Mergers and Acquisitions (M&As) in the Luxury Business

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M&As in the Business of Luxury Companies

5.1 Companies Acquisitions

Acquisitions are related to companies’ external growth. An acquiring company purchases a controlling stake in the share capital of another company (the acquired company), in return for a price\(^1\). Acquisitions might also involve a whole company or part of it through the transfer not only of shares but also of company assets (usually together with liabilities), as well as staff relocation\(^2\).

In the case of branch acquisitions, the acquiring company purchases parts of another business company and might integrate them into its own business structure. Usually, such partial acquisitions are targeted at specific products or product systems, retailing networks, company divisions and manufacturing equipment. Such interest in a specific branch is due to the fact that it might play a strategic role within the acquiring company’s business.

The strategic value made by the acquired branch is higher than the value created within the acquiring company by a similar internal activities. First, branch acquisitions enable the acquiring company to speed up the completion of a project: the acquiring company exploits an existing functioning structure. Second, branch acquisitions favour the creation of synergies between the acquiring company’s business and that of the acquired company. Third, they re-

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\(^2\) Cortesi A., *Le acquisizioni di imprese*, Egea, Milano, 2000, p. 19. Acquisitions might be carried out through various technical practices, which will not be explored in this book. For further information on such practices (merger through acquisition, leveraged buy out, take-over bid, aggressive take-over bid, public exchange offer, buying up, trade-in, etc.), please refer to Cortesi A., *Le acquisizioni di imprese*, cit., pp. 83 ff.
quire a smaller amount of financial resources to be invested compared to those required to purchase the whole company to which the branch belongs.

Through an acquisition, the acquiring company might mainly aim to own another company, without limiting its autonomy in decision making. Alternatively, acquisitions might be directed towards an integration with the acquiring company, which would affect the management autonomy of the acquired company. In the latter case, the acquisition might be followed by a merger, i.e. the technical practice through which the integration between the parties involved is formalised. Mergers do have an impact on how acquisitions are performed.

Mergers are extraordinary administrative acts that might result from acquisitions. Mergers refer to the combination of two or more companies to form a new one, through which the parties merged are dissolved. Consequently, the new company holds the assets and the liabilities contributed by the parties dissolved. Alternatively, a company acquiring two or more other companies, through which the acquiring company continues to exist having increased its size, while the companies acquired are dissolved.

Both mergers and acquisitions must not be considered as ends in themselves. On the contrary, they should be seen as means through which companies aim to reach or maintain conditions of economization. It is with a view to economization that the various steps and stages of an acquisition are completed: evaluation of the strategic problem to be solved, assessment and evaluation of alternatives between internal and external growth, choice of a specific acquisition policy, identification of acquisition candidates, outlining of the options to proceed with the acquisition, implementation of the acquisition deal and final integration. Furthermore, it would be reductive to consider

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such operations only from a technical point of view. In fact, they should be evaluated from a perspective of extraordinary administration. They are administrative acts in that they entail various issues concerning management. They are extraordinary because such operations are aimed at redefining business strategies and structures, even in a radical way. It follows that acquisitions might be viable solutions to strategic problems that, in general, translate into a lack of economization.

In order to draw a line between acquisitions and mergers, various criteria might be used. First, on the basis of the level of integration between the companies involved, when compared to acquisitions, mergers show a higher level of integration. The integration resulting from a merger might impact on various aspects: initially, the manufacturing systems are combined, and then integration involves the top management. Such integration, which is not an issue in acquisitions, is particularly complex. Second, on the basis of the motives behind such operations, acquisitions are aimed at improving the acquiring company’s competitive advantage through an expansion of its manufacturing mix. Mergers are carried out with the purpose of managing a new manufacturing mix resulting from the combination of those belonging to the companies involved.

An acquisition should be considered in relation to the strategic direction of the acquiring company, since it is one of many possible solutions of internal or external growth. In a strategic direction such as this, the acquiring company makes various decisions, such as where, what for and how to do business. Therefore, any acquisition policy has to be consistent with its strategic direction. In some cases, however, an acquisition might be performed in order to seize a sudden change opportunity.

The context in which the acquired company operates is crucial when evaluating the profitability of an acquisition. The acquired company might operate

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7 Cortesi A., Le acquisizioni di imprese, cit., pp. 23 ff.
9 Coda V., L’orientamento strategico dell’impresa, Utet, Torino, 1988, p. 25.
in the same sector as the acquiring company or it might operate in a different one. In both cases, the appeal of the sector\textsuperscript{12} (in terms of development opportunities and future performance) has a considerable impact on the acquisition policies, even though such appeal can dramatically change over time. Since an acquisition allows for the rapid development of business, it also raises the possibility to exploit promptly the opportunities associated with the sector in which the acquired company operates.

Some researchers have emphasised the relation between the appeal of a sector and the post-acquisition profitability of the acquired company\textsuperscript{13}. Such appeal is determined, on the one hand, by the growth rate of the sector in which the acquired company operates (acquisitions occur more often in sectors characterised by a high growth rate) and, on the other hand, by the level of business concentration (the lower the concentration, the more appealing the sector)\textsuperscript{14}. Other researchers have underlined a number of strategies that allow for more profitable acquisitions\textsuperscript{15}: for instance, the choice of the business context towards which the acquisition policies should be targeted.

The acquiring company might already be present in the strategic business unit of the acquired company or, alternatively, the acquisition might be performed in new strategic business units\textsuperscript{16}. In the first case, the main objective

\textsuperscript{12} Cortesi A., *Le acquisizioni di imprese*, cit., pp. 77 ff.


\textsuperscript{16} A strategic business unit is represented by one or more homogeneous product/market/technology combinations characterised by income responsibility. Each strategic business unit has its own economic structure as well as its own strategic management needs in relation to the competitive arena in which it operates (Coda V., *L’orientamento strategico dell’impresa*, Utet, Torino, 1988, p. 50 ff). Strategic business units might also be described as “companies within the company” or “near-companies”, each of which has its own competitive system and strategic problems. Each strategic business unit pursues objectives of competitive positioning thorough the implementation of specific strategies. The criteria for evaluating a strategy can be identified only by considering every single strategic business unit (Donna G., *L’impresa competitiva. Un approccio sistemico*, Giuffrè, Milano, 1992, p. 15 ff.). The definition of a portfolio of strategic business units allows for the identification of a
for the acquiring company is to improve its competitive advantage within the context in which it operates. Such a goal is reached thanks to the specific skills that allow for the company’s know-how\(^{17}\) and resources to be complete; and thanks to the new position that the company has gained in its market. In the second case, the acquiring company aims at expanding its business portfolio through purchasing a company existing in a specific market. If the acquired company plays a key role in its own context, the objective of the acquiring company is to gain the leadership of that market; conversely, if the acquired company is small and has a modest market share, the acquiring company aims at exploring the new context. Besides such types, intermediate forms of acquisition are to be found, in relation to the initial situations of the acquired companies, the markets that they have reached and the motives for the acquisition\(^{18}\).

### 5.2 Typologies and Objectives of Acquisitions

In spite of such intermediate forms, which vary in relation to the companies involved and the relevant sectors, it might be useful to classify the various types of acquisition on the basis of two criteria: commercial and productive fit between the parties involved; and difficulty of post-acquisition implementation.

The following are the main types of acquisition:

a) vertical acquisitions: the acquiring company expands in an earlier and/or later stage of its supply chain\(^{19}\); typically, it acquires one of its suppliers or one of its key customers. For instance, LVMH has purchased the French company Les Tanneries Roux, which manufactures high-quality leather for luxury com-

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panies such as Louis Vuitton, Christian Dior, Loewe, Céline and Moynat. LVMH has also purchased, together with the Koh family (the founders and majority shareholders of Heng Long International Ltd), Heng Long, i.e. one of the top five crocodile leather tanning firms in the world. Also, Chanel has purchased some of its suppliers in order to protect the excellence of their hand-crafted production. Chanel currently owns nine artisanal ateliers: Montex and Maison Lesage (specialising in embroidery), Goossens (gold and silver), Massaro (shoes), A. Michael (hats), Lemarié (feathers), Desrues (buttons), Guillet (flowers) and Causse (top-quality gloves). In 2012, the Richemont Group purchased 100% of VVSA (Varin-Etampage and Varinor), a traditional supplier of components and semi-finished products for world-class watches and jewellery; the management of the acquired company will not be replaced and existing customers will also be maintained.

Vertical acquisitions require an average level of integration: the manufacturing process does not have to be jointly carried out, since the acquired company is involved in an earlier and/or later stage of the supply chain. This entails interaction, especially at the corporate level, which might cause the acquired middle managers to feel unmotivated, even more so when they consider themselves as having been “conquered”\textsuperscript{20};

b) horizontal acquisitions: the acquired company operates in the same sector as the acquiring company and manufactures the same product or a very similar one\textsuperscript{21}. Horizontal acquisitions take place between two companies in the same strategic business unit\textsuperscript{22}. This was the case with the 100% acquisition of Church’s by Prada in 2006. The gains from this type of acquisition may result in economies of scale (both in manufacturing and in sales), on the one hand, and in increased bargaining power with suppliers and customers, on the


\textsuperscript{22} Cortesi A., \textit{La gestione del processo d’integrazione nelle fusioni e nelle acquisizioni}, cit., p. 4.
Implementation efforts are considerable, inasmuch as the manufacturing process has to be carried out in synergy, duplications have to be avoided and costs have to be reduced. This may cause considerable conflicts in the management of human resources: in the acquired company, people may feel conquered and deprived of their own company values and habits; in the acquiring company, such conflicts may be because of fears of company downsizing and power abuse.

