# The Benefits of Corporate Social Responsibility on Mergers and Acquisitions

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## *Introduction: M&A, Sustainability and Legislations*

Today, we may identify two important trends: sustainability and Mergers and Acquisitions (henceforth, M&A[1]).

In the first place, we hear a lot about companies that need to be sustainable[2] that is to say companies that should balance economic profit with social and environmental interests[3]. This concept is so popular that the United Nations even set targets in this regard: the Sustainable Development Goals (henceforth, SDGs), a set of goals to be achieved by countries by 2025 and related to the protection of the environment and the preservation of human rights.

On the other hand, the global economy faces an impressive amount of M&A operations. In 2017, 50'600 M&A transactions with a total value of more than 3.5 trillion USD were reported.[4] This tendency does not seem to be slowing down in 2018 as reports point to a strong deal activity again.[5]

Therefore, definitely, sustainability and M&A appear as the trends (or fads?) of the 21st century.

In the middle of this agitation, there are the States, which try to regulate as much as they can. How? By legislating (or not) about sustainability and M&A. In the case of M&A, is it effective? The answer is adamant: no. Given the rate of failure of M&A operations (which will be revealed later in this paper), we may doubt the effectiveness of the States' interventions with respect to M&A. Why affirming that M&A regulations are inefficient? There might be several reasons but I will argue that States tend to focus on economic aspects rather than including sustainability in the mix. Such approach is prejudicial to the extent sustainability might be the crucial aspect that could redress some M&A operations.

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[1] The words "merger" and "acquisition" shall be used without difference throughout this study. Even though an acquisition refers to the "situation in which the management of the acquiring company controls the acquired company" while a merger is supposed to be concluded "between equals", it is obvious that in both cases one of the parties is controlling the other. See Yaakov Weber *A Comprehensive Guide to Mergers & Acquisitions: Managing the Critical Success Factors Across Every Stage of the M&A Process* (1st edition, PH Professional Business, 2013) at part 1-1 paragraph 2.

[2] "Lifeblood Sustainability" (February 28, 2018), MinterEllison <https://minterellison.co.nz/our-view/lifeblood-sustainability>.

[3] World Commission on Environment and Development (WCED) – *Brundtland Commission Report of the World Commission on Environment and Development: Our Common Future* (1987).

[4] "M&A Statistics – Number and Value and Largest M&A Transactions by Region", Institute for Mergers, Acquisitions and Alliances <https://imaa-institute.org/mergers-and-acquisitions-statistics>.

[5] "The state of the deal: M&A trends 2018", Deloitte <https://www2.deloitte.com/us/en/pages/mergers-and-acquisitions/articles/ma-trends-report.html>.

In fact, more than sustainability, Corporate Social Responsibility (henceforth, CSR) might be the key to save M&A. According to the European Commission, CSR is "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis."[6] Broadly speaking, it refers to the companies' commitment to take actions with respect to sustainability (through social and environmental initiatives). The concept shall be developed further in this paper but the purpose of this study is to show how CSR might benefit M&A operations.

Part 1 will point out that M&A operations mostly fail because of the lack of consideration of sustainability and will argue that legislations have been clearly ineffective to regulate M&A, especially when it comes to sustainability. Part 2 will highlight the fact that through sustainability, and more precisely, Corporate Social Responsibility (CSR), legislations might positively impact M&A.

For the avoidance of any doubt, it is worth noting that this paper shall only focus on European and New Zealand legal frameworks. Although some United States cases will be mentioned, the mere European and New Zealand systems are largely sufficient to cover the topic.

# *I The Ineffectiveness of M&A Regulations*

## *A The Premise: M&A, a Theoretically Profitable Operation*

Before delving into the topic, it is worth wondering why so many companies are willing to pursue an M&A. Why is it such a trend? Why do everyone want to conclude M&A?

### *1 The Essence of M&A Operations: Obtaining Control*

#### *a) Control is the Ultimate Goal*

Such part might look like an unnecessary detour but understanding the essence of M&A enables to highlight the flaws in M&A business plans as well as the necessity to adopt a new approach.

[6] European Commission *Green paper – Promoting a European framework for corporate social responsibility* (COM/2001/0366 final) (Celex No. 501DC0366 European Union Preparatory Acts).

The main purpose of a M&A attempt is to obtain control over the target company. This control is essential because it encompasses the power to decide over the corporation's fate, its scope of work, its location, its development, its priorities and its profitability.[7] Such transfer of control has a significant impact on a various range of parties in both the bidder and target company, including stakeholders, managers, employees, and other stakeholders (such as customers): this represents a significant human impact.

In practice, how does it work? What does the potential acquirer do? What factors does the bidder consider? Very simply. In a takeover attempt, the bidder offers to buy a certain quantity of shares in the target company (enough to be able to eventually control the target company), whose shareholders may, or may not, decide to sell to the bidder. The bidder will wish to buy a certain minimum of shares to eventually control the target company and impact on its governance.

Indeed, control (this word shall be written numerous times in this part) of the target company enables numerous actions. The acquirer may access a new scope of work and benefit from this activity. The bidder may also be able to change the board and the management "in an attempt to ensure that the company is run in a different (more efficient?) manner."[8]

But control may also have a negative side when the aim is to liquidate the target company in order to benefit from the company's residual value. The latest is the speciality of the Swiss-American group Klesch & Company Limited, which is specialized in distressed and turnaround investing. Considered as a "vulture capitalist" by a part of the press[9], the American business-man Gary Klesch brags about boosting the companies he acquires but he is also dreaded, and loathed, by trade-unions for liquidating companies (and jeopardizing thousands of jobs as a consequence thereof).[10]

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[7] "What is the Essence of M&A?" in Beate Sjåfjell *Towards a Sustainable European Company Law* – A Normative Analysis of the Objectives of EU Law with the Takeover Directive as a Test Case (Wolters Kluwer – Law & Business, European Company Law Volume 3).

[8] Beate Sjåfjell *Towards a Sustainable European Company Law* – A Normative Analysis of the Objectives of EU Law with the Takeover Directive as a Test Case (Wolters Kluwer – Law & Business, European Company Law Volume 3).

[9] Ron Bousso "U.S. investor Klesch takes long view in Wales refinery deal" (August 1st, 2014), Thomson Reuters <https://www.reuters.com/article/us-murphy-refinery-klesch/u-s-investor-klesch-takes-long-view-in-wales-refinery-deal-idUSKBN0G143Y20140801>.

[10] "Klesch finally grasps the Italian steel industry" (July 22nd, 2013), Ship 2 Shore (online magazine of maritime and transport economics) <http://www.ship2shore.it/en/energy/klesch-finally-grasps-the-italian-steel-industry_49936.htm>.

Therefore, the essence of M&A could be summarised in one word that is "control". Control amounts to an important degree of power over the target company and has impact on a variety of involved parties and affected interests. It enables to decide to change the board, to liquidate the corporation, etc. In other words, M&A have the potential to enhance a company's turnover or make the company collapse.

Such operations might have important economic, human and environmental impacts. Human impact when the consequences of such M&A operations imply layoff or relocations of employees. Environmental impact when such operations involve the access to an activity that might be polluting. Economic impact as such operations obviously involve a transfer of money.[11]

*b) The Positive or Negative Impacts of Such Control Attempt*

One example of successful M&A operation might be the acquisition of Siri (the automated personal assistant) by Apple. Siri aka this little voice that takes too much importance in our day-to-day life (like any other smartphone devices to be fair). Behind this functionality of our iPhones, there is a particularly smart move by the acquirer company. By buying Siri, Apple accessed a new technology that enhanced its iPhones. Thanks to this acquisition, Apple obtained a new technology faster and at lower cost (and without never-ending research and developments processes).[12] In the end, Apple accessed a new market and has become a direct competitor to Google (and its famous "OK Google").[13]

An example of epic failure might be the acquisition of Kem One by Klesch Company Limited (again!). In 2012, the French chemical group Arkema divested one of its subsidiaries named Kem One, which was specialised in vinyl products.[14] Shortly after the acquisition and in spite

[11] At this simple stage, we might contemplate the importance of sustainability, which deals with human and environmental considerations.
[12] Marc Goedhart, Tim Koller and David Vessels "The Six Types of Successful Acquisitions" (May 2017), McKinsey & Company <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-six-types-of-successful-acquisitions>.
[13] Dan Frommer "Apple Buys Siri, A Mobile Assistant App, As War With Google Heats Up" (April 28th, 2010), The Business Insider <https://www.businessinsider.com/apple-buys-siri-a-mobile-assistant-app-as-war-with-google-heats-up-2010-4>.
[14] "Arkema finalized the divestment of its Vinyl Products segment" (March 7th, 2013), Arkema Online Press Release <https://www.arkema.com/en/media/news/news-details/Arkema-finalized-the-divestment-of-its-Vinyl-Products-segment/>.

of a commitment to develop a financing plan adapted to the needs of Kem One, Klesch transferred the shares of Kem One on an account in United Kingdom and started to discuss layoff of employees. This long episodic story involved a legal redress and an international arbitration[15] and ultimately, Klesch lost the ownership of Kem One.[16] Such case highlights the danger of M&A operations, which might have a dramatic economic and human impact.

Now that we have studied the noble essence of M&A, let us be more pragmatic and approach the concrete purposes of M&A operations.

### *2 The Concrete Motive of an M&A Operation: Making Economic Profit!*

Getting control is a rather large and blur statement. The question is: what for?

#### *a) Achieving Synergy*

What are the motives of an M&A operation? Without cynicism, the answer is rather obvious: to grow economic profit by, hopefully, **achieving a synergy**.

