the time we would be given an e-mail address to which we would send our request with the questionnaire so that the person would have a deeper idea of the topic and whom to contact for answers.

At this stage, we needed to have information from professional involved in M&A transaction. Indeed, it is important that the interviewees are professionals and work in the Due Diligence process during long time, in order to secure that, the respondents have got a great experience so the information they provide supports this research.

The respondents were initially contacted by phone, this were arranged through their receptions. Then for almost half of them we the questionnaires by email and then try to arrange a telephone interview later.

The respondent received information, background, and the questions a few days in advance of the telephone interviews by e-mail. This approach is better to give the financial analyst time to reflect on the questions and save time during the sessions, and as well to avoid any misunderstandings that might have occurred at a later stage in the interview (Saunders and al. 2003, page 255).

For the other half sample, after the first telephone contact, we sent them directly our questionnaires and these respondents should answer directly the questionnaires and resend it to us by mail.

During the interview:

First of all, we started the phone interview by presenting ourselves (field of study, etc), and Then the interviewees did the same.

The first interview took 80mn while the second one took 100mn. For the first interview, we had the possibility to record our conversation, but for the second one, the respondent did not allow us to use any recording device, such as a tape recorder etc. We then could take notes using pen and paper.

That is the reason why this interview takes place in the PWC location in Umeå in a conference room which we have booked according to the interview requirements.

We explained our ideas on what might be the best way to prepare a FDD but also analyzed if the audit company considered that FDD is enough to investigate and value a company.

To collect more efficient data suitable for our thesis, we needed first to see how the problem is perceived by the professionals of the market through the literature review. Then obtaining answers would be useful for us; we carefully selected our questions for the interviewee and tried to clearly express what we would like. For example, we put a short explanation when it was necessary (see appendix).

4.2 THE INTERVIEWS TRANSCRIPTION

Here we will expose in different relevant parts the outcomes of the interviews. In fact both auditors have answered nearly to the same questions. In fact the interview was semi-structured and we could have more or less directed the questions or followed the questionnaire. Nevertheless in general they have pointed out the same relevant topics on the subject and given their point of view we describe here:

4.2.1 GENERAL INFORMATIONS

- **Respondent A: Transaction Service Director.**

The respondent A works in an audit company X, which is among the big 4. He has been working in due diligence since 7 years in a full time basis.

The company service is mainly concentrated in the cities of Stockholm, Goteborg and Malmo. He is a Director of the transaction service of his firm and is in charge of coordinating, leading the team members as a project leader.

His main competence is on the financial due diligence composed of analysis of balance sheet, working capital, cash flows and other areas, etc...

The respondent A. mainly has worked with small and middle-sized companies. He also leads a team of pension analysts which is mainly involved in foreign countries deals which have difficulties in this area. Then he often performs tax advisory services for firms.

- **Respondent B: Financial Analyst.**

The respondent B also works in an audit company X, which is among the big 4. He has been working as a financial analyst in due diligence process in Stockholm.

He first was an auditor and then became a financial analyst. However in total he has worked on this position since 12 years and know a lot on the subject since he has witnessed the 90's where due diligence really began to take place and see a growing demand among companies.

He mainly deal with small and mid-sized companies owned by individuals which when they perform a merger and acquisition often have not enough experience in this area and then buy services from audit companies.

4.2.2 Due Diligence practices.

The respondent A agreed on the fact that a due diligence process may lead to M&A failure due to the diligence practice. For him, this is mainly the case when the buying company doesn't make enough investigations in the acquired company to uncover possible troubling elements. He also pointed out the fact that often financial companies

The respondent B also agreed on the fact that a due diligence process may lead to M&A failure. He thinks this is the case when the company doesn't strategically draw the scope of the due diligence but instead perform it without knowing the real reason behind it, which is often the case of industrial companies. To prove it he gives the example of companies which 15 days before concluding the deal call for the audit company service which shows that the exercise is not considered to require a lot of time. But in reality it does require a lot of time and often the buyers deadline is not followed and goes from 15 days to 4 months of required due diligence.

4.2.3 Due diligence: Limitation of scope and risk assessment

For auditor A, a company can consider the limitation of the due diligence scope as relevant. In fact performing a due diligence on all possible subjects might not be wise. He points out the fact that industrial buyers often for instance have not a very important budget then focusing on the main elements may be required. He pointed out that the company should assess the risks it is exposed to and defines the scope of the due diligence as a consequence. Then should a company face environmental issues in his business it would have to perform an environmental due diligence to avoid risk exposure.

For auditor B, the company should think about where to look at when drawing the due diligence scope. It is for him up to the buyer to establish the most important areas and see in which ones it is risk sensitive or not. For example for him commercial companies might be less risk sensitive to the market since they know a lot on the products they are selling and their tendencies. He emphasized the fact that commercial companies often perform a due diligence on Financial, Legal and Human aspects. And financial customers know a lot on financial aspects when it comes to due diligence exercise since their main goal in a merger and acquisition is to buy a company and re-sell it later to drive value. Then they often need to appeal for due diligence experts for the others areas of due diligence they lack of knowledge in. Moreover, he states that industrial companies know their industry a lot and have good information on their competitors but don't have a real knowledge on why they perform a due diligence which they see as a routine exercise.

4.2.4 Financial due diligence:

The respondent A emphasizes on the need to go beyond only performing an accounting focus due diligence when it comes to perform a financial due diligence and rely on financial statements only. He consider that the traditional way of performing the financial due diligence which is more accounting based may be a reason of badly performing a financial due diligence. In fact on the way it is done today, he pointed out the necessity to do a more analytical work and focusing on the findings dynamics.

Driving projections became then important and not only relying on past performances. This can be done through the establishment of proper way of valuing such as DCF (Dividend Cash Flow Model) which will help to understand how much cash the deal will generate in the future and compare it to the investment the buying company wants to make.

The respondent B emphasize on the fact that some companies don't perform a proper due diligence especially when they have their in-house due diligence teams. In fact they are for him often basing their analysis on few annual reports and draw conclusions from it. He think that a proper financial due diligence should be done through the establishment of a proper team which is skilled, getting the right information on the target company and quality information to understand the financial figures and projections.

4.2.5 Critical aspects in due diligence:

The auditor A pointed out the need to assess market issues for the buyer as critical for success. In fact he points out that the buyer should not only assess financial aspects in the due diligence but it should also drive analysis on the market issues of the deal to increase chances of success. The market outlook review is important according to auditor A, but most of all the company needs to understand what drives value.

The auditor B points out the need for the buying company to understand why it is performing a due diligence and link it with a defined goal or strategy instead of doing it randomly. He thinks the company should question itself and also assess the human due diligence aspect which is often not really looked at while it might be important to identify key persons in the company.

4.2.6 LIMITATIONS

As we said before, first it is very hard to find some people who want to be interviewed on Due Diligence process due to the confidentiality of the issue. In France, the rate of answer was of 0%, therefore, our research is limited to the point of view of Swedish audit company. Moreover, during the interview with the two interviewees, due to their reluctance to tell in which companies they have performed a due diligence, they never explicitly gave illustrative cases which could have been helpful to support our study.