In order to mitigate such conflicts, the acquiring company has to implement communication policies under the sign of transparency, with the purpose of involving people in reaching the objectives associated with the acquisition. Such communication has to be focused on the acquiring company’s history, as well as on the motives for the acquisition and for the merger that might come afterwards. Those motives should be made clear to internal and external stakeholders. As a result, the communication process can be focused on how the acquisition takes place and how its consequences are managed. Moreover, at least during transition, the communication process should respect the mindset of the human resources in the acquired company. When cultural differences are profound, the achievement of the planned performance might be delayed, or the operation might even fail;

c) concentric acquisitions: the acquired company manufactures a line of products in the same merchandise category as the acquiring company and uses similar technologies in its supply chain. An acquisition enables the acquiring...

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company to enter an adjacent business, share resources and reach a correlated market, with the ultimate purpose of completing its line of products and improving its market reach. The integration process is directed at combining certain processes, usually in technology and sales, with the purpose of using the know-how and skills of the parties involved.

This might create some difficulties in implementing the acquisition, which in any case are more serious than those associated with vertical acquisitions. In concentric acquisitions, the goal is to create synergies but in a limited number of processes. For instance, LVMH has acquired several important Italian luxury companies, such as Fendi, Emilio Pucci and Acqua di Parma; PPR has purchased Brioni, Gucci, Bottega Veneta and Sergio Rossi. Through such acquisitions, the two groups have expanded their lines of products, thus entering adjoining businesses; and

d) conglomerate acquisitions: these are formed through the combination of unrelated businesses: the acquiring company and the acquired company operate in different strategic business units. Such operations fall within diversification strategies. For instance, Richemont, the luxury group operating in the industry of jewellery and watches, has purchased the American clothing brand Peter Millar, with a view to expanding into a business other than its core business. The purpose is not sharing resources or creating manufacturing synergies: the companies involved maintain considerable autonomy in business and management, but they are also affected by cultural differences. Therefore, implementation is almost effortless. Occasionally, the management of the acquired company might be supplemented by a manager from the acquiring company: this may lead to conflicts among executives. Conglomerate acquisitions involved Korean groups (organised by business division) such as Samsung (electronics, chemicals, textiles and fashion), LG (electronics and fashion) and E.Land (food and fashion).

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28 Cortesi A., La gestione del processo d’integrazione nelle fusioni e nelle acquisizioni, cit., p. 4.

The types of acquisition so far analysed can be represented in a two-variable matrix considering the two criteria used, i.e. commercial and productive fit between the parties involved; and difficulty of post-acquisition implementation (Figure 5.1).

<table>
<thead>
<tr>
<th></th>
<th>Difficulties in implementation</th>
<th>Fit between the companies involved</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Horizontal acquisition</strong></td>
<td>Considerable</td>
<td>Considerable</td>
</tr>
<tr>
<td><strong>Concentric acquisition</strong></td>
<td>Average</td>
<td>Average</td>
</tr>
<tr>
<td><strong>Vertical acquisition</strong></td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td><strong>Conglomerate acquisition</strong></td>
<td>Little</td>
<td>Little</td>
</tr>
</tbody>
</table>

Figure 5.1  Types of acquisitions

Source: Personal elaboration

The objectives behind acquisitions vary in relation to the companies involved and in relation to the characteristics of the sectors in which they operate. Such objectives might be classified into the following categories:

1) indirect or mediate objectives: these are inspired by motives of a higher category than direct objectives. They include: an increase in the level of economization resulting from the purchase of a functioning company and objectives involving managers, especially when their salaries are performance based. Other indirect goals are related to speculation, i.e. achieving capital gains. This is the case when, prior to performing the acquisition, the acquiring company identifies a purchaser to whom the acquired company will be sold, with the purpose of making a profit, i.e. the difference between the sales price and the purchase price; and

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2) direct or immediate objectives: motives belong to a lower category than indirect objectives, in that they are deeply rooted in the companies involved and are often interweaved, which makes them difficult to prioritise. Furthermore, direct objectives might depend on the kind of acquisition performed (i.e. vertical or horizontal acquisition). Some scholars have listed a number of immediate objectives, by analysing a sample of companies involved in acquisitions:\(^32\): improved corporate image (purchases increase the visibility of the acquiring company); new positioning in the relevant business, after entering markets in which the acquired company operates, which increases opportunities of growth and development for the acquiring company; synergies created between the new skills contributed by the acquired companies and the existing skills; the know-how of the acquired companies becomes available, which is crucial when such know-how involves knowledge that is difficult to obtain; economies of scale and of scope\(^33\) obtained through synergies in manufacturing, sales and organisation; the financial resources of the acquired company become available and allow the acquiring company to gain greater financial strength; the manufacturing systems of the companies involved are combined, which allows for more stable processes and revenue flows, especially when manufacturing cycles are seasonal and therefore fluctuating; diversification in various markets or sectors, resulting in risk mitigation; and speculation, when an under-priced acquired company has in fact good growth potential. Immediate objectives are so numerous and diverse that any attempt at creating an exhaustive list might be in vain. However, all acquisitions share motives that might usefully be classified into two macro-categories:\(^34\):

a) first, reaching critical mass, defined as the sufficient budget level that makes it possible for a company to profitably do business. At an early stage, such critical mass equals the minimum level of investment that companies need to enter a new business and gain minimal market share. Later, it is aimed at maintaining the investment level at which the company can remain viable without having to add any more resources. When the critical mass is influenced both by the sector in which the company operates and by the character-

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\(^33\) Galassi G., Concentrazioni e cooperazioni interaziendali, Giuffrè, Milano, 1969.

istics of the company itself, acquisitions might usefully be aimed at reaching and/or maintaining optimal conditions in terms of critical mass; and

b) second, seeking synergies: acquisitions allow for synergies if, when sharing resources, the players involved need fewer resources to reach the same performance in terms of quality and quantity than when working individually. Alternatively, synergies might result in improved quality and quantity performance, while using the same amount of resources. Synergies are not an automatic consequence of acquisitions: comparing the value chains of the companies involved is crucial to evaluate the advantages of an acquisition and, ultimately, to assess synergy opportunities. Synergies might be sought both between companies operating at the same stage in the supply chain (such as when Nike acquired Umbro) or between companies operating at different stages in the supply chain (such as when Luxottica acquired a sales network in South America).

Such synergies might be classified in different categories within the various business functions. Here follows an analysis of the characteristic business functions:

a) R&D: the most crucial synergies result from M&As with highly innovative companies, with whom highly competitive networks might be created. An innovative partner brings benefits to the acquiring company: first, it stimulates innovation-driven policies; secondly, it helps in coping with competitors. In horizontal acquisitions, innovation-driven partnerships are aimed at improving the quality of new lines of products. In vertical acquisitions, synergies have an impact on the quality of the supply system and/or on the marketing and sales strategies. Another crucial synergy occurs in the opportunity of ac-

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37 The characteristic business functions are those which closely mirror the object and the scope of business. They make up the “core business” of a company (Ferrero G., *Impresa e Management*, Giuffré, Milano, 1987, p. 179), since they pursue the business objectives in a direct way. The core business might be described as the management operations that identify a company’s economic and technical functions (Airoldi G., Brunetti G., Coda V., *Corso di Economia aziendale*, Il Mulino, Bologna, 1989, p. 71).

quire and developing new technologies, especially when the acquired company is niche oriented, highly innovative and makes available its know-how. Innovation is a key element when choosing a partner: M&As might often be performed and internal growth given up because the latter would require too long a time for innovation to be achieved or it might not be successful. In some cases, M&As are deemed better than licensing, since the latter might not lead to meeting the required standards of quality and innovation;

b) manufacturing and logistics: the integration process between the parties involved is aimed at decreasing costs of production, improving cost-effectiveness and obtaining economies of scale and of scope. In the case of horizontal integration, increased bargaining power might result in better conditions of supply, together with reduced stock levels required for manufacturing purposes. Besides, manufacturing synergies enable a company to reach its optimal size without making its structure less flexible. In the case of vertical integration, better supply conditions derive from the acquisition of suppliers; moreover, technological synergies might be created when the companies involved share similar technological traits;

c) marketing: synergies between companies might lead to gaining greater market share in existing contexts and entering new markets. Furthermore, the new company might expand its line of products, thanks to the skills contributed by the companies involved. In addition, previously unexploited individual skills might be used and enhanced through cooperation. Last but not least, through brand extension policies, a company’s brand might be employed in the markets in which the other companies operate, thereby increasing opportunities for customer satisfaction; and

d) organisation and human resources: the management of human resources is rather complex, since each and every decision related to downsizing, staff relocation or redundancy has a considerable impact on the company atmosphere and affects the business context. Synergies have to promote organisational compatibility between companies in terms of tasks, roles and responsibilities. In particular, they involve aspects such as training, the allocation of tasks and the enhancement of staff at various hierarchy levels. Synergies should be directed at motivating and incentivising staff towards any new com-

pany project.