Synergy, aka the most common purpose that is rarely obtained. This appealing label refers to the force obtained when two corporations meet together to produce a result that cannot be achieved when done solely: in other words, it is about creating value by combining the resources of two corporations. M&A have many hopes in synergy including an enhancing performance, accessing economies of scale and obtaining supplementary resources.

However, synergy (or "hoped-for synergy") is also a chimeric motive. Indeed, synergy has also be defined as "the belief that the value of two firms after they have combined will exceed the sum of their values as individual stand-alone firms before the merger" [17]. Yes, a successful M&A operation might represent cost reductions or revenue enhancements that are realised

[15] "Arkema wins €73.6m in arbitration case with Klesch" (November 27th, 2015), Pastic New Europe <http://www.plasticsnewseurope.com/article/20151127/PNE/151129879/arkema-wins-73-6m-in-arbitration-case-with-klesch>.
[16] "Les 1800 salariés de Kem One victimes d'un prédateur financier" (March 27th, 2013), L'Humanité (French article : "The 1800 employees of Kem One, casualty of a financial vulture") <https://www.humanite.fr/les-1800-salaries-de-kem-one-arkema-victime-dun-predateur-financier>.
[17] Christopher C. Nicholls *Mergers, Acquisitions and other changes of Corporate Controls*, Toronto : Irwin Law, 2007.

when the merging companies integrate their businesses but such synergistic value is not guaranteed. In this regard, let us examine the two principal types of synergies.

Firstly, the synergy may be horizontal that is when the combining businesses belong to the same industry. In such case, cost reductions may occur thanks to improved economies of scale that is the ability to produce many products at once and at a lower cost. The M&A operation might also help the combined businesses to run more effectively as a single corporation.

Secondly, the synergy may be vertical that is when the combining businesses belong to different sectors (for instance, one corporation supplies goods while the other provides for services). Such synergy often aims at accessing economies of scope that is the ability to produce similar – but different – goods or services at a lower cost. For instance, one corporation with a strong and viable product distribution network may profitably be merged with another company that has great manufacturing facilities, but lacks developed means of selling and distributing its products. In such case, the association of complementary strengths including combined talent and technologies might result in cost reduction and revenue enhancements.[18]

In both cases, there is a mixing of talents and other human resources. Synergy is thus also about people.

Moreover, it is worth noting that synergies may not necessarily have a direct monetary value, but could reduce the costs of production and increase profit margin or future growth. A synergetic objective may be profitably combined with an international goal. In such case, one company with a strong presence in one geographical market, may profitably be combined with similar firms operating successfully in other markets.[19]

However, firms do not seem to notice that synergy can also be negative. Negative synergy occurs when the value of the combined companies is less than the value of each company if it operated alone. This could result if the merged firms experience problems caused by vastly different leadership styles and company cultures. Such negative impact shall be further developed in this paper. In any case, synergy is expected to have benefits on both companies by growing economic profits and reducing cost of productions.[20] Still, despite the promises of source of values for parties, some critics argue that the promised benefits of synergies are

[18] "Types of Synergies – The Different Sources of Synergies", Corporate Finance Institute <https://corporatefinanceinstitute.com/resources/knowledge/valuation/types-of-synergies/>.
[19] Christopher C. Nicholls *Mergers, Acquisitions and other changes of Corporate Controls* (Toronto: Irwin Law, 2007).
[20] "Synergy", Investopedia <https://www.investopedia.com/terms/s/synergy.asp>.

frequently exaggerated in the run-up to a proposed merger.[21] In any case, M&A operations have other rationales.

### b) *Other Motives of M&A*

The pursuit of an M&A may be motivated by other economic rationales such as **diversification of activity** (expanding product portfolios with the hope to grow revenues, or acquiring new technologies), **increasing market power** (absorbing a competitor and thus control the prices on a market), or **international goals** (expansion into new geographical areas and access to new customers).

However, not all of M&A are driven by noble pursuits. Indeed, several studies suggest that certain M&A are motivated by the egotism of the directors more interested into the **building of an empire** rather than the firm's profitability.[22] By acquiring larger companies to manage, executives hope to expand their empire and hence to raise their power, status and salaries. In other words, the motto could be: "be larger than your rivals and get power and influence". Empire building is often regarded as unhealthy for a corporation, as managers will often become more concerned with acquiring greater resource control than with optimally allocating resources but it might also bolster the company's long-term viability.[23]

Overall, all these motives seem legitimate (or at least understandable): M&A operations aim at building organizations with greater power and resources. What could possibly go wrong? In fact, a lot of things as there is often a massive gap between expectations and reality.

[21] Christopher C. Nicholls *Mergers, Acquisitions and other changes of Corporate Controls* (Toronto: Irwin Law, 2007).
[22] Patrick A. Gaughan "M&A Lesson: Beware of Empire Builders" (2004), The Journal of Corporate Accounting & Finance <https://onlinelibrary.wiley.com/doi/pdf/10.1002/jcaf.10229>.
[23] "Empire Building", Investopedia < https://www.investopedia.com/terms/e/empirebuilding.asp>.

### *B The Problem: M&A, a Large Amount of Failures*

#### *1 What is an M&A Failure?*

M&A are like having a child: it is easy to have but hard to raise. Similarly, it is simple to buy but difficult to perform an M&A. As seen above, there is a lot of different reasons to perform M&A but firms seem to neglect the fact that "there is, in general, very little clear indication of improved performance among firms that have been taken over."[24] In other words, there is a gap between the high expectations (or hopes) and the reality of M&A.

Above all, it is relevant to define the word "failure", which doesn't "refer to deals that fail to close, but to deals that close but simply… don't work out": that is when the expected synergy or the desired profits did not occur. The most conspicuous proof of failing is the divorce of companies following the merge which was superior to 30% in 2016.[25]

The number of failures raises questions as to whether a viable market for corporate control has positive effects on the performance of companies.[26] The reasons for such failures are numerous and we will only focus on the main ones.[27]

#### *2 First[28] Cause of Failure: The Absence of Synergy[29]*

Most of the time, a M&A operation may be considered as a failure when the **expected synergy did not occur** leading to financial failings: in short, the performance of the operation comes in "below expectations", which makes the deal pointless. Indeed, synergy is often seen as he pithy

[24] R.A. Chatterjee "The Financial Performance of Compabies Acquiring Very Large Takeover Targets", Applied Financial Economic 10 (2000): 190.
[25] Brian DeChesare "Why Most M&A Deals Fail: Love and Marriage?" (2016), Mergers and Inquisitions <https://www.mergersandinquisitions.com/why-most-ma-deals-fail/>.
[26] S. Baghat & R. Romano, 'Empirical Study of Corporate Law" in Handbook of Law and Economics, eds A.M. Polinsky & S. Shavell (Amsterdam: Elsevier, 2007).
[27] Nik Aliena Salwanee binti Dato' Nik Mohammed "Key Success Factors in Mergers and Acquisitions" (2008), Azmi and Associates <http://www.azmilaw.com/archives/Article_7_Key_Success_Factors_in_MA_00078783_.pdf>.
[28] The words "first cause of failure", "second," and "third" should not be construed as a classification of the most recurrent failures. It is simply the order that I chose.
[29] Linda Canina and Jin-Young Kim "Commentary: Success and Failure of Mergers and Acquisitions" (2010) Cornell University School of of Hotel Administration <https://scholarship.sha.cornell.edu/cgi/viewcontent.cgi?article=1955&context=articles> and Renée Houwers "M&A Failure Factors" (August 8, 2016) <https://essay.utwente.nl/70883/1/MASTER%20THESIS.pdf>.

of "1+1=3" but such statement is merely too simplistic as it does not take into account external forces such as other stakeholders and the broader market.[30]

Synergistic mergers aim at competitive advantage but the complexity of the merger can sometimes lead to integration problems. The acquiring company might be simply too optimistic, or overconfident, and is only considering an idealistic situation. All of this leads to an underestimation of the integration issues and difficulties. In fact, this is the common mistake of M&A: in theory, it works but in practice, external unexpected factors come into the mix and make a promising M&A an epic failure.

Consider the case of Kellogg's acquisition of Lender's Bagels. In late 1990s, the cereal company Kellogg bought Lender's Bagels (a maker of frozen bagels) with the aim to diversify its activities by including bagels. In theory, this is all perfect. Bagels were more and more popular among the consumers: what could possibly go wrong? A minor (huge) detail: the interest of the consumer was in fresh bagels and not the frozen bagels that Lender's sold. In short, Kellogg has been misinformed and too idealistic and underestimated the bagel business.[31]

Another example concerns the 2005 acquisition of Skype by eBay Inc. for $2.6 billion. The purchase price was incredibly high given the $7 million revenues of Skype. The aim was to improve the eBay auction site by giving its users a better platform for communicating. Ultimately, eBay's users rejected Skype's technology as unnecessary for conducting auctions, and the rationale for the purchase became null. However, this story has a happy ending! Two years after the acquisition, eBay sold Skype to Microsoft and realized a $1.4 billion profit. To sum up, this acquisition was a failure because eBay miscalculated its customers' demand for Skype's product.[32]

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[30] Emma Yuen "Merger Failures: Synergies Not So Simple" (December 16, 2015), The Market Mogul <https://themarketmogul.com/merger-failures-synergies-not-so-simple/>.

[31] Sayan Chatterjee "Why is synergy so difficult in mergers of related businesses?" in *The Antidote merged into strategy and leadership*, Emerald Group Publishing Limited, Vol. 35 Issue: 2, pp.46-52 (1996).