Since the information we gathered are from professionals, we assume that the answers have are of high quality due to their knowledge and their perception of their position in Due diligence.

The next chapter will present two concrete cases of Due Diligence exercise for two companies. The first case is about the French bank BNP Paribas will illustrate according to financial information gave by our interviewees (like balance sheet, income statement, cash flow) but also our literature review how we could analyze financial statement and which elements are important during the Financial Due Diligence process.

The second case is about HP will illustrate according also to the information from our interviewees and literature review which elements are critical for the buyer. Indeed, we could show how we can implement SDD in order to reach the initial objective of the buyer not just only according to financial information but more strategically as mentioned by both of the financial analysts from the audit company during the interviews.

5. ILLUSTRATIVES EXAMPLES

These illustrative examples goal are to answer RQ1 and RQ2. In fact the first case study deals with the Financial due diligence aspect whereas the second one deals with the Strategic due diligence aspect. We want to illustrate how in the concrete case we can use FDD and SDD according to our interviews and literature review.

5.1 BNP PARIBAS CASE STUDY

As we said previously, because we had limited respondents, we finally conducted two case studies to illustrate our findings from the literature review and from the interviews with both of the financial analysts. For BNP Paribas case study, the purpose is to give an overall financial valuation for this group based on the analysis of common financial statements like Balance Sheet, Income statement and Cash Flow Statement. Indeed, from our both interviews and literature review, we have noticed that this step is critical to avoid some mistake during the Financial Due Diligence process and thus, get more financial element for the company. The function of this case is to deal with financial statement of BNP Paribas and show which elements are important when the auditors process Financial Due diligence. We could see for example that the financial data come from not just one year but many years to see the evolution (increase or decrease) of certain value drivers like net income or dividends.

We choose BNP Paribas case study because it is the first bank in France specialized in performing M&A transactions. Moreover, due to the difficulties to find information about Due Diligence because of confidentiality aspect of the topic, it was easier for us to find financial information on the annual reports of the group which has disclosed this information every year.

Since we want to show how FDD could be done in order to reduce M&A failure, for this case, it seems important in our mind to first of all give an overall vision of BNP Paribas group through its business description and its acquisition strategy. Then we have taken quantitative approach to analyze earnings, assets, liabilities and cash flow statement of the group to be focus on the main information used to set up the FDD process and as base to going to more complex valuation with for example Discount cash flow model. Finally, we conclude with the analysis of FDD for the group, with some like the positive earning of the group in the past but also in the future which can be important for investor when they take decision to merge or not.

We have also highlighted the fact that Financial Due Diligence may not be enough to reduce M&A failure, since only the financial elements are used in this case.

Furthermore, since this case is completely based on financial information to perform Due Diligence, we take the decision to put together another case study about Strategic Due Diligence to show that financial information are not the only one element to build a 'complete' Due Diligence, and more to conduct M&A through the success.

The first case was about a French bank BNP Paribas which seemed to be a good example of M&A success, since BNP and Paribas have merged in 1999. This case gives a perspective on conducting FDD.

This case study is a way to show how we can conduct FDD to evaluate a company. As we mentioned before, we have not the pretension to develop here the FDD through the calculation tools mentioned previously; since the process is too complex. With this case we want to show how we could value a company through its financial statement by taking into account the past, present and future data.

5.1.1 BUSINESS DESCRIPTION

We choose this group since it has itself realized an M&A in 1999 with the merger between BNP and Paribas, two big banks in France.

Since both have conducted a great FDD with an exact valuation of the two companies, the group records today a great profitability. Besides, since their mergers, BNP Paribas follows the same strategy with the acquisition of others banks around the world, hence they are the first bank in French market specialized in the M&A transactions due to their strong experiences in this process.

Overview: BNP Paribas Group is the fruit of the 1999 merger between two of France's most influential banking groups, the retail-oriented Banque Nationale de Paris (BNP) and Paribas bank traditionally focused on the institutional sector. The newly merged group is France's largest bank and among the top five European banks.

Company profile: BNP Paribas is a European leader in banking and financial services, with a significant and growing presence in the United States and leading positions in Asia. The Group has one of the largest international banking networks, a presence in over 85 countries and more than 162,000 employees, including over 126,000 in Europe. Therefore we can see the impact of this group in the European but also international bank sector.

Company perspective and mission statement: BNP Paribas, powerful growth potential and value creation. With its large international presence, the new Group has the means to achieve its ambitions: to become a European leader in each of its markets by seizing the opportunities linked to the euro and to be a major player on the global scale, while continuing to improve shareholder value. To growth the company use the process of Organic growth, which is a more normal and sustainable process, can be done through new distribution channels, sales locations, develop production etc.

5.1.2 ACQUISITION STRATEGY OF THE GROUP

In 1999, BNP countered with its own bid a hostile takeover of both Société Générale and Paribas and was in a position to carry out a merger of equals with Paribas.

Building on strong banking and financial services businesses, the new Group's objectives are to create value for shareholders, clients and employees by building the bank of the future and becoming a benchmark player in the global world. To support these goals, acquisition and partnership have been done by the group since the merger in 1999.

5.1.3 BNP PARIBAS VALUATION

➤ Earnings

Earnings in millions of euros	2007	2006	2005	2004*	2003*
Net banking income	31,037	27,943	21,854	18,823	17,935
Gross operating income	12,273	10,878	8,485	7,231	6,650
Net operating income	10,548	10,095	7,875	6,553	5,289
Net income before tax	11,058	10,570	8,424	6,905	5,586
Net income attributable to the Group	7,822	7,308	5,852	4,668	3,761
Evolution		7,0%	24,9%	25,4%	24,1%

* Under French GAAP

Source: BNP Paribas registration report 2007 (own make)

Through its different subsidiaries and core business, the Net Income of BNP Paribas raises from EUR 3,761 million in 2003 to EUR 7,822 million, to the earning records an evolution of 137, 4% in 4 years.

Despite the strong economic downturn in the second half of the year in the financial market, BNP Paribas reported record earnings in 2007. Net banking income jumped 11.1% year-on-year to EUR 31,037 million, while net attributable income came in 7.0% higher at EUR 7,822 million.

This performance was driven by a buoyant organic growth, as well as the limited impact of the sub prime crisis on earnings and provisions. The Group's business model proved its strength in 2007, with all core businesses delivering further earnings improvements on the already buoyant performance in 2006, and BNP Paribas Capital reporting substantial capital gains (BNP Paribas website).