Synergies must be sought in a rational way and to a reasonable extent; otherwise, disadvantages might outnumber advantages and, as a consequence, the company might become weaker. This is especially true when considering that the new company has to be able to improve its performance after such synergies start to decline.

5.3 Mergers & Acquisitions (M&As)

In spite of the differences in form and content between mergers and acquisitions, the international literature refers jointly to these operations as “mergers and acquisitions” (M&As). These operations are considered complementary and defined with the one phrase “merger and acquisition”. This is not the case in Italian literature, where mergers and acquisitions are considered to be two different kinds of operation.

Some authors describe M&As as important strategies of external growth through which companies increase their size. This is especially true for mature sectors, where internal growth becomes more difficult, or for companies in which internal growth would be excessively time consuming. The literature

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40 Coda V., Prefazione all’edizione italiana, in Fubini D., Price C., Zollo M., Fusioni e acquisizioni. Il ruolo della leadership, cit., p. VIII.


has emphasised the strategic importance of M&As in terms of competitive edge. On the basis of the kind of substantial and formal agreement reached between the players involved, M&As might be classified in the following categories:

a) friendly agreements: M&As are performed through an agreement between the players; such an agreement might result from previous cooperation or from objectives leading to a mutually advantageous situation; and

b) hostile operations: M&As might consist of attacks on the shareholders or might pose a threat to the management. They may be gradually or immediately performed.

Such a distinction is not always clear cut. Sometimes acquisitions can start as hostile operations and be turned into more or less friendly agreements at a later stage, in order to mitigate damage to weaker players.

The motives for both friendly agreements and hostile operations might be various, given the specific situation of each company. Nevertheless, such motives might share commercial objectives (i.e. taking advantage of the competitive position of the acquired company) or size objectives (i.e. expanding in order for the acquiring company to obtain economies of scale and of scope). Moreover, the acquiring company might aim at exploiting the knowledge and skills of the acquired company, especially when such knowledge and skills cannot be easily replicated. It might also be driven by defence strategies, with the purpose of responding to competitors’ moves or creating barriers to entry in the markets in which it operates. The acquiring company may also aim at exploiting external factors that might create new business opportunities. Last but not least, the acquiring company might be left with no alternative other than a merger or an acquisition in order to enter a new market or gain greater market share. This is the case when markets are very mature and the only way to improve market reach is to purchase a company that operates in the relevant market(s).

M&As have considerably grown in number: this is due to the fact that the context has greatly changed, forcing companies to pursue external growth in

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45 Conca V., Le acquisizioni, cit., pp. 28 ff.
order to cope with competitors. Given the importance of this phenomenon, the literature has focused on analysing the performance obtained from M&As. Some researchers have emphasised the difficulties in reaching the financial objectives planned. According to some scholars, the new company is not worth more than when the two businesses were apart.

Besides external reasons, such as the impact of the global crisis and changes in the relevant sector, a number of internal reasons have been identified by the literature that account for the failure of M&As. One of the main reasons for failure is the inability of the management to manage the new company. This deficiency is determined, among other factors, by the inexperience that the management has in coping with similar situations. The management might fail to devise an appropriate competitive strategy when evaluating the acquired companies and the synergies actually obtainable with the

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operation\textsuperscript{51}. This ultimately causes wealth to be destroyed\textsuperscript{52}. Furthermore, the management might be more interested in increasing share price and forget that the company’s mission is to satisfy human needs (and not create value for shareholders). Therefore, leadership becomes crucial\textsuperscript{53}: the management should be prepared to cope with various situations in full respect of a shared vision\textsuperscript{54}. In order to do so, they should commit to promoting growth, helping the companies involved in making the transition to the new situation, adopting a humble attitude towards the human resources of the acquired company and putting aside pointless fights for power\textsuperscript{55}.

It is true that, on the one hand, integration requires mutual respect for cultural differences; on the other hand, however, it is only by bearing in mind the common goals that the process can be successful. The management must aim at reaching both strategic and organisational fit\textsuperscript{56}, which might be usefully analysed through the cultural web model\textsuperscript{57}. This model is helpful in evaluating fit

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\textsuperscript{54} Haspeslagh P.C., Jemison D.B., La gestione delle acquisizioni, cit., p. 19.
\textsuperscript{55} Coda V., Prefazione all’edizione italiana, in Fubini D., Price C., Zollo M., Fusioni e acquisizioni. Il ruolo della leadership, Egea, Milano, 2008.
through a number of dimensions or symptoms of compatibility, such as the average age of the board of directors, the ratio of bonuses to salaries and the number of levels in the organisation. Such a model shows that profound differences between companies might cause integration problems.

Also, the size of the new company is deemed a critical factor, in that it might affect the outcomes of M&As: the bigger the company, the more difficult it is to obtain economies of scale and of scope. An incongruous post-acquisition increase in size might cause diseconomies, resulting in increased unit costs of production, increased bureaucratisation and decreased cost-effectiveness.

Since the size factor is a crucial element in acquisitions, the literature has focused on it and has defined the ideal size at which the benefits outweigh the costs due to the diseconomies resulting from the higher complexity associated to a larger company. Some researchers have identified the ideal size on the basis of the ratio of the assets of the acquired company to the assets of the acquiring company, evaluated in the year preceding the acquisition. Some scholars have maintained that, when the acquisition target is a big company, it is more likely that value will increase. This is related to the possibility of exploiting the financial resources of the acquired company while obtaining considerable economies of scale.

The literature has not yet identified the ideal post-acquisition size. No evidence has been found of any connection between the size and the performance of the acquiring company. In fact, a sort of crushing of the acquired company

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might translate into worse working conditions, due to unmotivated and depressed staff. In addition, it has been proven that the performance of the acquired company tends to decline dramatically when the acquired company is much smaller than the acquiring company. This fact is detrimental to the image and to the distinctive skills of the acquired company.

Another reason why M&As fail lies in the cultural differences between the contexts involved: some cultural features are so elusive that they are said to have an impact “at a preconscious level”. The effects of M&As have been analysed and included under the umbrella term of “M&A syndrome” (Figure 5.3); reactions and responses might vary on the basis of the ages, roles, tasks, attitudes and personalities of the human resources involved. Typical reactions might be positive or negative and they often vary over time, especially after a careful evaluation of any new circumstance is made. Among the negative reactions are rage, worry, demotivation, stress and anxiety about the future; among the positive reactions are interest, commitment and acceptance. The wider the range of positive reactions, the higher the degree of commitment in the new company there is; this favours the success of the operation. In order to cope with the cultural variable, the management must adopt a cross-cultural

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approach focused on the cultural differences between the companies involved, as well as on the need for acculturation processes.  

Figure 5.2 M&A Syndrome
Source: Personal elaboration

5.4 M&As in the Luxury Market

M&As are frequently performed in the luxury business with the purpose of achieving external growth. The players might be differently combined in the roles of the acquiring company and the acquired company. As far as the acquired company is concerned, the player might own a well-established brand or, alternatively, might be an extremely specialised small company (typically when a former supplier is acquired).

As far as the acquiring company is concerned, the player is usually a large multi-brand and multi-product group that performs M&As in order to enlarge its line of products. Such large groups often pursue external growth by purchasing other brands: the brand is the key element of its competitive strategies. The purpose is the creation of a diverse brand portfolio allowing for the fame and identity of each brand to be used, and for opportunities for diversification from

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A brand extension is often performed: in other words, the brand is extended to other merchandise categories with the purpose of providing the consumer with a wide range of products with which they can satisfy various everyday needs. Such products are all associated with the brand or with a number of brands. When businesses decide to unify the merchandise categories while diversifying the levels of price, they have to constantly “re-differentiate"\(^{68}\), in order to come out with forms of differentiation different from those of their competitors.

This strategy of brand extension might create some confusion, in that the prices imposed by the company for the different types of products vary according to the product features, thus becoming either luxury prices, premium prices or mass prices: borders between products are not very clear cut for consumers. This problem might be avoided through the identification of ultra-premium products within a line of products. For instance, Armani S.p.A. has diverse lines of products: prestigious tailor-made garments for selected customers (such as an actress who commissions an evening dress for the Oscar ceremony, or an aristocrat who does the same for her wedding), mass-produced luxury collections (i.e. the lines Giorgio Armani and Armani Privé), premium lines (Emporio Armani and Armani Jeans) and medium-end lines of accessories with a licensed brand (such as glasses).

However, the acquiring firm might also be a non-luxury company. Such a strategy is successful provided the management is able to change their frame of mind: the luxury business should be considered as “an island” on which the consumer’s perception works as a \textit{trait d'union} of various attributes, both material and immaterial, which are beyond the product’s functions. The attitude has to be the same as that of the management of a non-luxury company when launching its own top-end brand: the operation is successful on the condition that the luxury line is considered as a unique thing, with attributes other than those characterising mass products. Of course, each synergy might result in economies of scale (especially in terms of R&D and human resources management) that are to be sought whenever the advantages gained are not detrimental to the brand image. For instance, Ford decided to acquire Jaguar with the purpose of entering the luxury business. Premier Automotive Group was consequently created and a number of both luxury brands (such as Jaguar and Aston Martin) and premium brands (Volvo) were purchased. Premier Automotive Group did not manage to generate profits and Ford decided to give up luxury


cars. The problems were probably due to the fact that Ford did not fully understand the dynamics governing the luxury business and failed to adapt its own strategies to the new target.