[32]Lawrence Pines " 4 Cases When M&A Strategy Failed for the Acquirer (EBAY, BAC)" (June 18, 206), Investopedia <https://www.investopedia.com/articles/insights/061816/4-cases-when-ma-strategy-failed-acquirer-ebay-bac.asp>.

### *3 Second Cause of Failure: Cultural Mismatch*

However, the problem is not always about the financial outcomes but can be related to **cultural mismatch**, which is too often underestimated.[33] Indeed, a merger is about merging businesses but it also includes merging cultures, which is not fully anticipated by merging companies.[34]

Usually, the buyer company is going to try to infuse its own culture (including power relations and working conditions) in the target company, which may be sceptical about such stranger culture.[35] The cultural clash between two companies may be so significant that the synergy simply does not work: because of cultural differences, employees are not productive and end up abandoning the company. This problem is tremendous for mergers that aimed to acquire new technologies. In this situation, the departure of key employees implies the withdrawal of professional knowledge and of the ability to develop and innovate.

#### *a) The Famous Example of the Time Warner/AOL Merger*

Cultural differences notably caused the divorce of the AOL / Time Warner merger after only seven years.[36] Time Warner is a huge company that owns different subsidiaries related to the entertainment sector (movies with Warner Bros Pictures, TV with Warner TV, etc.). On the other hand, AOL was at the time one of the leaders regarding Internet services. Two companies on the top of their industries then: what could possibly go wrong?

The clash apparently came from the lack of effective collaboration between the "aggressive and arrogant" AOL employees and the more traditional and old-school Time Warner staff. As a consequence, the expected synergies failed to realise as the employees of the two firms kind of refused to cooperate.[37]

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[33] Chris Cancialosi "Why Company Culture is Critical to M&A Success" (July 11, 2017), Forbes <https://www.forbes.com/sites/chriscancialosi/2017/07/11/why-company-culture-is-critical-to-ma-success/#7dd18f644168>.

[34] Michelle C. Bligh "Surviving Post-merger 'Culture Clash': Can Cultural Leadership Lessen the Casualties?" in *Leadership*, November 2006, Vol.2(4), pp.395-426.

[35] Ted Rouse and Tory Frame "Commit to one culture – The 10 steps to successful M&A integration" (November 4, 2009), Bain & Company <http://www.bain.com/publications/articles/10-steps-to-successful-ma-integration.aspx> at paragraph 7.

[36] Ola Sanni "The Biggest M&A Mistake in Corporate History" (December 14, 2016), Market Mogul <https://themarketmogul.com/the-biggest-ma-mistake-in-corporate-history-2/>.

[37] Rita Gunther McGrath "15 years later, lessons from the failed AOL – Time Waner merger" (January 10, 2015), Fortune <http://fortune.com/2015/01/10/15-years-later-lessons-from-the-failed-aol-time-warner-merger/>.

Nonetheless, are the employees to be blamed? The reasons behind the failure can be summarised as being the product of a failure in the due diligence process of evaluating organisational compatibility, together with the lack of assessment of both companies' working cultures: the due diligence have thus been clearly insufficient. Should the due diligence process have been exhaustive, the differences of working cultures would have been noticed and could (or should?) have been taken into account. Instead of that, the leaders of Time Warner and AOL apparently only focused on growth strategies.

Concretely, where did this cultural mismatch lead to? To the divorce of the two companies obviously, which pointed to the flaws of the firms' governance and highlighted the dangers of unprepared M&A. The cultural differences between AOL and Time Warner prevented the merger from actually happening. Indeed, the integration only took place at a superficial level but the employees of the two firms never really worked together. Insider reports pointed out that the cultures were too different and the employees at the two corporations seemed to resent one other. This was made worse by a very unstable management structure, with both companies fighting for the top executive spots, ending up to four individuals taking the Chief Financial Officer position in only three years and the resignation of Time Warner CEO, Gerald Levin only a year after the merger following a dispute (even though he had been hugely enthusiastic about the merger – how ironical is that?).[38]

The failure of this merger is even more spectacular as the expectations were particularly high. On one hand, Time Warner would have taken advantage of AOL online services while AOL would have accessed to the large goods and products of Time Warner (including the movies of Warner Bros Pictures – a good way to attract new customers). Sadly (?), in spite of this idealistic vision, which served as a rationale for the merger, the integration of the two companies was inadequately carried out. Many of the expected synergies between AOL and Time Warner never actually materialised. The culture clash meant that the executives and employees showed strong resistance to implement the growth strategies that the company had put in place. If AOL had thoroughly explored the organizational constraints and cultural differences during due diligence then they would have been a little less optimistic about achieving some of the synergies.

[38] Rita Gunther McGrath "15 years later, lessons from the failed AOL – Time Waner merger" (January 10, 2015), Fortune <http://fortune.com/2015/01/10/15-years-later-lessons-from-the-failed-aol-time-warner-merger/>

In the end, the failure of this merger was not caused by economic aspects but by…people. This sole example should be construed as an urge to consider factors other than economic when considering an M&A operation (sustainability, anyone?).

### b) *The Becoming-Famous Example of Google and Nest*

A current example that might just as well not get a happy ending is the recent acquisition of Nest by Google. Everybody knows Google and there is no point to introduce them. Nest, on the other hand, is a manufacturer of smart-home appliance (home safety and security devices such as smoke detectors and security cameras).

In 2014, Google closed a $3.2 billion deal to acquire Nest with the aim to enter the smart-home systems market (Nest was then renamed Alphabet by Google). In theory, such acquisition was promising. On one hand, we have Nest, the typical innovative young business that has the potential to develop in the future as populations are more and more equipped with technical devices. On the other hand, you have Google that is present on all continents. With the support of Google, Nest was expected to develop even more innovative devices as well as benefiting from the international presence of Google to reach more users in more countries.[39]

Alas, things do not seem to go that way. When you acquire an innovative business, the most important thing is the people. It is crucial to keep the management talent, especially in the field of new technologies because the said talents developed the said new technology and are essential for further developments (they are like the "source code"). In the present case, it was reported that 70 of the 1000 staff of Nest left the company following the Google acquisition "apparently unhappy with their new home".[40] The collaboration between the two firms has never been fully operational and would have led to "soap opera" clashes between employees unable to set up an effective business plan.[41] Nest, founded by an ex-Apple employee, would have a very rigid and secretive culture while Google employees are said to be more extraverted and less aloof.

[39] Lance Whitney "Google closes $3.2 purchase of Nest" (February 12, 2014), CNet <https://www.cnet.com/news/google-closes-3-2-billion-purchase-of-nest/>.
[40] Jack Torrance "Cultural class proves problematic for Google" (March 31, 2016), Management Today <https://www.managementtoday.co.uk/culture-clash-proves-problematic-google/article/1389481>.
[41] Edward Moyer "As Google reclaims Nest, ex-CEO Fadell says spin-off was a blunder" (February 10, 2018), CNet <https://www.cnet.com/news/google-nest-spin-off-was-blunder-says-ex-ceo-tony-fadell/>.

Two years later, in 2016, Google would have even considered to re-sell Nest (failure confession?) but changed its mind.[42] Lately, Google seems to have the intent to keep Nest under its wing but it would still be "struggling to keep top talent".[43]

In short, "Nest is a clear reminder that companies looking to merge overlook the importance of culture at their peril."[44]

### *4 Third Cause of Failure: Insufficient Due Diligence*

The failure of an M&A may also be due to **insufficient due diligence**. Due diligence aims at finding out everything possible about the target company before a deal takes place (financial statements, resources, potential liability, ongoing litigation, and any risk related to the deal).

There is no actual regulation regarding due diligence and it has been incumbent on companies (and lawyers working on the deals) to develop some sort of guidelines as whether needs to be ascertained or not.

The due diligence needs to be substantial, complete and must require all the time that is necessary. The consequences of rushed due diligence may be dramatic such as HP's $11 billion acquisition of Autonomy.

#### *a) A Financial Due Diligence Disaster: HP – Autonomy Takeover*

Again, in theory, this acquisition was expected to be successful. In 2012, HP, the manufacturer of hardware components, acquired Autonomy, a European maker of unstructured data analytics software. Price of the deal: $10.3 billion. Price of the loss: $9 billion.[45]

Indeed, it was later reported that HP had overvalued Autonomy at the time of the takeover. This insufficient due diligence led HP's stakeholders to sue HP's management for being

[42] Julia Love "With Alphabet, Google faces a daunting challenge: organizing itself" (June 27, 2017), Thomson Reuters <https://www.reuters.com/article/us-alphabet-tensions-insight/with-alphabet-google-faces-a-daunting-challenge-organizing-itself-idUSKBN19I0G9>.
[43] Anita Balakrishnan "Will Alphabet make good on its bets?" (January 29, 2016), CNBC <https://www.cnbc.com/2016/01/29/will-alphabet-make-good-on-its-bets.html>.
[44] Jack Torrance "Cultural class proves problematic for Google" (March 31, 2016), Management Today <https://www.managementtoday.co.uk/culture-clash-proves-problematic-google/article/1389481>.
[45] "Worst tech mergers and acquisitions: HP and Autonomy, Google and Motorola, and more" (February 12, 2016), ZDNet <https://www.zdnet.com/article/worst-tech-mergers-and-acquisitions-hp-and-autonomy-google-and-motorola-and-more/>.

negligent regarding Autonomy's income statements.[46] HP then sued Autonomy for inaccurate information and the litigation is still ongoing.