➤ Assets

In millions of euros	Note	31 December 2007	31 December 2006
ASSETS			
Cash and amounts due from central banks and post office banks		18,542	9,642
Financial assets at fair value through profit or loss	5.a	931,706	744,858
Derivatives used for hedging purposes	5.b	2,154	2,803
Available-for-sale financial assets	5.c	112,594	96,739
Loans and receivables due from credit institutions	5.d	71,116	75,170
Loans and receivables due from customers	5.e	445,103	393,133
Remeasurement adjustment on interest-rate risk hedged portfolios		(264)	(295)
Held-to-maturity financial assets	5.g	14,808	15,149
Current and deferred tax assets	5.h	2,965	3,443
Accrued income and other assets	5.i	60,608	66,915
Investments in associates	5.j	3,333	2,772
Investment property	5.k	6,693	5,813
Property, plant and equipment	5.k	13,165	12,470
Intangible assets	5.k	1,687	1,569
Goodwill	5.l	10,244	10,162
TOTAL ASSETS		1,694,454	1,440,343

Source: BNP Paribas registration report 2007

At 31 December 2007, the Group's consolidated assets amounted to EUR 1,694.5 billion, up 17.6% from EUR 1,440.3 billion, at end-2006. The main components of the Group's assets were financial assets at fair value through profit or loss, loans and receivables due from

customers, available-for-sale financial assets, loans and receivables due from credit institutions, and accrued income and other assets, which together accounted for 95.7% of total assets at 31 December 2007 (95.6% at 31 December 2006). The 17.6% increase in total assets reflects a rise in most of the Group's asset categories, particularly financial assets at fair value through profit or loss (up 25.1%), loans and receivables due from customers (up 13.2%) and assets available for sale (up 16.4%). These increases were partially offset by a fall of 9.4% in accrued income and other assets and 5.4% in loans and receivables due from credit institutions.

➤ **Liabilities**

LIABILITIES & SHAREHOLDERS' EQUITY		
in million of euros	31 dec 2007	31 dec 2006
LIABILITIES		
Due to central banks	1724	939
Financial Liabilities at fair value through profit or loss	796125	653328
Due to credit institutors	170182	143650
Due to customers	346704	298652
Debt securities	141056	121559
Others liabilities	61310	56334
Others elements	117960	111057
TOTAL LIABILITIES	1635061	1385519
CONSOLIDATED EQUITY		
Net income for the periode attributable to shareholders	7822	7308
Others elements	45977	42204
<i>Total Shareholders' equity</i>	53799	49512
Minority interest	5594	5312
TOTAL CONSOLIDATED EQUITY	59393	54824
TOTAL LIABILITIES AND EQUITY	1694454	1440343

Source: BNP Paribas registration report 2007(own make)

At 31 December 2007, the Group's consolidated liabilities (excluding shareholders' equity) totalled EUR 1,635.1 billion, up 18.0% from EUR 1,385.5 billion at 31 December 2006. The main components of the Group's liabilities were financial liabilities at fair value through profit or loss, amounts due to credit institutions, amounts due to customers, debt securities, accrued expenses and other liabilities, and technical reserves of insurance companies, which together accounted for 98.2% of total liabilities (excluding shareholders' equity). The 18.0% year-on year increase was driven by a rise of 21.9% in financial liabilities at fair value through profit or loss, 16.1% in amounts due to customers, 18.5% in amounts due to credit institutions, and 16.0% in debt securities. A 7.2% rise in technical reserves of insurance companies and a 9.6% rise in accrued expenses and other liabilities also contributed to the increase in total liabilities (excluding shareholders' equity).

Consolidated shareholders' equity attributable to the Group before dividend payments amounted to EUR 53.8 billion at 31 December 2007, an increase of 8.7% year-on-year.

This increase reflects net attributable income of EUR 7.8 billion in 2007, as well as the preferred share issue of EUR 2.3 billion, partially offset by the EUR 2.8 billion dividend payment in respect of 2006 and the negative EUR 1.2 billion impacts of treasury share transactions.

➤ **Cash Flow statement**

CASH FLOW STATEMENTS OF BNP PARIBAS GROUP		
In millions of euros	Year to 31 Dec.2007	Year to 31 Dec.2006
NET INCREASE IN CASH AND EQUIVALENTS GENERATED BY OPERATING ACTIVITIES	13 077	15366
NET DECREASE IN CASH AND EQUIVALENTS RELATED TO INVESTING ACTIVITIES	-2593	-13009
NET (DECREASE) INCREASE IN CASH AND EQUIVALENTS RELATED TO FINANCING ACTIVITIES	-1872	5625
EFFECT OF MOVEMENTS IN EXCHANGE RATES ON CASH AND EQUIVALENTS	-648	-473
NET INCREASE IN CASH AND EQUIVALENTS	7964	7509

Source: BNP Paribas registration report 2007(own make)

At 31 December 2007, the Group's consolidated net increase in cash and equivalent amounted to EUR 7964 million, up 6% from EUR 7509 million in 2006. The main components explaining this increase is the net decrease in investing activities but also the decrease in financial activities in 2007.

5.1.4 ANALYSIS ON THE PERFORMANCE OF FDD

In this part, we want to conclude on the previous analysis on the main financial statements of BNP Paribas and show how the FDD allows the investigation of all financial elements, but also demonstrate that the merger between the two banks is a success because the group presents today a higher performance which is in line with the initial strategic objective of the deal.

With the study of group's earnings, FDD seek to assess the level of maintainable earnings of the target through the Income Statement because they usually provide a guide to the future performance of the business. To assess the level of maintainable earnings is to gain a thorough understanding of the entire business and its market. We observe that the net income of the group increase positively each years since the merger from EUR 3,761 million in 2003 to 7,822 million in 2007, and records an evolution of 137,4% in 4 years. We can conclude easily that the FDD was well done since the group reach its initial objective to reach organic growth.

With the study of group's assets and liabilities, review; as we said previously, this review will have an eye on the future, either looking at accounting issues, and the nature of the assets and their suitability for the business. The investigation seeks to understand whether the business is equipped with assets appropriate to carrying on its activities. In this element also, the group records a positive profitability with an evolution of 17, 6% (from EUR 1,440.3 billion in 2006 to 1,694.5 billion in 2007).

The investigation of liabilities will tend to look for any liabilities which have not been disclosed, or of which the value has been underestimated. This part of the investigation tends to be more backward looking, but of courses, they key underlying objective is to assess the level of any unexpected future cash outflows.

FDD through the Cash Flow Statement understand which profits are not reflected as net cash inflows. An apparently profitable business which fails to generate any cash may raise concerns. But there may be good factors to generate cash, the business may have invested heavily before the deal period, or a business may be growing rapidly, with a resultant

increased working capital requirement acting as a drain on cash. These are important issues, key to understanding the likely or possible future performance of the business, and also key to ensuring that, following any acquisition, the business is properly financed.

We can assume that FDD is a good tool to investigate into the financial statement of the company but also help to confirm the acquisition strategy, which may be underpinned by the current financial strength and ongoing trading performance of the target company and in this case, FDD investigation should focus particularly on these issues (Rankine., Bomer., and Stedman., 2003). The analysis of BNP Paribas shows the success of the merger since the group recorded a high profitability in all core financial fields and is a leading player in the European banking sector, poised to compete on a global scale. The group reaches its objectives to create value for shareholders, clients and employees by building the bank of the future and becoming a benchmark player in the global world.

Since the mission statement BNP Paribas is focus on organic growth, the group based its strategy on acquisition opportunities that meet their profitability criteria and present an excellent strategic fit with their existing businesses and operations. BNP Paribas continues to be guided by the overriding aims of development and value creation, which have been at the heart of the Group's business ethic since its creation.