The various strategies of external growth within M&As in the luxury business might be classified on the basis of two characteristics of the acquiring company\textsuperscript{70}: the number of brands owned and its brand extension (Figure 5.3).

![Brand strategies within M&As](source)

These can be described as follows\textsuperscript{71}:

1) companies operating in one merchandise category with one brand: this strategy is often adopted by small businesses that operate in market niches, for instance a winery whose wines are considered luxury products and are well known abroad. Typically, when such a winery performs M&As, the target company is another winery. After the operation, the acquiring winery continues to operate with its own brand, since it is well known in the market;

2) companies operating with two or more brands in one merchandise category: this strategy is typically followed by groups that perform important M&As, resulting in the control of several brands focused on one merchandise category. M&As are directed at purchasing businesses that operate in the same merchandise category as the acquiring company, which maintains the acquired


\textsuperscript{71} Giacosa E., L’economia della aziende di abbigliamento, cit., pp. 6 ff., p. 91, pp. 314 ff.
brand and exploits it from a commercial point of view. The group Richemont is a good example. It operates in the industry of watches and jewellery with several well-known brands, such as Cartier, Piaget, Van Cleef & Arpels, IWC, Vacheron Constantin, Baume & Mercier, Panerai, Jaeger-LeCoultre and Montblanc;

3) companies operating with two or more brands in different merchandise categories: this strategy is implemented by large multi-brand, multi-product groups, which aim at creating a diverse brand portfolio while operating in various sectors. LVMH, PPR, Prada Group and Tod’s Group are good examples. The brands might be positioned at the same price level (LVMH Group, for instance, operates in the luxury business with a number of well-known brands) or at different price levels (Giorgio Armani owns, besides luxury brands, brands such as Emporio Armani and Armani Jeans that are positioned at lower price levels); and

4) companies operating with one brand in different merchandise categories: this is a strategy of brand extension for a diverse range of products, aimed at diffusing the brand values while offering customers a total look that can satisfy their various needs. A sort of “marquee” is therefore created, under which a brand extends its presence to various merchandise categories and offers a whole lifestyle, thereby enabling the customer to satisfy all of his or her needs. The acquiring firm manages an “umbrella brand”, i.e. it controls a brand portfolio. Fashion companies such as, among others, Versace, Armani and Fendi use their brands for garments, shoes, bags, accessories and interior design goods. The luxury business provides a plethora of examples of brands that have pursued growth by exploring different contexts: Fendi was established as a furrier, Gucci and Louis Vuitton started business in leather accessories and Chanel originally dealt with haute couture. Some of their lines remain central, i.e. they are symbolic of the brand, while others might be seen as peripheral, since they are not essential in defining the brand identity and can be marketed not only in dedicated boutiques. For Cartier, for instance, watches

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and jewellery are central, while leather accessories and glasses are peripheral 
lines.

In the following section, the fourth scenario is further explored, since brand 
extension in various merchandise categories is a very common practice in the 
luxury business.

Businesses choose brand stretching when they realise that, in a luxury 
company, the brand translates into capital 76. The fame of the brand is exploited 
in other contexts and the brand itself outgrows the product 77, thus conveying a 
message regardless of the products with which it is associated. It follows that 
such an “eponymous brand” 78 might be applied to various merchandise catego-
ries while maintaining its identity.

In order for this strategy to be successful, the new products have to match 
the customer’s perceptions. In other words, consumers should consider the 
brand’s extension to other products as a legitimate move and should realise 
that the brand identity has not been distorted in the process (this is the case 
with the brand Versace, whose elegance perfectly fits with interior design). If 
customers accept the new products, the company has reached its goal; when 
the existing line of products is innovative, this also contributes to success. 
This does not translate into repetitiveness when creating new lines of products. 
In fact, it is crucial that companies remain consistent with their distinctive 
values.

Businesses might implement brand extensions in different ways. First, de-
pending on the merchandise category of the new product 79, they might resort 
to:

a) category extension: the new product belongs to a merchandise category 
that is not part of the core business. Fendi, for instance, extended its brand 
from fur coats to garments, accessories, interior design, etc.; or

b) line extension: the new product belongs to the merchandise category in

2000, p. 280.
77 Fabris G., Minestroni L., Valore e valori della marca, cit., p. 159. Gabrielli V., Il brand, 
78 Ellwood I., The essential brand book. Over 100 techniques to increase bran value, Kogan 
79 Cappellari R., Il marketing della moda e del lusso, cit., p. 70. Giacosa E., L’economia 
della aziende di abbigliamento, cit., p. 314.
which the company operates, although in a new market segment\textsuperscript{80}. Dior, for example, has created a kids collection in addition to its line of womenswear.

Brand extensions are performed with various purposes\textsuperscript{81}, such as increasing turnover while providing loyal customers with new opportunities to satisfy their needs. Moreover, through brand stretching, companies can save the financial resources that would have to be invested in creating or purchasing a new brand. They can also succeed in risk diversification, since any expansion of a line of products translates into risk mitigation. Fendi is, once again, a good example: by the time the demand for fur coats started to decline, the company had already performed brand extension. Brand stretching might also be achieved through licensing, which favours business growth without requiring further investments and know-how.

Secondly, depending on price, companies might perform brand extension through the following practices\textsuperscript{82}:

a) vertical practices: companies expand their lines of products either by decreasing or increasing the prices of new products. When lowering prices, companies aim to attract new customers, especially “day trippers” (i.e. occasional purchasers of luxury products). Armani, for instance, offers haute couture, \textit{prêt-à-porter} and more affordable lines and accessories, some of which are licensed. When performing brand extension through lower prices, companies aim at guaranteeing brand recognisability by implementing various strategies: focus on the product’s intrinsic value, packaging and facing; aggressive communication and great care in designing stores. Furthermore, core products are usually pushed upwards with the purpose of making the gap between top-end and accessible items wider.

On the contrary, when increasing prices, companies aim at creating a finer line of products than existing ones, with the purpose of differentiating themselves from their competitors. American Express, for instance, launched Centurion, an exclusive credit card for clients who are introduced by a selected group of Platinum credit card holders. Profitability might change from one


product to another: some are considered as secondary items, in that they create lower profits; however, they are maintained in order to diffuse the brand (the average gross profit for a bag is about 75%). If luxury brands could be positioned on a scale, companies that perform vertical extensions would move them upward and downward, in the attempt to satisfy the needs of top-end target consumers; and

b) horizontal practices: businesses expand their lines of products without reducing prices, with the purpose of providing loyal customers with new opportunities to satisfy their needs. Brands remain crucial, since they convey the values towards which products should be directed. Therefore, each line of products becomes a sort of universe including various merchandise categories at a certain price level (the same within each category), all of which share the same amount of exclusivity associated with the brand. Ralph Lauren, for instance, has performed horizontal extension on garments, accessories, make-up, perfume, interior design, restaurants and cafés. In such cases, the purpose is not to differentiate variously exclusive sub-brands but to emphasise the values associated with the main brand on any purchase occasion.

Brand extension doubtlessly translates into a number of advantages. First, it allows for rapid growth without requiring large investment; however, it requires considerable brand equity, which assists in driving customers towards the new merchandise categories. In other words, brands are considered as potential value multipliers. The inclusion of more affordable products (such as perfume and glasses) together with a successful advertising campaign can result in greater customer awareness and satisfaction. Wider market reach ultimately results in increased turnover.

Secondly, when brand extension involves accessories, these herald the brand image, which greatly benefits from the fact that accessories display the brand logo. Accessories might work as a decoy and attract potential customers into a boutique: once there, they might be so engrossed by the brand universe that they not only purchase accessories but also other kinds of products.

Thirdly, barriers to entry might be created, resulting in competitors having to cope with a well-established brand on a variety of products. Last but not least, brand extension translates into economies of scale and of scope: the

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84 Mariotti J., Smart things to know about brands & branding, cit., p. 148.

85 Scannerini A.L., Le strategie di diversificazione nelle imprese di alta moda, Dami, Pistoia, 2000, p. 46.
former are obtained, for instance, when a clothing company manufacturing menswear decides to extend to womenswear; the latter are obtained when a company uses the same resources to manufacture a number of products, thus allocating the costs related to various functions (such as R&D, logistics and retailing) to different items.

Besides these advantages, brand extension might also translate into several disadvantages. For example, the combination of strengths typically associated with luxury companies, i.e. creativity, excellence and exclusivity, might “lose its grip”\textsuperscript{86}. This happens when a brand is extended to segments or merchandise categories that are not consistent with its values or when it is excessively “diluted” because of overexposure\textsuperscript{87}. Brand extension might not be accompanied by adequate elasticity of the brand’s goodwill: this would cause customer trust to plummet. When the quality of the new products is not consistent with the corporate brand personality, consumers tend to reject them\textsuperscript{88}. The risk of damaging the brand image might be mitigated by offering highly creative products and by distributing them in a selective way (for instance, in limited editions). When the brand image is damaged, brands suffer from a stretching effect\textsuperscript{89}, i.e. they are detrimentally distanced from their core values. This was the case with Pierre Cardin, which abandoned the specialisation attitudes originally associated with its brand, thus losing allure and prestige\textsuperscript{90}.