The fact is that…such disaster could have been avoided! It was reported that there were 15 different financial, legal and accounting firms working on the HP-Autonomy deal.[47] The problem seemingly came from the due diligence methodologies. The questions to Autonomy have been apparently unascertained and, above all, unaudited. The process seems to have lacked substantial completeness and transparency. In brief, HP failed to obtain a clear picture of Autonomy's corporate structure.

### *b) An Environmental Due Diligence Disaster: Koppers and Beazer*

Insufficient due diligence may also lead to **environmental liabilities**, which may be the consequence of incomplete due diligence that did not sufficiently assess potential future environmental liabilities.

For instance, the acquisition of the wood company Koppers by the construction giant Beazer turned into a failure, 25 years after the deal, as it was revealed that the absorbed company's facilities had previously caused water and soil pollution.[48]

Obviously, this list does not cover all the failure factors, which are even more various. Nevertheless, there is a recent concept named CSR that could have enabled to avoid some of these fiascos. But before analysing this concept, it is worth noting that all these failures are related to the lack of consideration of sustainability.

[46] Debbie Stephenson "Top 10 Due Diligence Disasters" (March 7, 2013), The Deal Room by Firmex <https://www.firmex.com/thedealroom/top-10-due-diligence-disasters/>.
[47] "Avoid deal disaster with due diligence Q&A", Ansarada <https://www.ansarada.com/news/avoid-deal-disaster-due-diligence-qa>.
[48] Greg C. Bruno "Brief owner of ex-Koppers' site liable for clean-ups" (March 6, 2004) The Gainesville Sun <http://www.gainesville.com/article/LK/20040306/News/604154496/GS/>.

### *C The Reason: The Lack of Sustainable Considerations*

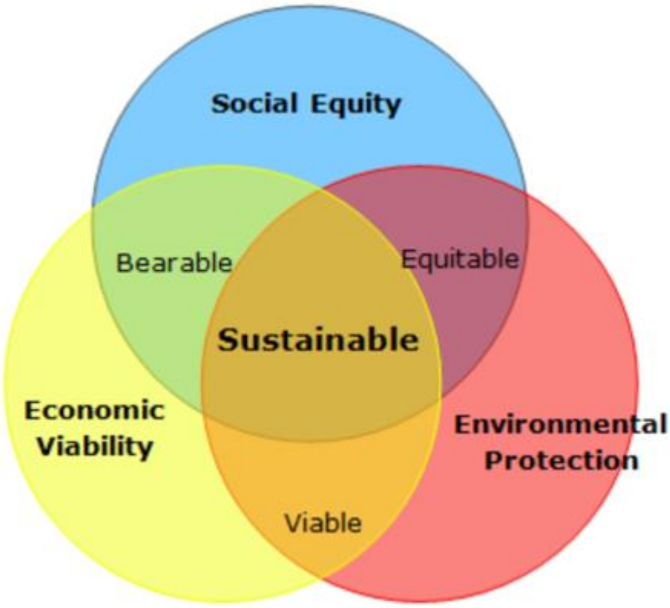
#### *1 What is Sustainability?*

“Sustainability”: a word that is pronounced by everyone in a lot of different contexts but what does it exactly mean? Is it a ground-breaking and crucial theme of the 21st century or is it merely a fad that will vanish in a few years? In spite of its debatable meaning, the term “sustainability” is the core of CSR and tends to be considered by more and more legislations. Therefore, before delving into the CSR aspect, it is worth analysing the meaning of “sustainability” and explain how it affects current regulations and policies.

In this regard, we can be honest: there is no universally agreed definition of the word “sustainability”, which appears to a new “catch-all” category. It can mean something entirely different to every person with whom you speak, with meaning going from ‘environmental effort’ to ‘a combination of business efficiency for a better world’. However, there seems to be a consensus on the following definition that defines sustainability as a “development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.[49] Broadly speaking, it aims at finding the balance between economic profit and responsible behaviour in order to leave a viable world to our children and grandchildren.

Sustainability may be implemented within businesses through are three pillars: economic, environmental, and social. These three aspects are interdependent and not mutually exclusive and need to be considered as a whole.

[49] World Commission on Environment and Development (WCED) – Brundtland Commission *Report of the World Commission on Environment and Development: Our Common Future* (1987)




The three aspects of sustainability[50] (all of them might have an impact on M&A operations as seen above).

In short, **environmental sustainability** refers to the protection of the environment (greenhouse emissions and carbon footprints, protection of natural resources, management of waste), **social sustainability** deals with the wellbeing of the society at large (communities including indigenous peoples, employees' welfare) and **economic sustainability** emphasizes a viable and ethical economy (effective corporate governance, transparency and fight against the corruption).

And what have been the motives of failures of some recent M&A? Economic factors of course (the expected profits did not occur) but also social factors (cultural clash between the merged companies) and environmental liabilities discovered after the takeover.

At this stage, it is sure that sustainability does affect an M&A success but some people could still argue that it is useless and that M&A failures are due to a lack of preparation as well as insufficient due diligence (which is also true). Thus, on a broader scale, the question is: why does sustainability matter and why should businesses take it into account?

[50] "The Three Pillars of Sustainability", FutureLearn <https://www.futurelearn.com/courses/sustainability-society-and-you/0/steps/4618>.

Businesses are concerned by this issue because sustainability is "the lifeblood of long-term business prosperity, growth and ultimately survival".[51] Sustainability affects various stakeholders of the society including communities, regulators, customers and shareholders. Our society currently faces numerous global challenges including environmental degradation, social scandals, and economic crisis. The solution of these problems are interlinked and companies have a part to play as they impact various levels of the society: the global economy, community relations and the ecosystem. It is therefore incumbent on the businesses to take these issues into account.

### *2 The Content of M&A Regulations Related to Sustainability*

This is not an assumption, this is a fact: the current M&A laws only focus on a few economic aspects while neglecting large areas of sustainability. In the first place, we may genuinely say that these regulations are overall inefficient (just check the rate of failures of M&A operations). However, some regulations tentatively integrated some sustainable aspects.

#### *a) The European Framework*

In this regard, the European Takeover Directive 2004/25/EC appears as a role model as it tackles sustainability by setting up transparency and information principles.

The purpose of the directive is to:

> "*to protect the interests of holders of the securities of companies […] when those companies are the subject of takeover bids or of changes of control and at least some of their securities are admitted to trading on a regulated market*."[52]

As well as:

> "*to create Community-wide clarity and transparency in respect of legal issues to be settled in the event of takeover bids and to prevent patterns of corporate restructuring within the Community from being distorted by arbitrary differences in governance and management cultures*."[53]

[51] "Lifeblood Sustainability" (February 28, 2018), MinterEllison <https://minterellison.co.nz/our-view/lifeblood-sustainability>.
[52] Directive 2004/25 on takeover bids [2004] L142/12 at paragraph (2) of the preamble.
[53] Directive 2004/25 on takeover bids [2004] L142/12 at paragraph (3) of the preamble.

From these two paragraphs, two words are striking as they have sustainable dimensions: "governance" and "cultures". The European directive mentions two sustainable aspects: the importance of taking care of corporate governance and corporate culture during a takeover operation.

In fact, the rules of the Directive do not really tackle the corporate culture aspect but mostly deal with corporate governance (that is the system of rules by which a firm is directed and controlled). A corporate governance is deemed sustainable when the control of the firm is stable and when a board of directors ensures accountability, fairness, and transparency in a company's relationship with its all stakeholders.

### *i. Shareholders Protective Provisions of the European Takeover Directive*

With respect to corporate governance, the Takeover Directive sets up the Mandatory Bid Rule, which aims to protect minority shareholders. In short, when a bidder acquires shares representing "specified percentage" of the voting rights of the target company, then the bidder must make "an offer for the remaining shares at a fair price."[54] The threshold at which the mandatory bid rule is triggered is not specified by the Directive but has been fixed to 30% in United Kingdom[55] and France[56] for example. This rule aims at harmonising corporate governance and facilitating the market for corporate control as it reconciles the shareholders and potential conflicting interests. The fairness of the price may be decided by the Member States but in any case:

> "*If, after the bid has been made public and before the offer closes for acceptance, the offeror or any person acting in concert with him/her purchases securities at a price higher than the offer price, the offeror shall increase his/her offer so that it is not less than the highest price paid for the securities so acquired.*"[57]

Thus, the minority shareholders must benefit the best price for selling their shares.

Similarly, the Directive requires the bidder, who would have obtained 90% or more of the target company's shares, to "squeeze out" the remaining shares that is forcing the remaining minority shareholders to sell.[58] On the contrary, "a holder of remaining securities is able to require the offeror to buy his/her securities from him/her at a fair price under the same

[54] Directive 2004/25 on takeover bids [2004] L142/12 at art 5(1).
[55] United Kingdom City Code on Takeovers and Mergers, rule 9.
[56] "Arrêté du 31 janvier 2011 portant homologation de modifications du règlement général de l'Autorité des marchés financiers", article V.
[57] Directive 2004/25 on takeover bids [2004] L142/12 at art 5(4).
[58] Directive 2004/25 on takeover bids [2004] L142/12 at art 15.

circumstances [of the squeeze out rule]".[59] In both cases, the minority shareholders should obtain an offer from the bidder.

To sum up, all these rules target the protection of minority shareholders by allowing them to exit when there is a hugely dominant majority shareholder (who might exploit the minority shareholders). In other words, they consist in preventive rules against any acts of oppression committed by the upcoming controller of the target company. Such rules may be related to the concept of sustainability as they oblige the bidder to be fair towards the stockholders of the target company.