5.1.5. GOOD TOOL BUT SOME LIMITS

FDD is obviously necessary in M&A transaction, but it's hardly sufficient to ensure a transaction's long-term success.

Financial statements, however, are only one aspect of due diligence. Many transactions fail to achieve their goals not because of unexpected earnings adjustments or tax liabilities, but because the acquisition did not provide the strategic benefits that originally inspired the buyer's interest or the buyer was unable to integrate the two organizations. Establishing a detailed due diligence plan that encompasses not only a review of the financial statements and legal documentation, but also an evaluation of the seller's operations is critical to ensuring a transaction's success (Fay 2005).

Indeed, some others relevant elements are not taken into account in the FDD like the investigation on operating plan, commercial perspective, human capital skills and abilities, IT anti-trust rules etc... Which are the others area in the Full Due Diligence. It is beyond the scope of this paper to prove the use of all Due Diligence components, but most to explain since each deal is unique, that the acquired company should think strategically in accordance with the specificity of the target and set up a Strategic Due Diligence which involves the critical success factors of the M&A transaction.

Because each circumstance pertaining to a sale, merger or purchase is unique, as are the individuals involved, every due diligence investigation should be tailored to meet your specific needs. It is imperative to clearly identify the terms of the engagement, defining exactly what will be investigated. A proper due diligence encompasses legal, business and financial factors so that you learn enough to begin formulating your strategic business plan to implement under your ownership. (Michael 2004)

Then bellow we will show the case of Hewlett Packard merger which is an example of using SDD to go beyond the limits of FDD stated above.

5.2 HEWLETT-PACKARD-COMPAQ CASE STUDY

This case is an illustrative example of how a strategic due diligence approach can lead to better perform a merger and acquisition deal for success. It shows also how this approach may help to point out important elements by taking the time to perform the due diligence process in a thorough way. It shows the importance of a strategic approach on the due diligence exercise for reaching success with a concrete example. We will summarize the case using the strategic due diligence definition above and see how it has been applied in the case of Hewlett-Packard – Compaq deal.

In this study we used an illustrative case study in order to reflect the SDD concept. The purpose of the case is to show how an SDD can be conducted in a company and specially highlight how understanding the acquired company is important for the success of the deal. In fact the idea is that a company should strategically plan its due diligence in order to reach success. The Hp merger is a concrete example which illustrates this case where the DD was strategically performed. In fact we will try to show how in this merger, the SDD was used using the description of SDD concept we have defined earlier.

The information to the cases was found from different articles and documents relating to the M&A. Some of the information came from HP website, where we could find concrete figures of the deal and description of the company. Some information came from documents and exhibit published by the SEC on the website.

The information were compiled in order to show how it follows the SDD concept. In fact it was focused on a DD which concentrate on the source of value of the M&A.

Companies profile:

- Hewlett– Packard: HP is a technology company that operates in more than 170 countries. It was founded in 1939 by Willian Hewlett and David Packard, two graduates in electrical engineering. It is now among the world's largest IT companies with revenue totaling \$107.7 billion for thee four fiscal quarters ended Jan 31st 2008. HP was incorporated in 1947 and began offering stock for public trading 10 years later. HP introduced its first personal computer in 1980. Carleton S. Fiorina replaced Platt as president and CEO of HP in 1999. Today the CEO is Mark Hurd.
- Compaq Computer Corporation: It was an American personnel computer company founded in 1982. Today it is named Hewlett-Pachard. The company was formed by Rod Canion, Jim Harris, and Bill Murto – former Texas Instruments senior managers. The name "COMPAQ" was derived from "Compatibility and Quality", as at its formation Compaq produced some of the first IBM PC compatible computers.

Merger announcement:

On September 3rd 2001, Carly Fiorina announced HP's plan to acquire Compaq in a stock transaction valued at \$25 billion. In fact she was convinced that turning the company around required more than just strategy from within.

The goal was to become more competitive since both HP and Compaq had been hurt by price wars in the computer industry.

Analyst criticism:

Moreover Mr. Sacconaghi a computer analyst for C.Bernstein & Company who has been an outspoken critic of the deal, was also clearly impressed by the enormous and diligent effort the two companies had put into planning in the pre-deal phase how the combined entity would operate. In fact after 2 years he finally issued a “buy” recommendation on Hewlett-Packard. He justify his position on 2 aspects”

- First the fact that Hewlett-Packard shares have dropped about 25 percent since the deal was announced, from 23.21 a share to 17.44 on Friday, which increases the attractiveness of the stocks.
- Second, Mr. Sacconaghi pointed out the “*enormous and diligent effort*” Hewlett-Packard and Compaq had put into planning how the two companies are put together. So he says the new company can achieve sizable cost-cutting gains over the next year or so, partly by eliminating 15.000 workers from a combined payroll of 150.000.

5.2.1. A STRATEGIC DUE DILIGENCE EXERCISE IN HP:

In fact as mentioned by Sacconaghi, the two companies have put enormous and diligent effort in planning the pre-deal phase (i.e. DD) how both companies would operate.

Hewlett has also emphasized a lot on assessing the deal attractiveness by defining the rationale of the merger and acquisition. In fact they have assessed the deal rationale by defining their strategy and pointing out its main value driver in the integration planning process. Moreover the cultural aspect of the deal has been the center of attention since it is an important element for HP.

The company has performed numerous due diligence analysis to assess the company potential from the merger and as well evaluate the future outcomes of the deals.

● Strategic planning to assess merger attractiveness:

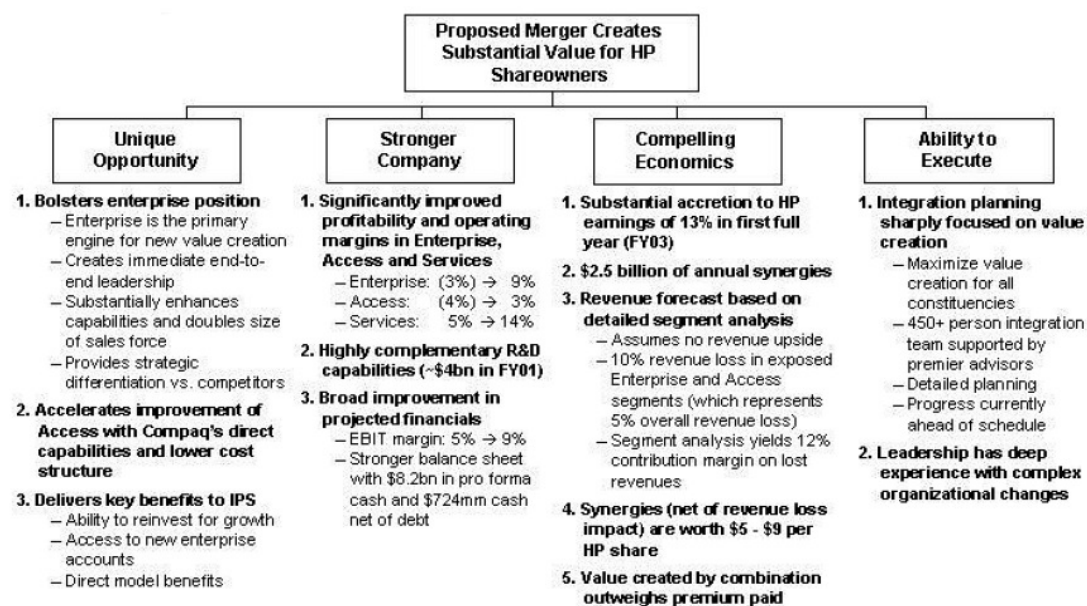
Strategic planning is the outcome of a process of good governance, deliberation and vigorous debate among board members. During 2 ½ years, the HP board and management team have thoroughly analyzed a wide range of strategic alternatives and concluded the merger with Compaq represents the single best way to create sustainable shareowner value across our businesses.

