

The Foreign Policy of Mergers & Acquisitions (M&A)

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The atmospherics

As companies' profits have increased and their balance sheets have gotten stronger, the M&A engine is revving up again, as Laura has mentioned. The last wave occurred in the late 90s, coming to an abrupt halt in 2001, partly because the general economy went into recession and ... perhaps because most people could not stand the pain any longer from M&A mania.

For example, one study indicated that 80% of M&As during the last great wave destroyed value for the acquiring company ... another that between 1998 and 2001, M&A destroyed \$134 billion in value.

So I think the first observation I would make is that M&A is hard ... even without the complications of crossing borders. Having said that, I think that companies have learned from the last round of M&A ... and that during the current period, we are being much more focused (and realistic) about creating value.

The ideal world

Since we are high in the Alps and everything is beautiful in this part of the world, let me talk for a moment about what the ideal world would look like from an M&A point of view ... in fact, for business in general.

It would be a world where all countries have adopted (and adapted to) classical liberal economies ... where the law of comparative advantage would work its magic ... advanced economies would not protect industries that are better handled by developing economies ... and thereby would devote capital to higher value added activities ... in other words, everyone would do what they are good at ... trade would flourish and economies would continue to advance ... the proverbial rising tide that lifts all boats.

Meanwhile, because free markets can be brutal in the short term, government would help people who are displaced by this type of dynamism ... realistically recognizing that a 55-year-old welder at a shipyard, for example, whose work has migrated from the U.S. to Korea ... cannot and will not be a computer expert overnight ... that he or she would need training and financial support ... and governments need to provide those things.

This ideal world of liberal economies would also be free of political interference ... governments would step in where necessary to develop infrastructure and also set the rules of fair play ... regulators would be market purists ... only rejecting acquisitions in order to preserve competition ... and protect consumers from monopolistic practices ... and their decisions would be based on a universal set of rules and decisions would be made quickly.

The real world

But what I have just described is not the world as it is ... or is likely to be ... any time soon ... this weekend we will all climb down from this mountain and return to a world that doesn't always – or even usually – make the distinction between trade, economics, politics, and security.

The real world is one where cross border mergers are more difficult than they used to be ... I think there's probably general agreement on that. The more interesting question is why?

I think it has to do with a number of factors.

The first is globalization, which has made the world much more competitive place. The push for greater efficiency and high productivity is very great ... and in the case of acquisitions, that often means rationalization and restructuring ... translation: loss of jobs for the country whose company is being acquired. Though it may be true that over time, the acquisition may actually create jobs and growth opportunities ... government officials, especially elected ones, look to the here-and-now ... a loss of jobs can become the loss of an election. Simply stated, the political process works much faster than the economic process, often to the dysfunction of the latter.

The second reason – and this may seem counter-intuitive – is the transition from a bi-polar world, dominated by two Superpowers, to a multi-polar world, with one – at least for the time being. I am not nostalgic for a return to the Cold War ... but it was a simpler world in many ways and in some ways a much less dangerous one. Despite their enmity, the Soviets and the Americans were pretty good at one thing: the non-proliferation of nuclear weapons and the non-proliferation of high technology that could easily be applied to military purposes.

That job is now much harder ... so is the task of combating terrorism ... and so countries are much more sensitive to security issues, especially after the attacks on New York, London, Beslan, and Bali.

The third reason has to do with misgivings about unfettered capitalism and the power of the United States ... which I think has a lot to do with some countries drawing up lists of “national champions” ... often companies that have nothing to do with threats to either security or competition ... or even good economics ...

but which have everything to do with nationalism. I think also that the growth of the United States in the 1990s added to the fear of the behemoth ... that very few people, including many in the United States, thought that an economy so large – and with so many apparent problems, including a high national debt and ongoing government deficits – could grow so robustly... and actually increase its size as a percentage of world GDP. The economic dynamism and sheer size of the United States cannot be underestimated.

The fourth reason is as old as the industrial revolution ... and that is that countries are always in different stages of economic development ... and take different paths of developing ... some are closed economies, some wide open ... most are somewhere in between. This is fertile ground for disagreements about reciprocity ... “You can import into my country but I can’t export to yours ... you can buy assets here, but I can’t buy assets there.” As I say, this has more or less been a problem since the dawn of the industrial revolution. I dare say if you put a 19th century American in the same room with a 21st century American, you would witness a very lively disagreement about the value of protective tariffs ... and for that matter, about the efficacy and limits of international law.

Which begs the question, how do I, as an industrialist and by definition, a pragmatist, operate in the real world? I am guided by four “Rules of the Road.”

#1: Don’t do a cross border acquisition without reasonable certainty that it can be done ... which often means heavy involvement with your host government ... for example, in the early 1990s when Germany was privatizing the state-owned – and mostly dilapidated – industries of the former German Democratic Republic, one of the properties for sale was the huge chemical complex around the city of Leipzig ... an historic city not only because it was the home of Johann Sebastian Bach for 27 years, but also because it was the place (during WWII) where synthetic oil and rubber were developed.

The German government had asked the big German chemical firms if they were interested ... their interest ranged from bulldozing the site and leaving it that way ... to cherry-picking the “good parts”. The German government was interested in developing the region economically for the long term. By working closely with the government, we were able to modernize the site into what is now a world-class integrated plant that serves the growth markets of Eastern Europe ... the plant and its associated value park is now one of the economic bulwarks of the region

Rule of the Road #2: Sometimes it’s better to do a joint venture than a 100% cross border acquisition ... this has many advantages ... knowledge gained from your local partner ... sharing the risk ... reducing the capital intensity ... leveraging one another’s advantages ... in the chemical industry that includes everything from technology to oil and natural gas costs ... to market knowledge and cultural knowledge.

Rule of the Road #3: Experience helps ... Dow has had the good fortune of being an international player (in a big way) since the 1960s ... first in Europe and Latin American ... in Australia and Japan, Malaysia and Thailand ... and now in China, India, Russia, and Eastern Europe. What this means is that we are a “local company” in every region of the world, which gives us credibility and knowledge.

Rule of the Road #4: Don't give up on harmonization and on liberalizing closed economies ... but be patient, and be appreciative of progress, as slow as it is. As I mentioned earlier, politics and nationalism will continue to intrude upon trade and economic issues. Sometimes there will be setbacks. But we are making progress and we will continue to do so.

Summary

So my observations in a nutshell are:

- Recognize that a successful M&A is difficult in-and-of-itself.
- Understand the forces that make it even more so from a political and nationalistic point of view.
- When you do make the plunge, be prepared and be patient ... and always have a plan B and a plan C.