Furthermore, all creative and productive aspects must be closely monitored, especially when manufacturing is outsourced, so that each and every product might successfully herald the brand in the market. With the same purpose, large fashion companies choose not to lower their prices under a certain


\textsuperscript{88} Ellwood I., \textit{The essential brand book. Over 100 techniques to increase brand value}, cit., pp. 28 ff.

\textsuperscript{89} Sherrington M., \textit{Added value. The alchemy of brand-led growth}, cit., p. 74 ff.

limit, even though they often perform brand extensions towards accessories, in order not to lose brand allure. Chanel, for instance, sells its simplest and most casual bags for no less than 1,000 euros. Armani, in a similar way, consistently protects its brand image (in spite of its various lines, from haute couture to casual clothes) by keeping such lines separate and by distributing them through different channels.

Licence monitoring is also crucial, since licensees tend to pursue their own profit rather than brand development. From the point of view of manufacturing, such monitoring is essential in all cases of outsourcing where there is no contact between the creative team and the production line.

When pursuing brand extension, companies might opt to outsource certain stages of the manufacturing cycle or might commission semi-finished products or components from third parties. Undoubtedly, such choices bring various advantages. First, companies achieve higher elasticity and flexibility in coping with changeable market demand, because they do not have to make investments that would increase their structural rigidity and they can remedy structural deficiencies in the manufacturing system. Second, businesses have more opportunities to change their lines of products promptly without bearing any extra cost. However, outsourcing also involves the risk of companies becoming sheer intermediaries between manufacturers and customers, since they do not physically manufacture the products.

Companies might outsource the whole manufacturing process, or part of it, to a country where labour costs are lower, either in company-owned premises or in factories belonging to third parties. Businesses usually outsource standardised labour activities with low added value and low innovation content with the purpose of increasing profitability. However, outsourcing might damage the unique cultural traditions associated with a product: manufacturing a luxury product in a context other than its own may damage its allure, in that customers might miss part of the dream of purchasing a product that has been manufactured in the right place.

Moreover, outsourcing may deprive a product of its geographical identity, which results from the use of raw materials coming from the context where the product itself is manufactured (such as handmade embroidery from Bruges). In addition, outsourcing might extend manufacturing and delivery

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91 Giacosa E., L’economia della aziende di abbigliamento, cit., pp. 249 ff.
92 Farneti G., Economia d’Azienda, cit., p. 33.
93 Cesaroni F.M., La funzione di produzione nelle piccole imprese, cit., p. 108. Melis G., Elementi di Economia d’Azienda, cit., p. 132
94 Giacosa E., L’economia della aziende di abbigliamento, cit., pp. 249 ff.
times, consequently delaying restocking. Last but not least, it does not allow companies to monitor product quality.

5.4 M&A Trends in the Luxury Business

In 2011, the number of worldwide M&As in fashion and in the luxury business decreased by 33%, with 91 operations performed (137 in 2010; 149 in 2007), which is accounted for by the global crisis. In spite of such reduction, the quality of M&As has increased: for instance, the French group LVMH purchased Bulgari, a historic brand that produces top-end Italian jewellery, together with Ole Henriksen (make-up) and ArteCad (watches). PPR, another French giant of the luxury business, purchased Brioni (an Italian clothing company), Volcom (specialising in action sports; PPR has therefore gained a stronger position in this new segment), Sowind (produces top-end Swiss watches such as Girard-Perregaux and JeanRichard), Wilderness Safaris (a South African company specialising in environmentally friendly luxury tourism) and Cobra (manufacturers of golf equipment).

As far as the acquiring companies are concerned, private equity funds play a leading role, having performed 18 M&As (20% of the total number of M&As), followed by apparel companies (16), retailing companies (15), private investors (10) and large luxury groups (9). From a geographical point of view, 30 M&As were performed between Italian companies (acting either as acquiring or acquired companies), 7 were targeted at foreign companies by Italian firms, 15 were targeted at Italian companies by foreign firms and 39 were performed between foreign companies.

Foreign investors have shown considerable interest in the Italian luxury sector: 16% of the M&As performed in 2011 were targeted at Italian companies by foreign firms (15 M&As). Such Italian businesses are characterised by the excellent quality of their products; some of them own historic world-class brands. On the one hand, this phenomenon testifies to the exclusivity of Italian brands; on the other hand, it carries the risk of eroding the Italian prestige in the luxury business.

LVMH and PPR have been the two keenest purchasers of Italian businesses. LVMH has acquired Bulgari, thus achieving an extremely rich brand portfolio (including, among others, Fendi, Emilio Pucci and Acqua di Parma). Several financial newspapers have defined LVMH and Bulgari as “the perfect

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95 Pambianconews, February 2012.
96 www.moda24.ilsole24ore.com
couple” from a strategic point of view: thanks to this operation, LVMH not only doubled the turnover of its jewellery and watches division but also gained greater market reach in Europe, Asia and the United States. PPR has added Brioni to its other brands such as Gucci, Bottega Veneta and Sergio Rossi.

Besides the two French groups, other foreign players have directed their attention to Italian luxury companies: for instance, the Austrian group Labelux has gained control of Belstaff; Paris Group (Arab Emirates) has acquired Gianfranco Ferré; the Chinese company Shandong Heavy has purchased Ferretti Group Yacht; and the Arab fund Mubadala has acquired 40% of Ballantyne.

Abroad, Labelux has purchased the brand Jimmy Choo (luxury shoes) from the English private equity fund Towerbrook; Jean-Paul Gaultier has been acquired by the Spanish company Puig.

In 2011, some Italian businesses played the role of acquiring company in a number of M&As. For instance, Luxottica (a leader in designing, manufacturing and marketing top-end, luxury and casual glasses) performed various important operations, which resulted in the creation of considerable value. Luxottica has achieved a good track record by focusing on small-scale M&As (in comparison with the acquisition of Oakley in 2007). By implementing a sun belt strategy aimed at improving its market reach in the segment of sunglasses, Luxottica has become stronger both in South America and in some European markets. In particular, Luxottica purchased 100% of Tecnol Group (Brazilian eyewear leader), 470 stores in South America (Chile, Peru, Ecuador and Colombia) and two Mexican chains specialising in sunglasses (High Tech and Stanza), which own more than 70 stores.

Also, 2012 has witnessed a large number of M&As targeted at Italian fashion and luxury brands. In particular, some companies that are still owned by the founding family are considered extremely appealing targets, thanks to their considerable brand equity: Ermenegildo Zegna (turnover of 1.1 billion euros in 2011), Giorgio Armani (about 1.6 billion), Tod’s (893.6 million), Ferragamo (986.5 million), Versace (292.3 million), Pomellato (140 million) and Cavalli (178 million).

In the role of the acquiring company, a number of Italian businesses might play a key role in international markets, thanks to the good performances achieved after entering the stock exchange: Prada, for instance, was listed on the Hong Kong Stock Exchange in 2011; Salvatore Ferragamo was listed on the Milan Stock Exchange in the same year. Luxottica has purchased from Multiopticas Internacional a chain of 120 stores specialising in sunglasses throughout Spain. Safilo has acquired Polaroid Eyewear, which is not only the
world leader in technology for polarised lenses and optics but also the owner of several world-class brands.

Groups headquartered in the Far East and in emerging countries, which can account for considerable financial resources and sell their products in booming markets, have shown a keen interest in Italian businesses, thus becoming competitors of LVMH and PPR. Valentino Fashion Group has been purchased by Mayhoola for Investments (a financial holding company based in Qatar and owned by Sheik Hamad bin Khalifa Al Thani, a majority shareholder in Tiffany) from Red & Black, a Luxembourg company owned by London-based private equity fund Permira (80%) and by members of the Marzotto family (20%). Thanks to this acquisition, Mayhoola for Investments now owns the brand Valentino and the licence for M Missoni.

In addition to a number of M&As in the fashion industry, the royally funded Qatar investment authority (Qia) has recently performed other important operations in Europe. In Italy, for instance, it has purchased Costa Smeralda Holding (which owns land, four luxury hotels, the marina and the docks in Porto Cervo, a golf club in Pevero), together with Hotel Gallia in Milan. In Germany, it has a share in the car manufacturing group Volkswagen (which, in turn, controls luxury brands Audi and Lamborghini). In the United Kingdom, the royal fund owns 100% of Harrods; in France it has a share in LVMH and 100% of the Paris Saint-Germain football team.

The French brand Vionnet has been acquired by London-based Go To Enterprise Sarl, owned by Kazak businesswoman Gaukhar Erkinova Berkalieva, with the purpose of extending the brand in the Balkan area and in former USSR countries. A total of 80% of the French fashion house Sonia Rykiel has been purchased by Fung Brands, a Chinese group based in Hong Kong: this could lead to the international development of the French brand, especially in Asian markets.

Concerning the most important M&As performed in the luxury business in 2011 and 2012, the following remarks might be made.