The merger with Compaq substantially improves both the market position and profitability of our enterprise business, it comprehends that scale and profitability are linked in the consolidating PC business and it recognizes that growth in our imaging and printing business

is linked to the innovative capabilities of HP Labs and our computing systems business (Lohr, 2002)

In exhibit 2, we see the analysis of HP with details on the attractiveness of the deal. The deal is presented as a unique opportunity to ameliorate the company position. It is also viewed as a way to drive the company stronger through improved financial records (ex: EBIT> from 5 to 9%), and complementary R&D. Also it evaluates the potential synergies expected of 2.5 billion a year and the value created for shareholders through premiums. Then it assesses the ability to execute which emphasize on the key value creation at the integration stage.

EXHIBIT 2 HP's Position on the Merger



Source: <http://investor.hp.com/edgar.cfm>, Form 425 filed by HP with the SEC on December 19, 2001

● Detailed planning:

At HP, a detailed integration plan was developed long before the merger closed. "The HP-Compaq plan was incredibly detailed and comprehensive," recalled Braun. "We asked ourselves: What would the new organization structure be, overall and in all its details? What would the product lines be? Who would manage the largest accounts for the new company? What would the top management structure be? Which business processes would be used? Which IT systems? The result was a detailed roadmap laying out what needed to be accomplished in every area of the company, who was responsible, and when it had to be completed.

● Forward Looking statements:

HP has prior to the deal elaborate forward looking statements which involve risks, uncertainties and assumptions. It includes creation of benefits and opportunities, industry and customer trends, sources and rates of future growth of both business and markets generally; improved profitability and operating margins; future earnings and accretion to earnings and /or share price; achievement of synergies; overall impact of the merger and segment contribution margins; execution of integration; differentiation against competitors; planned strategies and objectives of future operations.

The risks, uncertainties and assumptions referred to above include the challenges of integration and restructuring associated with the merger and achieving anticipated synergies; the ability of HP to retain and motivate key employees; the timely development, production and acceptance of products and services and their feature sets; the challenge of managing asset levels, including inventory; the flow of products into third-party distribution channels; the difficulty of keeping expense growth at modest levels while increasing revenues; the possibility that the merger may not close or that HP or Compaq may be required to modify some aspects of the merger in order to obtain regulatory approvals; the difficulty of maintaining pro forma market share and revenue following the merger.

- **Importance of cultural matters:**

Webb McKinney who is leading the integration planning with Compaq's Jeff Clarke, pointed out the fact that the real strength of this integration with Compaq and it is the vision that we would end up with one strong new company. And in order to do that culture and cultural integration and how you get things done and how you work together and what kind of a place this feels to work for all of the employees is at the heart of the matter.

The company conducted 130 focus groups already in both Compaq and Hewlett-Packard. As part of the "*cultural due diligence*," some interviews and focus groups were conducted to analyze both companies' cultures. HP has always valued contribution, integrity, respect and community, Fiorina, CEO of HP added.

Then such cultural questions in the due diligence processes are relevant for the deal success: How will the new organization work? Will I have a voice and will I be valued in the new company? How will the governance structure be set up? Who's in charge? What happens if you don't know?

- **Outcomes of the merger:**

Whereas many have criticized the success of the deal at its announcement, the merger has been in reality a success.

In fact the cultural integration was largely successful. In fact the deal created an 87 billion global technology leader. HP became a big competitor to IBM, Sun and Dell. It largely succeeded the cultural integration and captured beyond the expected synergies with 150% of synergies captured. (\$3.7 billion /year) In fact the expected annual synergies amounted to 2.5 billion annually (www.hp.com).

Moreover a research from Deloitte presented after the analysis of Hewlett Packard merger success has shown that a thorough due diligence integrating the strategic aspect of the exercise is important for success. The idea is that successfully acquiring and integrating businesses only occurs through a disciplined process.

In fact the company have soon well integrated the approach of performing a thorough due

Deloitte research shows that the following 12 practices enhance the likelihood of success

Approach	Strategy	<ol style="list-style-type: none"> 1. Establish a targeted improvement strategy that focuses on the sources of value and customer service 2. Determine the business case prior to executing strategies 3. Do thorough due diligence – financial, legal and strategic
	Value	
Execution	Focus	<ol style="list-style-type: none"> 4. Determine the degree of integration and address integration issues, especially management and culture, prior to operational execution 5. Clearly quantify synergies 6. Focus on a quick integration – ensure operating commitments are met 7. Focus integration on clearly defined drivers of value 8. Launch small, rapid, iterative integration teams 9. Align and communicate organization roles and responsibilities 10. Address retention issues early and often 11. Consider the importance of culture – “humanize” the merger 12. Clearly and frequently communicate to stakeholders the implications and progress of the merger
	Process	
	People	

Source: Solving the Merger Mystery by Deloitte Research. A survey of 540 organizations with annual revenues or budgets of at least \$500 million

diligence and identifying the need to develop a strategy.

First they identified their approach and then executed it into concrete steps:

5.2.2 ANALYSIS ON THE PERFORMANCE OF SDD

This case is a concrete example of how a strategic due diligence might be used by a company to reach success. In fact one should remember that the strategic due diligence aim is to answer two questions as mentioned above which help to know if the deal is commercially attractive and if the buying company possess the capabilities to realize the targeted value. It requires an internal and external inquiry to assess the rationale of the deal. HP has through its different exercises analyzed these two main concerns. In fact it didn't rely on financial and legal aspects of the due diligence only but instead it has performed a thorough due diligence exercise by planning it.

For the first question which is assessing the commercial attractiveness, the company has analyzed through different perspectives how the deal would create value. In fact Exhibit 2 shows the main financial outcomes the deal would create.

The company has also through forward looking financial statements assessed the competitive position the deal would create and all the competitive elements relevant to the market and the deal creation.

Then for the second question which is about assessing whether the company has the abilities to meet the targeted value, HP has performed a deep analysis of its capabilities and ability to

manage critical success factors. In fact its ability to meet the potential synergies has been assessed.

It also has assessed the importance of the cultural aspect for the company and well integrated it in the due diligence exercise as a key success factor.