### *ii. Transparency Provisions of the European Takeover Directive*

Besides, the Takeover Directive sets up transparency principles. Article 6 obliges offerors to make public the decision of a bid as well as stating "its intentions with regard to the future business of the offeree company".[60] The target company is obliged to give "its opinion of the bid and the reasons on which it is based, including its views on the effects of implementation of the bid on all the company's interests."[61]

Companies are also expected to be transparent towards each other as they must publish information on the structure of their capitals, "any restrictions on the transfer of securities", and "any agreements between shareholders which are known to the company and may result in restrictions on the transfer of securities and/or voting rights within the meaning".[62] The structure of the boards must also be revealed as the information must notably include "the rules governing the appointment and replacement of board members and the amendment of the articles of association" as well as "the powers of board members, and in particular the power to issue or buy back shares".[63]

Lastly, the Directive tentatively aims to reveal any kind of "bombshells" as companies are required to reveal:

> "*any significant agreements to which the company is a party and which take effect, alter or terminate upon a change of control of the company following a takeover bid, and the effects thereof, except where their nature is such that their disclosure would be seriously prejudicial to the company; this exception shall not apply where the company*

[59] Directive 2004/25 on takeover bids [2004] L142/12 at art 16.
[60] Directive 2004/25 on takeover bids [2004] L142/12 at art 6(3)(i).
[61] Directive 2004/25 on takeover bids [2004] L142/12 at art 9(5).
[62] Directive 2004/25 on takeover bids [2004] L142/12 at art 10(a), 10(f), and 10(g).
[63] Directive 2004/25 on takeover bids [2004] L142/12 at art 10(h) and 10(i).

> *is specifically obliged to disclose such information on the basis of other legal requirements*."[64]

Likewise, companies must reveal any advantages for the board or employees (golden parachutes, poisoned pills, etc.) as the Directive requires the disclosure of:

> "*any agreements between the company and its board members or employees providing for compensation if they resign or are made redundant without valid reason or if their employment ceases because of a takeover bid.*"[65]

Such transparency requirements enable to get a substantial overview of the two merging companies, reinforcing the due diligence process with respect to corporate governance and therefore the success of the M&A operation. These transparency rules both aim to facilitate the operation and to protect the involved parties.

*iii. Employees-Related Provisions of the European Takeover Directive*

The issue of the employees is also mentioned by the European Takeover Directive. For instance, the companies must be transparent regarding "the system of control of any employee share scheme where the control rights are not exercised directly by the employees".[66]

But above all, the Directive seems to take care of the employees' fate of both companies. Indeed, the Directive indicates that the bidder must draft a document detailing:

> "*the offeror's intentions with regard to the future business of the offeree company and, in so far as it is affected by the bid, the offeror company and with regard to the safeguarding of the jobs of their employees and management, including any material change in the conditions of employment, and in particular the offeror's strategic plans for the two companies and the likely repercussions on employment and the locations of the companies' places of business*."[67]

The board of the bidder company must also give its view "on the effects of implementation of the bid on employment, conditions of employment and the locations of the company's places of business."[68]

[64] Directive 2004/25 on takeover bids [2004] L142/12 at art 10(j).
[65] Directive 2004/25 on takeover bids [2004] L142/12 at art 10(k).
[66] Directive 2004/25 on takeover bids [2004] L142/12 at art 10(e).
[67] Directive 2004/25 on takeover bids [2004] L142/12 at art 6(3)(i).
[68] Directive 2004/25 on takeover bids [2004] L142/12 at art 3(1)(b).

Likewise, the board of the target company is obliged to give its opinion the "likely repercussions on employment and the locations of the company's places of business".[69]

All these rules enable to protect the employees in a takeover situation but also the local communities to the extent the Directive refers to the "locations of the company's place of business". Therefore, the Directive encompasses the social impact of a takeover as it deals with the potential detrimental effect of the takeover on the employees and the local communities.

To sum up, the European Directive does take some steps regarding sustainability. It could be more substantial but to a certain extent, it promotes consideration of governance and social aspects when contemplating a takeover.

### *b) The New Zealand Framework*

On the other hand, the New Zealand M&A framework seems rather weak in comparison. New Zealand takeovers are governed by the Takeovers Code, which was established by the Takeovers Act 1993. The purpose of the New Zealand legal framework is not really focused on sustainability but aims to make sure that the acquirer of shares in a company complies with certain rules when certain thresholds are met.[70]

#### *i. The Content of the New Zealand Takeovers Code*

The six objectives set up by Takeovers Code are the following:

> *"(a) encouraging the efficient allocation of resources:*
>
> *(b) encouraging competition for the control of code companies:*
>
> *(c) assisting in ensuring that the holders of financial products in a takeover are treated fairly:*
>
> *(d) promoting the international competitiveness of New Zealand's capital markets:*
>
> *(e) recognising that the holders of financial products must ultimately decide for themselves the merits of a takeover offer:*

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[69] Directive 2004/25 on takeover bids [2004] L142/12 at art 9(5).

[70] Silvana Schenone "New Zealand takeover laws; what you need to know" (June 7, 2018), Minter Ellison <https://minterellison.co.nz/our-view/new-zealand-takeover-laws-what-you-need-to-know>.

*(f) maintaining a proper relation between the costs of compliance with the code and the benefits resulting from it."*[71]

The objectives of the Takeovers Code do not contain any actual sustainable aspects and only focus on economic issues (ensuring competitiveness and the market for corporate control, etc.). This is even more a shame as New Zealand benefits of a strong "green" image abroad but it could be understood to the extent that New Zealand is a smaller market than Europe.

Clearly, the New Zealand Takeovers Code is focused on the control of transactions and any other events affecting that impact on the voting rights attaching to the shares owned by shareholders of "Code companies". "Code companies" refer to New Zealand-registered companies that are listed on the New Zealand Stock Exchange (that is the public authority notably controlling the trade of assets) or have 50 or more shareholders and 50 or more share parcels.[72]

The Takeovers Code rules vary according to the voting rights owned by the shareholders. The fundamental principle is the "20% rule".[73] Broadly speaking, this rule forbids a person from buying or increasing its share above 20% in a Code Company, except in accordance with the Takeovers Code.[74] The increasing of shares above 20% may be authorised provided it is made through a takeover offer under the Takeovers Code.

When the takeover offer concerns more than 20% of the shares of the target company but less than 90%, the rules are rather simple. The potential acquirer must issue a "takeover notice" to the shareholders of the target company. Such notice must provide for information about the offeror, its intentions, and details regarding the financial aspects of the bid.[75]

For instance, we may find a variation of the mandatory bid rule in the New Zealand Takeovers Code. When the offer aims to acquire more than 90% of the voting rights, then the bidder must make an offer to all target shareholders to buy all the remaining shares.[76] This rule is a "sort of" mandatory bid rule to this extent the 90% threshold is a rather strict requirement (far from the 30% rule of some domestic implementations of the European Takeover Directive).

[71] Takeovers Act 1993, article 20.
[72] Takeovers Act 1993, article 2A and "Guidance – Takeovers Code Overview", Takeovers Panel <http://www.takeovers.govt.nz/guidance/takeovers-code-overview/>.
[73] Takeovers Code Approval Order 2000, article 6.
[74] Silvana Schenone "New Zealand takeover laws; what you need to know" (June 7, 2018), Minter Ellison <https://minterellison.co.nz/our-view/new-zealand-takeover-laws-what-you-need-to-know>.
[75] Takeovers Code Approval Order 2000, article 15.
[76] Takeovers Code Approval Order 2000, article 7.

The Takeovers Code also contains some transparency and equality obligations. The shareholders of the target company must be given substantial accurate and up-to-date information regarding the takeover offer. The offeror must disclose any relationships, arrangements or agreements between the offeror and the target company's directors or senior managers.[77] Furthermore, the directors of the target company must establish for the company's shareholders an independent adviser's report on the merits of the transaction (including benefits and downsides).[78] The directors must also give their view to the shareholders about how to respond to the takeover offer.[79] Lastly, the Takeovers Code requires that all shareholders, regardless of their size or influence, have equal, informed opportunities to participate in significant share transactions. Overall, such requirements aim at a viable corporate governance to the extent they may reveal conflicts of interests and enables more transparency of the takeover procedure.

### *ii. A Particularity of New Zealand Legislation: The Schemes of Arrangement*[80]

Thus, we may find some sustainable provisions in the New Zealand Takeover Code but the unique particularity of this Code that might be related to sustainability concerns the schemes of arrangement.