M&As performed by Italian companies acting as acquiring companies have been characterised by a strategic approach to internationalisation. When targeting companies based in countries where labour costs are lower, their goal was not only to improve cost-effectiveness; they were also seeking business partners with whom synergies could be created, in terms of manufacturing and sales. The acquired companies were often highly innovative and specialised and/or niche companies relying on a well-established brand and efficient retailing networks.

When the role of the acquiring company was played by foreign businesses, these were often large multinational groups that were trying to create a diverse
brand portfolio, i.e. extending to more than one sector or productive segment, such as LVMH, PPR and Richemont. M&As were focused either on one price category (e.g. luxury products) or on different price categories for various customer segments. When the target company was an Italian firm, the key element was the “made in Italy” factor, i.e. a mix of creativity, manufacturing excellence, quality and good taste, especially for French and American investors. The acquiring company was often a royal fund, which is a symptom of the fact that power is shifting from mature economies to the Middle East and Asia.

Summarising the motives behind the numerous M&As mentioned would be an extremely difficult task. However, it is possible to outline some of their general features. From the perspective of the acquiring company, such “merger mania” in the luxury business has been characterised by the following objectives:

a) increase in size: the synergies created in manufacturing, sales and organisation have an accelerating effect on external growth. This is possible thanks to the exploitation of each partner’s skills, productive capacity, sales potential, brand and market reach. Acquisition strategies fit particularly well in mature markets, which might otherwise be difficult and expensive to penetrate or further explore;

b) expansion of business scope from a geographical point of view: by using the sales network of the acquired company, the acquiring firm might be able to expand its business scope. Markets offer new opportunities: more and more customers can be attracted and lines of products can be expanded. The target markets are often the same as those in which the acquiring company is based or mainly operates;

c) acquisition of an appealing well-established brand: brands are certainly one of the appealing elements for acquiring companies. In case the acquired company owns a well-established world-class brand, the acquiring company might decide to be consistent with the values traditionally associated with the brand, in order to not damage its identity. Therefore, the acquiring company tries to combine the look and values of the acquired brand with a more modern vision of it. When the acquired company owns a luxury brand, each and every product that is marketed with that same brand acquires the allure of a luxury product. In other cases, the acquired brand needs to be re-launched into the market: the financial resources and skills of the acquiring company give new


appeal to the brand and enhance its growth perspectives. This happened when LVMH purchased Emilio Pucci and when Gucci Group acquired Yves Saint Laurent. Another possible scenario is that of an emerging brand being acquired and developed thanks to the resources of the acquiring company: this is the case with the brand Stella McCartney, which was bought by Gucci Group;

d) brand extension to several merchandise categories: when the acquiring company owns a well-established luxury brand, it might be interested in extending this brand to various merchandise categories. Therefore, the target might be a small firm that is capable of manufacturing high-quality products that match the appeal of the brand. Brand extensions might occur in the business unit where the acquiring company operates or in a different business unit. In the first case, the company aims at strengthening its role in the business unit; in the second case, the ultimate goal is diversification;

e) creation of synergies: since the companies involved share their skills and know-how, synergies are created and cost-effectiveness is improved in manufacturing, sales and organisation. Moreover, business risks are spread between the companies involved. Lines of products might be expanded and sales increased by using the skills and know-how of the partner, thus avoiding investments that would make the company structure more rigid; and

f) control of the supply chain: in vertical acquisitions, the purpose of the company is to defend its competitive advantage, through cooperation with or management of the other players in the chain. By doing so, the acquiring company is able to maintain direct control of supply channels and target markets.

From the perspective of the acquired company, M&As have a positive influence in terms of manufacturing, sales, organisation and performance. Thanks to the financial resources of the acquiring company, new investments might be made to develop new ideas or to strengthen the brand. By combining the acquiring company’s skills and know-how with those of the acquired company, the latter might improve the manufacturing process and expand its scope. Furthermore, the managerial skills of the partner might increase the profitability of the acquired company, especially when the latter is in a situation of financial crisis and needs fresh management skills to achieve normality.

Such advantages are counterbalanced by a number of disadvantages. Acquired companies often lose their autonomy in decision making, especially when the acquiring company has a very different managerial culture. This can be detrimental to the company atmosphere, in that both the creative team and the management team no longer feel free to create and manage what used to
be their own company. Finally, when the acquiring company belongs to a different sector, the integration process might be more difficult because of the inability of the acquiring company to grasp the dynamics of the sector in which the acquired company operates.

5.5 The Integration Process

Integration follows acquisitions performed with a view to external growth. It is a process through which two or more companies aim at sharing their competitive advantage, with the ultimate purpose of creating a sort of osmosis between them. Thanks to an interactive consecutive process, people who work there learn to successfully work together and cooperate in transferring and sharing skills and resources. In other words, integration is the process through which the companies involved in an acquisition work together in order to create value.

Such advantages result from the use of and combination with the partner’s

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99 A competitive advantage might result from:
- cost leadership: companies are capable of developing the same business activities as their competitors while bearing lower costs;
- differentiation-based leadership: companies stand out in respect to competitors along the whole value chain;
- leadership of focus: companies pursue increasing specialisation in order to meet specific customer needs.


manufacturing system, skills and know-how, with the purpose of developing the acquiring company’s potential. It follows that the competitive advantage deriving from a successful integration is higher than the sum of the competitive advantages contributed by the companies involved and evaluated prior to the integration\textsuperscript{103}. Therefore, integration creates conditions that favour value creation\textsuperscript{104}.

Not all acquisitions require a process of integration. Integration takes place only when the management aims at achieving advantages that depend on the level of cooperation reached by the companies involved. At the end of such processes, the companies might merge, i.e. the acquired company is taken over by the acquiring company, or the businesses are dissolved and a new company is formed.

Integration does not take place when the acquiring company performs acquisition in order to achieve capital control of the acquired company, without creating any synergies (e.g. acquisitions performed by institutional investors; purchases of minority shares\textsuperscript{105}).

Integration not only involves a physical exchange of resources; in fact, it affects company habits and it significantly influences internal processes. It requires considerable efforts in terms of interaction between the people who work for the companies involved\textsuperscript{106}: in the manufacturing process, when interaction is directed at transferring skills and know-how; in the administrative processes, when interaction is focused on the development of information and control systems; and at a symbolic level, when interaction is aimed at persuading the acquired company that the beliefs, ideas and behaviour of the acquiring company are viable. Last but not least, integration requires people to be involved: the staff that, at various levels, work for the company must adapt to renewed work procedures and be engaged in the new company project.

\textsuperscript{103} Fazzini M., Aggregazioni, accordi e alleanze tra imprese, cit., p. 7. Giacosa E., L’economia delle aziende di abbigliamento, cit., p. 262.


\textsuperscript{105} Conca V., Le acquisizioni, cit., pp. 199 ff.

\textsuperscript{106} Haspeslagh P.C., Jemison D.B., La gestione delle acquisizioni, cit., pp. 156 ff.
In order for integration to be successful, the exchange of distinctive qualities, skills and know-how is crucial, in that it avoids integration being imposed on the acquired company\textsuperscript{107}. Therefore, integration is a challenge first and foremost for the managing directors: when two companies merge, the process might have an impact on their health more than any other event in their business life\textsuperscript{108}. Every delayed or wrong move in the integration process (i.e. delayed strategic decisions, counterproductive compromises, and contradictory inbound/outbound information and communication flows) might have devastating consequences on all aspects of company management\textsuperscript{109}. 

Any integration process reflects a resource-based view\textsuperscript{110}: the acquiring company aims at achieving control of the resources and skills of the acquired company, which are often quite difficult to find on the market. Adequate exploitation of resources and know-how assists in achieving a competitive advantage. Furthermore, proper management of the acquired resources might result in the creation of further resources, which might in turn strengthen the competitive advantage.

The literature has focused on the importance of properly managing post-merger integration in order to achieve value creation\textsuperscript{111}. Such integration should not be considered as a simple automatic incremental practice subsequent to external growth. In fact, it is a very delicate stage in a company’s life: post-merger integration that is not properly dealt with might cause M&As to fail\textsuperscript{112}. It requires considerable integration efforts to identify cultural, management and organisational differences and to turn them into opportunities, while

\textsuperscript{107} Cortesi A., \textit{Le acquisizioni di imprese}, cit., p. 192.
avoiding hostility and stress.\textsuperscript{113}

Post-merger integration might be considered as a crucial phase in value creation, i.e. an absolutely critical stage following M&As.\textsuperscript{114}

In order to achieve successful integration, various key factors should be taken into consideration: the strategic interdependence to be reached between the companies involved and their organisational autonomy. On the basis of how these factors combine with each another, the integration process might take place in different ways. The possible approaches are:\textsuperscript{115}

\textbf{a) the absorption approach:} when the companies involved operate in a similar context, the level of interdependence to be reached is quite high, at the expense of organisational autonomy. This kind of integration is aimed at obtaining significant economies of scale and of scope, thanks to the thorough unification of activities, organisational structures, cultural variables, manufacturing systems and sales networks. The ultimate goals are the creation of synergies and the elimination of all kinds of barriers between the businesses involved, which thus become one efficient company. Integration might be quite complex, especially when the companies involved are of the same size: in such cases, it is crucial for the acquiring company to behave in a very convincing way and to implement communication strategies under the sign of transparency. A high level of interdependence might create some confusion regarding where one company ends and the other starts: this may generate stress and discontent in the management of the acquired company, in that they would like to maintain their autonomy;

\textbf{b) the preservation approach:} the companies involved maintain their organisational autonomy and independently manage a number of activities, except


for those that might be efficiently managed when concentrated in few hands, such as the top management, the management of cash flows and the management of financial risks. Integration takes place with a view to preserving the unique characteristics of each company involved. In cases where such characteristics are not maintained, the performances of the businesses involved could decline, and the benefits deriving from the acquired company would ultimately be lost. Such preservation might favour learning attitudes in the acquiring company, in terms of skills, know-how and managerial attitudes; and

c) the symbiosis approach: integration is based on a combination of inter-dependency and organisational autonomy. In a first stage, the companies operate autonomously while maintaining their functional independence and distinctive features. In a later stage, more intense synergies might profitably be created. The barriers between companies become less and less impenetrable and synergies result in better performance. Ultimately, the mutual exchange of skills and know-how is strongly favoured. This kind of integration is the most difficult to perform: the management has to take company borders into consideration and favour symbiosis at the same time.