Then we see that HP has at the very beginning adopted a strategic way of performing the due diligence by planning this process in a efficient way and putting enough effort in the critical success factors.

6. INTERVIEWS ANALYSIS

In this part, we will present the analysis of the interviews we have performed as well the information we have found and the way we have interpreted them in regards to our topic. Mainly we emphasized on findings elements in accordance to the financial due diligence and strategic due diligence aspects. In fact, based on relevant information from the interviews, we were able to conduct the topic of our paper and underline the key points of concern. Mainly they rely in the way of performing the financial due diligence and key elements in the strategic due diligence that are critical for success.

6.1 INTERPRETATION OF THE INTERVIEWS

When interpreting the interviews, we needed to see how we would transcript the information given by the auditors. In fact they gave us many elements which we didn't find relevant to state them all because it could disturb the reader. In fact we decided to highlight the main information in line with our subject, that is to say everything related to Financial Due Diligence and Strategic Due Diligence approach. Then what is shown here represent 1/3 of the information given by the auditors. This will help to be more focus on the subject and avoid being lost when reading the following. Then we have divided into 2 parts the information and tried to link them with both of our RQ in the way we present them. We will also support it with the literature found.

- **FINANCIAL DUE DILIGENCE:**
 - IMPORTANT ASPECT IN COMPANY

Interviewee mainly pointed out the financial due diligence: they assume it is crucial to perform it. In fact they pointed out the importance to find the financial information of companies in the financial statements. It's sometimes difficult to find relevant information due to the asymmetry of the information which can exist between the two parts. Indeed, the companies don't have the same financial information at the same time. The information will be given at two different moments and the persons who are involved could be different too. When we have done our case study one about BNP Paribas valuation, it was primordial for us to use the same time base for our calculation, for example, the data used came from the annual report of the company (which are disclosed at the same time every year) and not at different moment.

We see that getting the right informations straight away may be difficult for companies. In fact the due diligence team needs to make the investigations in the firm which is being bought. Also if the acquired firm doesn't gives the right informations straight away and present the key issues this drive the due diligence team work harder in investigating and uncovering the reasons for trends and it may impact on the quality of the due diligence. For example a reduction in provision for the benefit of cash could make think that the company has create value while it is only an internal intervention. But still it is up to the due diligence team to uncover it and inspect deeply what is behind the figures and ask if necessary the needed supplementary information to the acquired company which in fact require more time. In fact the interviewee A and B pointed out many times the importance of

the financial due diligence stage and the need to analyse deeply and thoroughly the information of this process to be the efficient.

One should not forget that the acquired companies tend to present attractive values and information although it has to prepare itself to furnishing the needed documentation. In summary the idea is that it is not that easy to arrive at gathering data of quality. In fact the due diligence model seems simple to set but still they don't speak about the necessity to get the right datas otherwise the process still would lack of efficiency.

The interviewee A and B also emphasized on the need to perform the process well which is not always the case and the need to find documents of quality and relevant ones since they will be the basis of the analysis in the FDD. In other terms they pointed out the need to analyze the financial information in an efficient manner by trying to beyond the figure to understand why they look the way they are which generally is best done by experienced DD teams.

- THE PROCESS

When defining the process of a Financial Due Diligence, both auditors pointed out the need to assess these statements: Balance sheets, Working Capital, Cash Flow Statements, Income statements. We will show through the case study one that these financial instruments provide some financials key elements for the M&A process in giving reasonable information to evaluate the target and reduce the risk of wrong estimation.

The two interviewees also pointed out the importance to analyze the future projections which is inline with what we have found in the valuation performed in the BNP Paribas case study. As presented by (Vakin 2007) the financial due diligence process should include statements of Balance sheets, Income statements, Cash Flow statements, Audit reports (preferably done according to the International Accounting Standards, or, if the firm is looking to raise money in the USA, in accordance with FASB), Cash Flow projections and the assumptions underlying them. In fact in a due a financial due diligence , these are the main elements which are investigated, moreover, in the BNP Paribas case study, we see that it illustrate well the process of financial due diligence since it includes these elements.

- LIMITS OF THE FDD

The auditors pointed out the need to also asses the company risks in other areas since the financial due diligence is not the only issue a due diligence should cover unless it is a relevant and well studied choice. In that way we think that the interviewees consider the fact of performing a FDD only might be a limit.

In fact often they pointed out the need to seek the value drivers of the deal and analyze the trends of activities such as market trends and other relevant information.

For (Fay 2005), establishing a detailed due diligence plan that encompasses not only a review of the financial statements and legal documentation, but also an evaluation of the seller's operations is critical to ensuring a transaction's success. In fact only relying on the financial aspect of the due diligence might be insufficient in concluding if the deal should be done or not because many other aspects are left apart such as cultural, commercial, operational, environmental issues which might be relevant to the deal success.

In fact one should not forget that due diligence is something that companies value.

This should be a rationale issue, but for this idea we had 2 different perceptions. The first interviewee seemed to point out the fact that industrial companies for example may have tighten budget which may led them to concentrated on the financial DD only to avoid spending too much in the process. However the second auditor seemed to point out the fact that usually the deal require a lot of investment, then the idea of not investing enough in the due diligence may not really be acceptable. In fact, often the deals involve millions. We think that the issue must be real, in fact from the literature it was said that company didn't really want to invest in something when they are not sure the deal will be concluded. (Howson 2003)

But still for a very small company the problem might exist since it involves a lot of money as well for a company which is trying to cut costs such as some industrial companies with lower budget. However the general idea agreed is that if the risk is too small, the cost to pay a consultant might be too high compared to the risk.

The interviews where then revealing that a financial due diligence alone might not be enough. In fact the company may face the necessity to look beyond the basic scope and widen the required informations. It has to uncover what drives value which can help gain comfort of dynamic of project as mentionned by auditor A and B. Then, the strategic due diligence is also about knowing what drives value and adapt also the due diligence according to it.

- **STRATEGIC DUE DILIGENCE**

- INVESTIGATE FAR BEYOND FINANCIAL DUE DILIGENCE

The interviews gave us elements which point the need for the company to look into the company it is buying and as well make external inquiries on the market, see how the deal will be in the future, what drives value in the market and see if the company can reach its goal. In other term this represents the assessment of the deal attractiveness and see if the deal will in the future create in reality value or meet the initial objective, we then considered it to be the assessment of the deal rationale.

In fact the main elements to consider in the strategic due diligence is that it is about looking out the companies in term of market attractiveness, the possible competitors reactions and analyze the potential synergies. Obviously the Financial due diligence doesn't analyze those elements but rather focus on a backward looking since its based on past elements.

Moreover the strategic due diligence also question the firm internally in different areas, it is about knowing if the company will be able to meet the objectives. And as well connect the key value drivers to the due diligence key topics.

The strategic due diligence emphasize also on the team capabilities, by assessing whether the combined companies will be able to meet the synergies expected and as well the necessity to appoint skilled financial teams when it comes to analyze the financial values on market attractiveness etc

The financial due diligence however doesn't imply all these questions, which as we have shown earlier are common issues to consider for the success of a Merger and acquisition.