A scheme of arrangement is defined as:

> "*a reorganisation of the share capital of a company by the consolidation of shares of different classes, or by the division of shares into shares of different classes, or by both those methods*."[81]

In other words, a scheme of arrangement is an agreement between a corporation and its shareholders to reorganise the company's structure. It is an alternative to an actual takeover operation. A scheme of arrangement may be used to reorganise a company through a merger or an acquisition and enables to overrule the 20% principle. In this latest context, a scheme of arrangement just aims at the same result of any M&A operation (merging of two entities). A

[77] Takeovers Code Approval Order 2000, article 16.
[78] Takeovers Code Approval Order 2000, article 18.
[79] Takeovers Code Approval Order 2000, article 19.
[80] The schemes of arrangement also exist under United Kingdom and Australia legislations but as per different conditions. See "Scheme of Arrangement", Thomson Reuters – Practical Law <https://uk.practicallaw.thomsonreuters.com/0-107-7201?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1>.
[81] New Zealand Companies Act 1993, article 235.

scheme of arrangement is a statutory Court-approved procedure, which is mainly governed by the Code Company and the Companies Act, but still subject to the jurisdiction of the Takeovers Code. In general, schemes of arrangement are seen as "most popular way to conduct friendly takeovers of Code Companies" as it relies on the unconditional approval of the stakeholders.[82] Friendly takeover implies more transparency between the merging firms (and transparency builds trust) and a better consideration of the different stakes (including financial and cultural aspects): in other words, a more viable takeover operation. Nonetheless, it is worth noting that the schemes of arrangement are rather hard to obtain. Indeed, they need a certain number of requirements including the approval of 75% of the shareholders.[83]

Therefore, the New Zealand Takeovers legislation do not contain numerous sustainable provisions such as but the scheme of arrangement definitely enables a "less traumatizing" procedure for various stakeholders of the merging firms, including the stakeholders and the employees. As they rely on trust between the two firms, such schemes might remedy some common M&A issues such as cultural clash and insufficient due diligence (as the two companies would be more willing to share accurate and complete information).

### *3 The Weaknesses of the M&A Regulations With Respect to Sustainability*

#### *a) The Weaknesses of the European Framework*

Above all, it is worth noting that in theory, the objective of the European Union law targets sustainability. Indeed, article 2 of the Treaty of Lisbon (which forms the constitutional basis of the European Union) affirms that "the Union's aim is to promote peace, its values and the well-being of its peoples" and:

> "*shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment*."

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[82] Silvana Schenone "New Zealand takeover laws; what you need to know" (June 7, 2018), Minter Ellison <https://minterellison.co.nz/our-view/new-zealand-takeover-laws-what-you-need-to-know>.
[83] Companies Act 1993, article 236.

Therefore, the values and objectives of the European Union clearly encompass sustainability issues as they integrate economic, social and environmental aspects. Now, it is time to see whether the European Takeover Directive responds to these noble objectives by taking into account these various aspects.

To put it simply, even though the European Takeover Directive considers sustainable aspects, this remains far from being sufficient. The numerous rules aiming to protect minority shareholders (such as the Mandatory Bid Rule) or employees have the merit to exist but they do not go far enough.

*i. The Case of the Mandatory Bid Rule*

The so-called protections are indeed inefficient and even useless. As an example, the famous Mandatory Bid Rule did not have any significant positive effect. Even though its main purpose might seem to be the protection of the minority shareholders, the real deal is to limit the number of takeovers. If a bidder has to pay for 100% of the shares when the initial intent was to buy, for instance, 30%, this strongly increases the cost of a takeover. As result, because of the excessive acquisition cost it triggers, the Mandatory Bid Rule tends to deter the practices of M&A operations. This rule does not seem to be sustainable but more protectionist as it might hinder cross-border M&A attempts. On the whole, it seems inefficient as the number of M&A operations keeps growing.[84]

Going further, some authors even implies that the absence of a Mandatory Bid Rule makes more likely the occurrence of efficient takeovers.[85] Indeed, such takeovers tend to be value-decreasing rather than value-increasing. To sum up, the Mandatory Bid Rule appears as a deterrent of M&A operations rather than a rule related to sustainability.

*ii. The Case of the Employees' Protections*

Regarding the employees, the protections do not seem to be significant.

Articles 6(3)(i) and 9-5 of the Directive specify that the employees of both the bidder and target companies are to be given information and their views are to be heard, but they do not have any actual "voice" in the process: they are not able to enforce their opinions. In fact, except for key personnel, most of the employees do not have significant impact and cannot "withdraw"

[84] In 2017, 50'600 transactions with a total value of more than 3.5 trillion USD were reported. See *M&A Statistics – Number and Value and Largest M&A Transactions by Region*, Institute for Mergers, Acquisitions and Alliances <https://imaa-institute.org/mergers-and-acquisitions-statistics>.

[85] L.A. Bebchuck "Efficient and Inefficient Sales of Corporate Control", The Quarterly Journal of Economics, 109 (1994).

from the bid. In short, they do not have any decisional rights. In reality, only the opinions of the shareholders matter and employees are not an actual part of the M&A equation. In such situation, the Directive is not really helpful to remedy post-merger adverse effects such as cultural clash.

*iii. The Possibility for Improvements*

Therefore, the positive effect of the Directive with respect to sustainable development seems rather limited as social aspect is only briefly tackled and environmental considerations are not even mentioned. Thus, the Directive does not truly encourage the parties to have a high level of environmental and social awareness when contemplating a M&A operation.

And yet that could be possible as the European framework provides for several domestic legislations that deepened sustainable issues.

Notably, some Northern European systems enable employees to involve in the M&A process. For instance, the codetermination system set up in Germany allows the employees to participate in the management of their company when an M&A operation occurs.[86] Broadly speaking, when such takeover affects a certain number of employees, the board must discuss restructuring measures and a social plan with the employees' representatives. Such measure is an evidence that social concerns may be implemented in M&A regulations. As a matter of fact, the recent M&A failures have indeed been caused by the lack of consideration for sustainable issues.

*b) The Weaknesses of the New Zealand System*

To a certain extent, the New Zealand M&A system is even worse. There are no actual sustainable rules as there is no express mention of environmental and social issues notably the potential relocation or the employment.

Yes, New Zealand has a smaller market but it does not justify the fact that, in view of the global challenges the world currently faces, the New Zealand legislator should realise the interdependence between M&A and sustainable development. At this very moment, the focus of the New Zealand legislation is only on the shareholders and the directors (the Takeovers

[86] Jörg Neubauer and Mathias Schönhaus "Private mergers and acquisitions in Germany: overview" (December 1, 2016), Thomson Reuters – Practical Law <https://uk.practicallaw.thomsonreuters.com/2-628-0847?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1>.

Panel even published two guides in this regard: none of them deals with anything else other than the controlling rules[87]).

Indeed, in addition the rules aiming to protect the shareholders, the New Zealand Takeovers Code is constructed around the idea of control of shareholding increases. Any increase in ownership above the 20% threshold must be carried out in accordance with the Takeovers Code.[88] Then, depending of the threshold, particular rules apply. In any case, all these rules seem to aim to regulate the market for corporate control rather than tackling any other topics.

The procedure of a takeover offer is a good example. The Takeovers Code contains a rather precise description of a takeover offer, which "must include offers in respect of all the securities in each class of equity securities, whether voting or non-voting, of the target company"[89] as well as various details about the offer (information about the offeror and its securities, etc.).[90]

There is one requirement that could have been sustainable and which is contained in the Schedule 1 of the Takeovers Code. It is required that the bidder provides for a statement of its intentions regarding material changes of the target company. Such statement must cover:

> *"(a) material changes to the business activities of the target company or its subsidiaries; and*
>
> *(b) material changes to the material assets of the target company or its subsidiaries; and*
>
> *(c) material changes to the capital structure of the target company (including the target company's dividend policy, raising capital, and taking on debt); and*
>
> *(d) any other information about the likelihood of changes to the target company or its subsidiaries that could reasonably be expected to be material to the making of a decision by an offeree to accept or reject the offer."*[91]

This article could have been the perfect opportunity to introduce sustainable aspects. For instance, there could have been a particular emphasis concerning the intentions of the offeror regarding the employees of the target company, its locations, etc. Even though the term

[87] "Basic Guide for Directors", Takeovers Panel <http://www.takeovers.govt.nz/guidance/guide-for-directors/> and "Basic Guide for Shareholders", Takeovers Panel <http://www.takeovers.govt.nz/guidance/guide-for-shareholders/>.
[88] New Zealand Takeovers Code, article 6.
[89] New Zealand Takeovers Code, article 8(2).
[90] New Zealand Takeovers Code, article 44.
[91] Schedule 1 of the New Zealand Takeovers Code, article 14.

"material changes" is large enough to include sustainable issues, the fact is that without any guidance on its meaning, the offeror can construe the word "material" the way it wants and includes what he wants to include or not. Besides, the fact that the Takeovers Code does not tackle any sustainable aspects does not encourage the offeror to consider sustainable issues in its statement of intentions. Therefore, the statement of intentions contained in a takeover offer remains vague and might not be substantial and complete.

Overall, what is missing in these regulations? Lots of things. No due diligence requirements. No picture of the target company. None of them enables to avoid the motives of failures such as cultural mismatch or insufficient due diligence. Indeed, the M&A regulations only tackle the economic aspect (and not that much) but do not provide any guidance about how making a takeover operation successful, or at least operational. I do not claim to propose the miracle solution but Corporate Social Responsibility (CSR) might be helpful in this regard.

## *II Corporate Social Responsibility, a Potential Solution?*

### *A Corporate Social Responsibility: A Broad Concept With Various Impacts on M&A*

#### *1 What is Corporate Social Responsibility?*

##### *a) Overview of the Concept of Corporate Social Responsibility*

##### *i. Definition of Corporate Social Responsibility*

As stated above, the takeover regulations do not address sustainable issues. And yet, there is a concept that aims at sustainability: it is the Corporate Social Responsibility (henceforth, CSR). This concept may be summed up by the following quotation: "The business of business should not be about money, it should be about responsibility. It should be about public good, not private greed."[92]

Behind this candid and almost idealistic sentence lies the concept of CSR. Many denominations have been used to address this notion (corporate conscience, sustainable business, or corporate

[92] Anita Roddick, *Business as Usual* (Thorsons London 2000).

citizenship) but in all cases, it states that companies should be concerned by not only economic profit but also sustainable issues.