The integration process will be explained in detail by the following topics:

a) critical factors of integration process;
b) integration process stages;
c) horizontal integration;
d) vertical integration.

5.6.1 Critical Factors of Integration Process

The critical factors that determine the success of an integration process are various: their combination enables integration scenarios to be efficiently managed. Such factors must be dealt with in an interactive and consecutive way, with no factor prevailing over the others. The main critical factors are (Figure 5.4):

a) cultural and organisational differences: the cultural and organisational context of the acquired company might be significantly different from that of the acquiring company. The context is made up of the individual traits, motivations and aspirations of the people who work for the company, together with

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the skills and know-how that they possess, as well as personal and hierarchical-organisational behaviours. The cultural features of the acquired company cannot be easily obliterated because they are the result of lengthy processes. Therefore, integration should be aimed at making such features complementary to those of the acquiring company, with the ultimate purpose of making it easier for the latter to adapt to the new context. The best results do not occur when one context prevails over the other, as some cultural traits might be worth being preserved, even if only to a certain extent. However, when the cultural features of the acquired company are outstandingly successful, they should be maintained, or otherwise part of the competitive advantage would be lost.

Cultural fit is crucial for the acquired company to maintain motivation and commitment to the new company project. The performance of the companies involved is determined not only by organisational variables but also by the level of compatibility of the information systems, especially the accounting and management ones. In order to make such systems more compatible, any opposition has to be mitigated: people who are used to certain company practices might be reluctant to adopt new procedures. Another controversial issue is related to top management integration: leadership definition plays a key role in the success of the operation, in that it prevents the new company from becoming a very powerful car driven by an unsuitable or incapable driver.

Top managers should become the driving force of business success: time and energies should be devoted to favour integration between the top managers of the acquiring company and those of the acquired company; roles and responsibilities should be clearly defined. When coping with problems related to the cultural and organisational contexts, the management should not lack flexibility, i.e. they should not stick to the original motives of the operation when the actual situation is rather different from the intended scenario. Strong leadership would assist in reaching such goals by defining any new post-merger objectives;

b) consensus: the higher the level of integration, the higher the need to achieve a consensus, which reaches its highest level of importance in the cases of mergers. In order to reach a consensus, it is necessary to create a positive participatory atmosphere for the staff of the companies involved. In other words, the staff of the acquired company should be motivated, stimulated and rewarded; the staff of the acquiring company should not feel threatened.

Therefore, effective communication strategies should be implemented in order to successfully outline the post-merger objectives. A consensus is easier to reach if the companies involved promote pre-merger cooperation, thus creating a positive atmosphere of mutual respect and trust.

A consensus should not only be considered from an internal point of view; the management should also protect external stakeholders, i.e. customers, commercial partners and the community in which the company operates, against the negative effects of integration. Any communication process should be targeted at reinforcing the message that, in the medium/long term, the operation might bring advantages to the external stakeholders, whose reaction is often an important source of feedback on the results achieved through M&As;

c) the transfer of resources and skills from the acquired company to the acquiring company: such a transfer has two functions: creating favourable conditions for creating synergies between the acquiring company and the acquired company; and avoiding the rejection of the new scenario. When such a transfer involves hard resources (such as technologies, patents, equipment, machinery, etc.) that are by their very nature easily transferrable, the difficulties are less serious. On the contrary, soft resources (all immaterial resources, such as distinctive, managerial and organisational skills, etc.) involve more serious difficulties, due to the fact that such resources are intangible and therefore cannot be automatically replicated in a new business context; and

d) more rapid adaptation to new circumstances: in order for the acquired company to achieve good performance in the new context, integration must result in rapid and thorough adaptation. To achieve this purpose, roles and responsibilities should be made clear from the very beginning, so that the conditions for good performance might be created. Furthermore, motivation policies might assist in alleviating integration problems and, therefore, in making the process shorter.

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120 Fubini D., Price C., Zollo M., Fusioni e acquisizioni. Il ruolo della leadership, cit., p. 15.
Integration is aimed at achieving various objectives:\(^\text{121}\):

a) an increase in company size: integration makes it possible for companies to reach a size that allows for competitiveness;

b) organisational learning: each company involved has the opportunity to acquire new skills and know-how from the others; this process would otherwise be difficult, expensive and/or time-consuming to go through. Organisational learning favours the identification of new development opportunities, which translate into basic research as well as product and process innovation. It also results in an improved use of resources, which in turn increases both the productivity of the means of production and the profitability of capital\(^\text{122}\). Last but not least, organisational learning favours the identification of new practices for strategy development and organisational adaptation\(^\text{123}\);

c) economies of scale and of scope: the companies involved might obtain significant economies of scale thanks to various factors: rather uniform production, larger production volumes, and shared resources and know-how (which may even be complementary). On the contrary, when lines of products

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are expanded, companies might obtain economies of scope\textsuperscript{124} resulting from reductions in cost thanks to the fact that various products are manufactured within the same system. Such cost reductions resulting from integration are higher than the transaction costs that would be borne when making transactions, i.e. exchanging resources\textsuperscript{125}. In spite of the fact that cost reduction is often necessary for the companies involved, the management should develop a broader vision of the integration process; a vision that promotes the creation of a new flourishing company\textsuperscript{126} capable of operating in the market in the long term;

d) mitigation of business risk: risk is spread between the companies involved, which is also thanks to product diversification;

e) defence and resistance against competitors: integration might enhance the new company’s bargaining power, thereby increasing its competitive advantage. Moreover, competition might be mitigated by involving a competitor in the process of external growth;

f) overcoming obstacles in terms of legislation and government measures: when companies are interested in reaching markets that are heavily regulated and difficult to enter for foreign investors, integration with businesses based in the country might assist them in overcoming such obstacles; and

g) consolidation or development of an international image: when the integration process involves foreign businesses, entering international markets is less complicated, since it is easier for the companies involved to cope with local traditions. This helps in gaining international reach.

5.6.2 Integration Process Stages

There is no one integration approach, since each company involved is unique, as is the context in which they operate. However, regardless of the integration practices adopted, establishing borders between companies is crucial, in that it translates into the possibility of protecting the skills and resources typically associated with each context, while maintaining the opportunity of sharing them. As a result, companies can avoid the coercion that they may

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\textsuperscript{126} Coda V., \textit{Prefazione all’edizione italiana}, in Fubini D., Price C., Zollo M., \textit{Fusioni e acquisizioni. Il ruolo della leadership}, cit., p. VII.
otherwise encounter when sudden context changes are resented by the people who work for the businesses involved\(^\text{127}\).

Without forgetting that each situation is unique, integration processes might be split into the following stages\(^\text{128}\) (Figure 5.5):

a) pre-integration: this stage consists of the creation of the conditions that are necessary to transfer skills and know-how between the acquired company and the acquiring company\(^\text{129}\). It implies thorough knowledge of the initial situation regarding the corporate culture and atmosphere and the distinctive skills and financial resources that are concerned. The strengths of each company involved should be enhanced and any weaknesses should not be underestimated. With a view to acculturation, the management should cope with the conflicts and turbulence inevitably associated with pre-integration, which are due to the fact that the companies involved tend to protect their own values and resources. When particularly serious, such conflicts might cause alienation and rapid staff turnover\(^\text{130}\).

Pre-integration requires, on the one hand, information and control systems\(^\text{131}\), which should be used to evaluate the initial situation and to transfer


resources; on the other hand, it requires efforts to favour attitudes of trust in the people involved in the integration process. While maintaining leadership, the management should emphasise the advantages of integration and persuade the human resources of the benefits they could gain from it, with the purpose of promoting the idea of a new united company from the very beginning. Initially, they should determine the distance that the companies involved should reciprocally keep, in terms of increased or decreased integration and management autonomy. At a later stage, the mission of the companies involved should be defined and this might or might not be different from the pre-merger mission. Mission definition translates into a global view of company objectives, i.e. an overall view of the new company as a coherent whole.