In fact we found out that most reason of failures are poor synergies, paying too much due to bad valuation, integration plan not developed in advance, cultural differences not addressed.

Moreover, (Howson 2003) points out the fact that financial due diligence is tends to be internally focused because it collects its market and competitive information from management which is one way of reaching an assessment of future prospects. However, by itself it is often not enough. In the BNP-Paribas case study, we see that all the elements covering the due-diligence are financial information. This might be a drawback in the fact that the company doesn't have enough view on the remaining aspects of the deal such as market trend, human, operational aspects for instance. Moreover, the HP-case study shows how a due diligence may be wide in its scope and cover far beyond financial information such as market characteristics investigations, cultural issues analysis, synergies evaluation , and so on.

- IDENTIFY VALUE DRIVERS AND RISK ASSESSEMENT

We identified from the interviews the need to assess the deal attractiveness by identifying the value drivers of the deal during the Due Diligence process. The auditors both pointed out the need to perform a due diligence on the risk sensitive areas which should be earlier identified by the company.

In fact this means that the company should tailor his DD exercise according to what it considers to be risky area for him. For instance one of the auditors gave the example of a company which plans to buy another one but which main profile is based on environmental ethics. Such company should when making a MA deal take into consideration in the DD process the target company ethical implications since this aspect is critical for the MA success.

Also what would be the reason of performing the deal if the MA would at the end damage the buying company ethical reputation and in worst case reduce its value as a consequence of customer reaction.

In fact, Strategic due diligence is all about testing the synergies. In fact poor synergies are one reasons for M& A failure. In fact companies often over-estimate the synergies but once the deal is concluded it is found out that the projected synergies are not met which may lead to failure to meet the initial objective. In other terms it is the case where the NPV is negative as explained earlier.

The strategic due diligence in a sense helps avoid this scenario by giving relative importance in assessing the potential synergies and assess whether a company has the capabilities to meet projected synergies. In that case the reasonability and attainability of projected benefits helps to estimate the possibilities of synergies. Then early in the merger and acquisition, the due diligence assess this criteria in order to know if the deal is worth it or not.

Valuation is a key element when making a merger and acquisition. In fact it has been proven that paying too much a deal may lead to failure. In fact it then becomes hard to create enough value.

Paying a very high price compared to the normal is unwise since the deal may not create enough value. The more the company pays for acquiring a business, the more it has to work to satisfy shareholders and increase their value.

The strategic due diligence put a lot of attention to the need to appoint experienced team in the due diligence. This helps to make a logic valuation since the strategic due diligence assess the rationale of the deal. In fact this can help the buyer to negotiate if necessary a lower purchase price if it founds out that the expected synergies are not so rationale. And in

the same time the company will then protect himself from paying too much for a deal that will not be able to cover the investment with value creation.

Another criteria identified as part of relevant causes of failure is the cultural differences of two businesses combining. Indeed the companies' organizational culture may be very different and then cause poor efficient communication. In that way the strategic due diligence advice to assess the issue by assessing the fit of organizations and employees with strategy.

The idea is to assess the associated risks which the company is exposed to considering the context. Should these elements be important, the company needs in fact to analyze how far the executives which will be involved in the combined companies know about the value drivers. For example "Booz and Company" illustrate the case where an in-market merger where the right question would be to know if the potential risk in terms of cultural issues can be managed and as well if the preserving increased market share is a key driver of value for example, leaders had better be sure that executives of the new company know their customers' needs, can meet them, and can fend off competitors who will surely try to pick off customers and clients during this period of uncertainty. Moreover the HP case study shows it in the fact that Hewlett at the very beginning pointed out the importance of the cultural aspect in the deal which it incorporated in the due diligence exercise it planned.

While planning the scope and nature of a due diligence program, an investor must determine the degree of business and legal risk he will accept. Scope in this context consists of the depth of questioning on any subject and the quantity of original documents to be reviewed. (Bing 1996) From the case study of HP-Compaq, we have seen how a due diligence should integrate the major success factors of the deal in the due diligence process. In fact in that case for instance, the Cultural aspect was very important for Hewlett which integrated it in its due diligence process.

- CUSTOMIZATION OF DUE DILIGENCE

Then in that way the due diligence should be customized depending on each business profile. It is more an exercise of setting strategically its main areas of concern during the process. In fact when we asked the auditors which due diligence should companies perform according to their type, they emphasized on the fact that the process requires prior decision from members of the board and should be adapted to each company context.

In fact one of the auditors pointed out the fact that some clients would even not really know why they should do a due diligence but because the deal contract stipulates the need to do the exercise, they then feel obliged to perform a DD, otherwise they lack of knowledge on the way they should define the process.

Michael I also point out that because each circumstance pertaining to a sale, merger or purchase is unique, as are the individuals involved, every due diligence investigation should be tailored to meet your specific needs. It is imperative to clearly identify the terms of the engagement, defining exactly what will be investigated. (Michael, 2004)

Indeed, the due diligence process should adapt to each deal specificity as mentioned by (Adolph, 2006) who states that no transaction are treated the same way, and that each deal has its own value drivers, and thus the composition of each due diligence team must change. Executives should determine which areas of the organization will produce value in the

merger, and draw members of the team from those areas. Companies much then tailor their process to the issues and potential integration challenges of each specific deal.

Furthermore, for Rosenbloom (2002), every transaction is unique and requires a customized approach. Executives should determine which areas of the organization will produce value in the merger, and draw members of the due diligence team from those areas.

The HP-Compaq case study illustrates well these assumptions since the due diligence was adapted to the deal characteristic with an emphasis on the cultural issues of the deal.

7. CONCLUSION & SUGGESTIONS

7.1 CONCLUSION

This paper have given us better understanding on the due diligence topic. In fact the literature review, the cases studies and the interviews where for us valuable elements which have allow us to better understand this process and its implications as well.

As we have mentioned in our paper, the cases studies we have illustrate where important in justifying our position and giving concrete examples of the Due Diligence process in financial and strategic aspects. In fact that is why we have tried to illustrate the financial due diligence through BNP PARIBAS case as well to analyze the limits of the process which is focused on the analysis of financial statements only. Here the financial due diligence process was composed of investigation on various statements such as Income statements, Cash Flow statements, Working Capital, Balance sheets, with a vision on the past, present but also future.

However, from the interviews and literature review, it has been found that the Financial due diligence might be a limitative way of performing a Due diligence when it is the only element of the exercise included by the company because it doesn't include many other factors which might be relevant to the deal success.

Then the HEWLETT-PACKARD case was a good way to illustrate the Strategic Due Diligence process which goes far beyond financial aspects and consider the deal value drivers.

Finally we conclude that adopting a Strategic Due Diligence is a good way of enhancing the M&A chances of success. And because each deal is unique, the acquirer should consider an acquisition in regards of its specificities and what its value drivers are. Instead of trying to answer the question of 'can the deal be made?' the company should try to know if the deal will be a success by looking to the past but also towards the future. Hence, Strategic Due Diligence (SDD) allows the buyer to question itself in a critical way on the way to plan the due diligence process and which area it should emphasize during the investigation thanks to the identification of its key elements of success of the M&A. Then in the end the company should adopt a unique way of performing its due diligence and not follow pre-determined process.