### *ii. The European Framework*

It is worth noting that there is no commonly accepted definition of CSR. The European Commission started to define CSR as "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis". [93] In other words, CSR aimed at encouraging companies to go above their legal obligations towards society and the environment. Then, the European Commission defined CSR as "the responsibility of enterprises for their impacts on society" and dropped the "voluntary basis".[94] The European Commission also provided for a brief business plan:

> "*To fully meet their corporate social responsibility, enterprises should have in place a process to integrate social, environmental, ethical, human rights and consumer concerns into their business operations and core strategy in close collaboration with their stakeholders, with the aim of:*
>
> *a. maximising the creation of shared value for their owners/shareholders and for their other stakeholders and society at large;*
>
> b. *identifying, preventing and mitigating their possible adverse impacts*."[95]

### *iii. The International Framework*

On a larger scale, there are several sources about CSR but the most relevant one is definitely the framework provided by the International Organisation for Standardisation. This organisation developed a standard (the ISO 26000 standard) that enables to clarify the notion of CSR by providing a clear-cut definition. Indeed, the ISO 26000 standard refers to CSR as:

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[93] European Commission *Green paper – Promoting a European framework for corporate social responsibility* (COM/2001/0366 final) (Celex No. 501DC0366 European Union Preparatory Acts).

[94] European Commission *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - A renewed EU strategy 2011-14 for Corporate Social Responsibility* (52011DC0681 COM/2011/0681).

[95] European Commission *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - A renewed EU strategy 2011-14 for Corporate Social Responsibility* (52011DC0681 COM/2011/0681).

"*the responsibility of an organisation for the impacts of its decisions and activities on society and the environment that, through transparent and ethical behaviour:*

*a. contributes to sustainable development, including health and the welfare of society;*
*b. takes into account the expectations of stakeholders;*
*c. is in compliance with law and consistent with international norms of behaviour;*
*d. and is integrated throughout the organisation and practiced in its relationships."*[96]

In other words, CSR is a business approach whose object is to encourage corporations to be more aware of the consequences of their operations on the rest of society.

For doing so, the ISO 26000 standard includes seven "core areas":

- Organisational governance (complying with law, transparency, accountability, and respect of stakeholder interests);
- Human Rights;
- Labour practices;
- Environmental impact;
- Fair operating practices (including the fight against corruption);
- Consumer-related issues;
- Community involvement and development (employees of the firm but also communities at large that may be affected by the corporation's activity).[97]

Going further, CSR is related to the concept of "appropriate governance" that the governance that includes assessment of "imperatives for decision-making to adequately represent, and reflect the interests, demands, and expectations of, one or more relevant constituencies that might otherwise be overlooked by more narrowly drawn, private interests."[98] Broadly speaking, it is about "balancing the demands and welfare of interested parties that lie outside the potentially closed world of the stakeholder-manager relationship". CSR tries to reflect other interests that private interests of corporate performance. It aims to include not only the

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[96] ISO 26000 Standard, International Organisation for Standardisation.
[97] "The ISO 26000 standard on social responsibility: a private-sector standard adopted around the world" in France's Commitment to Corporate Social Responsibility (CSR) <https://www.diplomatie.gouv.fr/en/french-foreign-policy/economic-diplomacy-foreign-trade/corporate-social-responsibility/>.
[98] Stephen Brammer and Stephen Pavelin "Corporate Governance and CSR" (March 2013) in *The Oxford Handbook of Corporate Governance*, edited by Douglas Micharl Wright, Donald S. Siegel, Kevin Keasey, and Igor Filatotchev, Oxford University Press, at page 4.

promotion of beneficial impacts from firms' business activities, but also the furtherance of social and/or environmental objectives that – perhaps due to significant economic power or distinctive technological capabilities – firms may be distinctively well-placed to address.

#### *iv. Ways to Practise Corporate Social Responsibility*

There are many ways to practise CSR including transparency measures (disclosing policies regarding the company's activities with known and likely impacts), environmental efforts (notably reducing the carbon footprint, management of natural resources, etc.), human resources management (employees' welfare, actions enhancing community relations) and philanthropy (donating to charities). The latest is by far the best-known and contributed to giving CSR the reputation of being merely a "look good" policy.[99]

CSR is a very broad concept that covers various topics as long as they relate to social, ethical and environmental issues. Nonetheless, all these various implementations fulfil a common purpose: sustainability, which refers to "development that meets the needs of the present without compromising the ability of future generations to meet their own needs"[100]. Broadly speaking, it aims at finding the balance between economic profit and responsible behaviour with a view to the long-term.

### *b) What is the Difference between Corporate Social Responsibility and Sustainability?*

This is a common argument: why should we care about CSR? Isn't it the same thing as sustainability?

Sustainability is the global initiative integrating the three pillars: economic, social and environmental. CSR is the corporate aspect of sustainability. It is the way corporations implement sustainability in their business model. It refers to the corporate commitment, the business strategy, utilised to implement sustainability.

But concretely what are the benefits of CSR over Sustainability? In fact, everybody agrees on adopting a sustainable approach but nobody has a clue about making sustainability operational. CSR will tentatively provide an operational business plan. It is a mechanism for sustainability, the latter being more a philosophy that needs to be understood in its entirety. To sum up, CSR

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[99] Think of these large oil and gas companies building up a school or a hospital in third-world countries.

[100] World Commission on Environment and Development (WCED) – *Brundtland Commission Report of the World Commission on Environment and Development: Our Common Future* (1987).

represents the company's commitment to integrate sustainable concerns into its business model.

*2 The Impact of Corporate Social Responsibility on M&A Operations*

We could discuss about the potential synergy between CSR and M&A for a very long time. M&A highlight the flaws in a firm governance and the corporate responsibilities but companies do not seem to discuss the real motives of failures.[101] CSR may enable to develop "informative lessons for the practical tailoring of governance structures to facilitate managerial decision-making". [102] Indeed, the concepts of CSR and corporate governance are linked "as companies play an important role in shaping the governance of social and environmental issues".[103] This is one of the reasons CSR is relevant to corporate governance in general, and M&A in particular.

*a) CSR Ratings: An Enhanced Approach of the Due Diligence*

CSR ratings appear as an upgrade of M&A due diligence. In brief, "a CSR assessment is an evaluation of how well a company has integrated the principles of CSR into their business".[104] The objective of the CSR scores is to provide a clear insight of the implementation of CSR practices in a corporation (policies, actions and results with respect to sustainability). In short, a CSR assessment aims to measure the quality of a corporation's CSR management system – through its policies, actions and results – and highlights a company's practices regarding sustainability.

Most of the time, the assessment points out **environmental practices** (a company's environmental impact including its carbon footprint and its initiatives in reducing pollution), **corporate governance**[105], and **human resources management (**quality of work-life, power

[101] Please refer to the first part of this paper regarding the M&A failures.
[102] Stephen Brammer and Stephen Pavelin "Corporate Governance and CSR" (March 2013) in *The Oxford Handbook of Corporate Governance*, edited by Douglas Micharl Wright, Donald S. Siegel, Kevin Keasey, and Igor Filatotchev, Oxford University Press.
[103] Stephen Brammer and Stephen Pavelin "Corporate Governance and CSR" (March 2013) in *The Oxford Handbook of Corporate Governance*, edited by Douglas Micharl Wright, Donald S. Siegel, Kevin Keasey, and Igor Filatotchev, Oxford University Press.
[104] "What is CSR Assessment" in *CSR Assessment*, EcoVadis <http://www.ecovadis.com/csr-assessment/>.
[105] Maria-Gabriella Baldarelli, Mara Del Baldo, and Caterina Ferrone "The Relationships Between CSR, Good Governance and Accountability in the Economy of Communion (EoC) Enterprises" in S.O. Idowu, C. Strue

relations, implementation of labour regulations and diversity such as the presence of minorities).

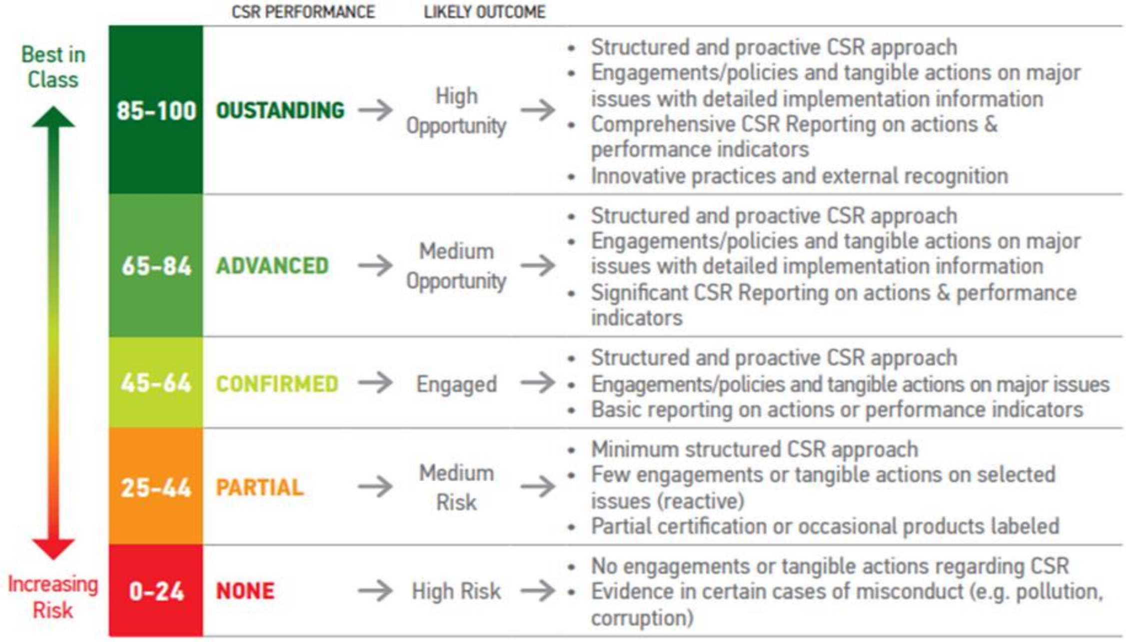
We could refer to several CSR assessment systems but EcoVadis appears as a good example. EcoVadis is a European organisation auditing companies with respect to CSR and attributing them a mark. The CSR assessment of EcoVadis is carried out around these four themes:


Figure 1 Example of assessment criteria (by EcoVadis[106])

Following the assessment, the auditing company attributes a mark:

¬Frederiksen, A. Yüksel¬Mermod and M.E. Juul¬Nielsen *Corporate Social Responsibility and Governance – Theory and practice* (Springer International Publishing, Cham, 2015).