In order to evaluate integration performances, the management of the acquiring company should implement evaluation and control policies that might assist with any redefinition of company objectives. Often, the acquired company needs restructuring (in terms of organisation, finance and manufacturing systems) before the integration process gets under way;

b) integration management: this stage focuses on translating the advantages resulting from acquisitions into economies of scale and of scope, when strategic skills are transferred and resources shared. Integration should not be managed in haste, since this might prevent the company from focusing on a partner’s specificities and thereby missing opportunities and increasing the risk of integration failure. Furthermore, every single aspect of integration management favours organisational learning, which in turn assists each company involved in aligning with its partners; and

c) post-integration: this stage is focused on translating the advantages typically associated with business combinations into an increased competitive advantage. The performances obtained in this stage might be usefully protected through various mechanisms.

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133 Fubini D., Price C., Zollo M., Fusioni e acquisizioni. Il ruolo della leadership, cit., p. 118.
The literature has identified the main sources of integration problems. According to some scholars, size can play a key role\textsuperscript{134} as corporate size increases, managing a company might become more difficult and the integration process might become longer and more complicated. Other scholars\textsuperscript{135} have observed that integration problems are due to cultural differences, which make thorough integration more difficult to achieve without changing fossilised differences, habits and behaviours. Moreover, the time it takes for the integration process to be completed is related to the level of integration to be reached: when this level is low (for instance, when a manufacturing company is acquired by a financial holding company or when acquisitions are performed with a view to diversify), the integration process is usually short. On the contrary, problems are more serious when a considerable level of integration needs to be reached, typically in cases of horizontal acquisitions: the integration process becomes lengthier and integration costs become higher.

Integration problems depend also to the various types of integration in which the companies are involved:

a) horizontal integration; and
b) vertical integration.

\textsuperscript{134} Kitching J., “Why Do Merger Miscarry?”, cit., pp. 84-101.

5.5.3 Horizontal Integration

Horizontal integration results from strategies of external growth aimed at strengthening the role that companies hold in their sector and in their line of business\(^\text{136}\). Such a goal is reached by focusing on existing products; new markets might be reached or existing markets might be tackled more aggressively.

Alternatively, the company offer might be expanded through differentiated products, i.e. through various lines of products with similar technologies to be sold on the same market. Last but not least, companies might further develop the potential functions of their products, in order to improve customer satisfaction (Figure 5.6).

![Figure 5.6](image)

**Figure 5.6** Possible moves of horizontal integration

*Source: Personal elaboration*

Integration is not only aimed at increasing sales; in fact, it is also directed at reaching a more sound competitive position\(^\text{137}\) within the sector and the business in which the companies operate\(^\text{138}\).

Integration often involves competitors operating in the same sector\(^\text{139}\): for instance, a company manufacturing watches might decide to acquire another company that manufactures watches targeted at the same segment or at different

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ones. Both companies seek growth within their sector and aim at increasing the size of their manufacturing or commercial units.

The benefits deriving from horizontal integration might be evaluated on the basis of the improvements achieved by the companies involved in terms of competitive advantage:\footnote{Giacosa E., L’economia delle aziende di abbigliamento, cit., pp. 267.}

a) greater market reach: gained thanks to the position that each company held in the market before merging. The companies involved might gain greater market share in the segments in which they operate or in new ones;

b) wider lines of products: the synergies created with other companies translate into wider lines of products being offered, both in the segments in which the companies involved operate and in new segments. When LVMH acquired Bulgari, they not only doubled the turnover of their jewellery and watches division but also gained greater market reach in Europe, Asia and the United States;

c) increased resources and know-how: synergies also allow for organisational learning. The skills contributed by the companies involved in the integration process are often highly specialised and would be difficult and/or expensive to develop. In addition, resources that are scarce might be made available;

d) lower unit costs of production: integration allows for some of the activities individually performed by the companies involved to be united (particularly sourcing and logistics activities), which translates into lower unit costs of production; and

e) increased bargaining power: for all the previous reasons, the companies involved become more competitive, thereby successfully preventing new competitors from entering the market.

\subsection{5.5.4 Vertical Integration}

phase in which the integration takes place, the following types might be defined 142 (Figure 5.7):

a) upward integration: this involves the phases that are closer to the suppliers. Target markets are not modified, since integration efforts are concentrated on the manufacturing stage. This might assist in reducing sourcing-related costs, which are replaced with more easily monitored costs of production. Likewise, when resources are scarce, vertical integration increases the availability of such resources in terms of when and how they are needed. Vertical integration takes place, for instance, when an apparel manufacturing company acquires one of its fabric suppliers. Companies such as Armani and Valentino have opted for vertical integration and purchased various manufacturing companies, some of which used to work for them as subcontractors;

b) downward integration: this involves the phases that are closer to the customers and focuses on products. This process might be aimed at integrating one or more external retailing partners (in the case of indirect sales) or at establishing a direct relationship between the company and the final customer through a sales network (in the case of direct sales). Luxottica, for instance, has purchased over 470 stores in Chile, Peru, Ecuador and Colombia. Target markets might be modified, since companies may decide to focus on distributing and marketing their products. When integration involves retailing partners, it results in more flexible management of stock and, ultimately, in decreased retailing costs; companies also get part of the mark-ups created in the marketing phase.

Vertical integration might also involve partners located in more than one phase of the supply chain, i.e. closer to suppliers and closer to customers.

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142 Giaccari F., Le aggregazioni aziendali, cit., p. 39.
It follows that, thanks to upward and/or downward vertical integration, companies can increase their competitive advantage as a result of the increase in size; this makes it more difficult for new competitors to enter the market, since they have to cope with the higher bargaining power achieved by the company. When the added value associated with the various activities internalised is integrated, the added value created by the company (as a whole) increases.

Vertical integration is typically associated with the following advantages:\(^{143}\):

a) increased added value: added value, i.e. the difference between revenues and external costs, might increase, thanks to the integration of the added value associated with each activity internalised;

b) improved sourcing activities: control of manufacturing companies translates into control of sourcing activities, which results in more efficient and timely supplies of the means of production. In the case of upward integration, such control also allows for reductions in production costs;

c) improved product quality: when focusing on the manufacturing phase, companies achieve an increase in product quality. For instance, a luxury car manufacturing company might decide to integrate a small leather tanning firm, in order to get full control of the quality of the leather used to manufacture its car seats. Product quality is also enhanced thanks to the skills and know-how contributed by the companies involved: this improves the level of innovation, which in turn enhances quality;

d) more effective barriers to entry for competitors: closer control of the supply chain, or even full control of the supply of very scarce resources, makes it difficult for competitors to enter the market. Moreover, companies

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that purchase suppliers might later decide to increase prices, thereby making it
difficult for competitors to get certain means of production. In the case of
downward integration, restocking in favour of competitors might cause prices
to increase when a certain means of production is not easily available from
other sources; and

e) improved planning and control in manufacturing processes: vertical in-
tegration enhances the planning and control of the manufacturing phases con-
trolled by the company. This provides more opportunities to promptly cope
with changeable market conditions.

However, vertical integration also involves various disadvantages, such as:

a) increased production costs: vertical integration does not always translate
into reductions in production costs. In the case of upward integration, external
suppliers might be more competitive than the integrated ones, thus causing
sourcing costs to increase. Furthermore, the rapid obsolescence characterising
technologies might increase the obsolescence risks for the company’s own
systems. Such risks are considerably increased when integration involves
more than one phase of the supply chain. Nevertheless, companies opt for ver-
tical integration, or often for partial vertical integration, in order to improve
their image, i.e. to show that their products are internally manufactured;

b) reduced flexibility: when the new company reaches a considerable size,
it might be flooded with bureaucracy and become rigid in management proce-
dures. This causes organisational costs to increase;

c) difficulties in de-integration processes: because of major barriers to exit,
companies might have to cope with serious difficulties in order to give up in-
tegration. Typically, it may be impossible to dismiss staff;

d) problems in dealing with demand: when demand is fluctuating, compa-
nies might find it difficult and time consuming to coordinate the various ac-
tivities along the supply chain. On the contrary, external sourcing requires
more flexible management and less planning; and

e) reduced market demand: reductions in the demand affect the whole sup-
ply chain, since they have an impact on satellite industries. Therefore, thor-
oughly vertically integrated groups are greatly affected by declines in con-
sumption, which impact on the various phases integrated into the group. For
instance, a reduction in the demand for jewellery affects both the business of
shops and the business of the manufacturing and retailing companies that are
integrated with those same shops.

In order to mitigate the advantages and disadvantages resulting from verti-
horizontal integration, companies might opt for a combined form of integration, i.e. partial integration. From the point of view of manufacturing processes, some of the activities are carried out internally, while others are outsourced (for example through subcontracting). From the point of view of retailing, companies might use their own sales networks or resort to external retailing companies.

Partial integration is efficient in terms of manufacturing flexibility, since it does not require a complex manufacturing structure while allowing for large quantities to be obtained: the demand that cannot be satisfied by the company might be satisfied by external players. Furthermore, partial integration translates into increased competition between the supply market and the companies integrated, thereby enhancing product quality and avoiding problems related to delays. However, partial integration does not allow for significant economies of scale, since some manufacturing processes are outsourced. Finally, combining the processes outsourced and those carried out internally during the manufacturing and retailing phases requires considerable coordination efforts.  

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