That is why the Strategic Due Diligence which goes far beyond the financial aspect, and evaluates the deal rationale by measuring the target company against the aim to achieve and also by highlighting the value drivers palliates the limits of the FDD. In fact in the end the Due Diligence exercise should be drawn according to the specificities of the deal and should be approached strategically as a consequence to improve M&A chance to success.

Additionally, we think that companies should develop a DD culture especially if the company plans to be involved in many M&A because the more it knows about the implications of the process, the more it will be aware of the importance of the process and consequently know how to manage it and adapt it to the company specificities. In fact the exercise is often seen as an obligation rather than a way to reach success.

7.2 SUGGESTIONS FOR FUTURE RESEARCH

For future research we think that it could be interesting to study how companies protect themselves against risks of a MA failure. In fact from interviews and literature review, we have seen that some companies may not put enough skilled persons in performing the due diligence or even don't really understand the goal of the process.

It might then be relevant to see how companies approach a deal and how they assess the risks their companies may undergo if they don't really put enough preliminary attention to the Due Diligence exercise especially in industrial companies as mentioned by one of the auditors.

In fact the first auditor pointed out the fact that sometimes they put a small budget in the Due Diligence process while the other one pointed out the fact that they often don't know why they perform a Due Diligence but instead do it by obligation. Then the question is how do they protect against the risks inherent to the M&A deal?

8. CREDIBILITY CRITERIA

In this chapter, we will present the credibility criteria which help us to write this research paper and to demonstrate the criteria have been met to support our thesis. The three criteria that we are talking about are credibility, validity and dependability.

8.1 CREDIBILITY

Before our interviews the respondents were initially contacted by phone, this was arranged through their receptions. Then we have sent the questionnaires by email and then try to arrange a telephone interview later. The respondent received information, background, and the questions a few days in advance of the telephone interviews by e-mail. This approach is better to give the financial analyst time to reflect on the questions and save time during the sessions, and as well to avoid any misunderstandings that might have occurred at a later stage in the interview (Saunders et al. 2003). Finally, we arrange the date and time of the phone interview with the financial analyst from Audit Company. It was the appropriate way to handle the issue of different geographical locations due to the time constraint and still allow the credibility of data collection to be fulfilled.

8.2 VALIDITY

We needed to have information from professional who got a great experience in Due Diligence process. Indeed, it is important that the interviewees are professionals and work in the Due Diligence process during long time, in order to secure that, the respondents have got a great experience so the information they provide supports this research. We receive the agreement for two respondents who had willing to answer our questions by phone interview. The two interviewees were the head of Transaction Service, the Due Diligence department in Audit Company. Which means they had both a great and long experience in this domain, since they work since more than 7 years in addition to be the head of the department. We can affirm that their information is considered as valid and relevant. Moreover, they information were in accordance with those gathered from literature review the M&A reasons of failure, but also about Financial and Strategic due Diligence. Since the two interviews were support our theory about Due Diligence, we can said that our data are valid.

8.3 DEPENDABILITY

Dependability should show that the research processes are systematic, rigorous and well documented (Hussey, 1997). For the need of our qualitative research, we had to be well documented on the subject to be able to conduct the interview but also to develop our purpose and set up our theory review. We used the semi structured interview to collect information from our respondents. In a semi structure interview, the questions are flexible and allow new questions to be bought up during the interview as a result of what the interviewee says. The interviewer in a semi structured interview generally has a framework of themes to be explored. In did that, we cannot be influence wholly the answers of the financial analysts and gather efficiently the information. Besides, we wrote in the same time the answer to keep in mind the ideas, which have helps us for draft our two cases studies.

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APPENDIX

- **interview questionnaire:**

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Master Thesis 2008

Evaluation of the Process of due diligence in mergers and acquisitions.

Our purpose:

We want to study and analyze the role of the auditor work in the Due diligence process. While some theories claim that Financial Due Diligence (FDD) is the most important factor in the success of the M&A, others ones claim it is the Human Due diligence (HDD).

We want to know the point of view of the auditors on other due diligence models such as best alternative in this conflict.

General information:

1-What is your position ?

2-How many years have you been working in this position?

3-Have you ever participated in a due diligence in your career? If yes, in how many cases?

4-When did you perform the most recent one?

5-Which ones were the most relevant according to you? Why?

6- What were your different roles in the due diligence in which you participated?

Due diligence and auditor role

7-How would you define due diligence?

8-What is the role of the **audit company** in the process of due diligence?

9-When you prepare the plans (strategy, business or integration...) which are the main elements that you consider the most? Could you rank them and tell us why they are important? Classify them according to their relevance.

Due diligence: review of the process

10-Could you give us the case of due diligence process which lead the M&A failure or on the contrary success? What are in your opinion the determinant aspects in the both case? Do you have concrete examples?

11-Do you think that the recurrent mistakes in a due diligence depend on the nature of the firms involved in the merger and acquisition? (By nature we mean for example IT firms, Industrial firms, manufacturing firms...)

12-What are the common mistakes done in performing a due diligence according to you? You may list per type of industry if relevant.

Comparison between traditional and new due diligences.

13-What do you think about traditional way of performing the due diligence (=financial, legal aspects)? Are they working well? Why and do you have examples?

14-Do you think that the traditional due diligence (based on financial, legal fields) is enough to build efficiently a deal? Why?

15-This table shows the common aspects taken into account in a traditional due diligence. Which other elements do you think are relevant to consider relevant to consider for a successful merger and acquisition?

<u>Traditional due diligence.</u>	<u>Other relevant elements that should be considered according to you.</u>
financial	
Legal	

16-Have you ever performed a new approach of due diligence in your career? If yes, in how many cases?

17-Could you tell us which new approaches of due diligence did you conduct in your work?

18-Could you list us cases where the use of new due diligence approaches led to the success of a merger and acquisition or on the contrary didn't help?

19-What do you think about current way of performing the due diligence (based on for example Human resource, corporate culture, environmental aspects)? Do you think that they are more efficient?

20-Some ideas support that the new approaches of due diligence are more efficient than traditional one because they take into account others critical success factors in the achievement of M&A such as SDD. What is your opinion?

21-Could you tell us which types of due diligence are more used and why?

22-Among the new types of due diligence could you tell us which ones are more oriented towards the following characteristics and their importance (high, medium or low level)

ELEMENTS	NOUVELLES DUE DILIGENCE	LEVEL OF RELEVANCE
The situation of the Merger and acquisition in the long run		
The intellectual capital and intangible assets (patents, progiciels...)		
The confidence between partners of both firms		

Some theories propose to combine the traditional and new diligence (full due diligence):

23-Do you think that is it possible? What could be the constraint (time pressure, expensive, sensibility of the seller, auctions...?)

24- Do you think that the nature of the buyers involved in the M&A (industrial, financial) could influence the scope of the full DD and also influence the use of one DD instead of another one?

25- What is the common business valuation method used (free cash flow, Gordon growth model...)?