[106] “EcoVadis CSR Rating Methodology: Overview & Principles”, EcoVadis <https://theme.zdassets.com/theme_assets/143203/d135d5e09447424a01d01f8c84411972f146dc1d.pdf> at page 6.




Therefore, a CSR assessment evaluates the CSR management system and attributes a grade. An assessment programme is a first step into an ongoing monitoring process. The objective of the assessment is to get a clear picture of CSR practices within one company. The assessment results enable to understand how one corporation is positioned and can also be used to communicate CSR commitments to various stakeholders (investors, customers or consumers). Where is a company strong and weak with respect to CSR?

Nonetheless, it is worth remaining careful: these ratings certify that the company has a strong and viable CSR management but does not imply good results with respect to environment or social issues. In other words, CSR ratings mainly mean that a company has a viable and transparent management system but they are still an enhanced approach of due diligence, that tackles all the topics that the law does not deal with. The number of due diligence disasters speaks for itself: the information ascertained before the deal are not sufficient. On the other hand, CSR provides a system of rating highlighting a company's practices regarding sustainability.

### b) *The Implementation of CSR in the M&A Process: A Tool to Assess the Deal*

#### i. *The Influence of CSR on a Firm's Propensity to Engage in M&A*

CSR may help an acquiring company to choose a suitable target.[107] Individual elements of CSR ratings (i.e. corporate governance, employee relations, environmental practices, and quality and safety) directly influence the choice to merge or to acquire a new company as it would be a way to improve CSR results and to gain a competitive advantage. On the other hand, the companies with excellent CSR scores shall be less likely to engage in M&A as they would not want to be "corrupted" by another firm.

In this regard, the **corporate governance ratings** are crucial as they reflect the relations between executives and other stakeholders.[108] High CSR ratings in this matter point out organizations with sound and established corporate governance practices including transparent governance procedures as well as mechanisms making the directors accountable to stakeholders. Such companies would be reluctant to start an M&A activity, as it might damage stakeholder relations, but they might be the targets of corporations which experience governance issues. Rather than reforming their existing governance mechanisms, these organizations prefer to identify target companies with viable corporate governance mechanisms.

Likewise, **social ratings** are essential as several operations have been a failure due to the decrease of employees' commitment (hurting the product or service offered by employees), which resulted with departure of workers, taking with them their knowledge and abilities to contribute to the goals, profits and performance of the M&A.[109] High CSR employee relations scores emphasize a greater attention and provision of information on health and safety, staff development processes and employee welfare. Companies with high results in this matter are less likely to pursue M&A because they do not wish to damage these practices. On the flip side, companies with low CSR employees' scores do not seem to take employees' concerns

[107] Sara Josselyn "The impact of corporate social responsibility on M&A pursuits" (February 19, 2015), Deal Law Wire <https://www.deallawwire.com/2015/02/19/the-impact-of-corporate-social-responsibility-on-ma-pursuits/>.

[108] Maria-Gabriella Baldarelli, Mara Del Baldo, and Caterina Ferrone "The Relationships Between CSR, Good Governance and Accountability in the Economy of Communion (EoC) Enterprises" in S.O. Idowu, C. Strue ¬Frederiksen, A. Yüksel¬Mermod and M.E. Juul¬Nielsen *Corporate Social Responsibility and Governance – Theory and practice* (Springer International Publishing, Cham, 2015).

[109] Frederick L. Bereskin "The Effect of Cultural Similarity on Mergers and Acquisitions: Evidence from Corporate Social Responsibility" (July 23, 2017), Harvard Law School Forum on Corporate Governance and Financial Regulation <https://corpgov.law.harvard.edu/2017/07/23/the-effect-of-cultural-similarity-on-mergers-and-acquisitions-evidence-from-corporate-social-responsibility/>.

into consideration when making strategic decisions and thus are not concerned about the disruptive nature of M&A. This increases the likelihood of these companies to pursue M&A.

Last but not least, **environmental ratings** are indispensable since the number of environmental regulations keeps increasing. The identification of environmental liabilities in M&A consists of looking at existing pollution, the value of the liability and the cost to remediate it. According to a survey carried out by KPMG UK LCC (2008), almost one-third of large European companies discovered environmental issues after completing M&A transactions although most of the companies had realised an environmental due diligence assessment.[110] Acquiring companies need to know whether they are taking on environmental issues but this issue is difficult to assess as potential liabilities may arise many years after the deal. Companies with high environmental strengths are less likely to pursue M&A because of the inherent lack of transparency in the other company's environmental practices. But they might be a target as they have a competitive advantage consisting of a complete transparency in their environmental practices. [111]

### ii. *CSR: A Determinant of M&A Integration Speed*

CSR has also an effect on the integration period of merging the firms. Broadly speaking, the M&A integration speed is the period of time needed to complete the intended integration of systems, structures, activities, and processes of two companies. CSR scores may represent disparities between merging companies' systems, cultures, value, principles, policies, standards and procedures. Such discrepancies imply a longer integration process.

This part is a major stake: unprepared M&A transactions might result in unexpected governance, social or environmental issues post transaction, despite efforts during the due diligence process to identify the threats before the deal.[112] As previously stated, **cultural mismatch** may causes resignations, low morale or resentment of the acquired employees.[113] **Environmental or governance differences** may be very costly to correct as one of the entities

[110] Scott M. Morgan "The Impact of Corporate Social Responsibility on Mergers and Acquisitions" (June 5, 2009), <https://ir.library.oregonstate.edu/concern/honors_college_theses/bg257g98p> at page 19.
[111] "How Green is the Deal? The Growing Role of Sustainability in M&A" (2008), Deloitte <https://www2.deloitte.com/content/dam/Deloitte/il/Documents/risk/CCG/other_comittees/how_green_is_the_deal_deloitte_102408.pdf>.
[112] "Mergers and Acquisitions deals impacted by Corporate Social Responsibility risks", PharmaField <https://www.pharmafield.co.uk/features/2004/07/Mergers-and-Acquisitions-deals-impacted-by-Corporate-Social-Responsibility-risks>.
[113] Carol Yeh-Yun Lin and Yu-Chen Wei *The Role of Business Ethics in Merger and Acquisition Success: An Empirical Study*, Journal of Business Ethics (2006) 69:95-109.

may be more responsible than the other in these matters and may commit more resources than the other in this regard: therefore, aligning the practices between the two companies may take both time and money.

To sum up, M&A failure is often associated to the inability to achieve the intended objectives in a time interval that makes the deal worthwhile from an economic standpoint. Greater differences between acquirer and target CSR ratings will result in longer integration periods.

### *B The Impact of CSR Regulations on M&A Operations*

#### *1 The Current State of CSR: The Absence of Global Framework*

##### *a) The Absence of Consensus Regarding CSR*

CSR is increasingly important on the international agenda and has been the subject of numerous negotiations within many bodies but we cannot help noticing that…there is simply no consensus about it.

Obviously, everybody agrees that CSR deals with environmental, social and economic issues but the number of sources regarding CSR is huge, preventing from a common understanding of the concept.

Indeed, the many different forums about CSR include the United Nations (through the Sustainable Development Goals – SDGs – but also the Global Compact[114]), the European Union, the International Labour Organisation (notably with the Alliance 8.7[115]) as well as some private entities such as the International Organisation for Standardisation (through its standard ISO 26000) or the Global Reporting Initiative[116].

[114] A set of ten principles related to sustainable matters that encourage companies to be more aware of their impact on the rest of society. See "GC Mission", UN Global Compact <https://www.unglobalcompact.org/what-is-gc/mission>

[115] The Alliance 8.7 is a group of different stakeholders aiming to speed up measures related to target 8.7 of the Sustainable Development Goals (SDGs) in terms of slavery, human trafficking, child labour and forced labour. See "Background note on Alliance 8.7: Working together to end child labour and modern slavery", International Labour Organisation <https://www.ilo.org/global/topics/forced-labour/publications/WCMS_421047/lang--en/index.htm>.

[116] A framework and set of standards aiming to help corporations to report on their non-financial impact. See "About GRI", Global Reporting Initiative <https://www.globalreporting.org/Information/about-gri/Pages/default.aspx>

With such a large amount of different sources, it is sometimes difficult to apprehend the notion of CSR. The sole agreement is that it aims at sustainability, that is, in this context, leaving a great world to future generations.

Leaving a great world to future generations: that definitely sounds like a good label but it is a subjective one, for which the definition may vary. The priorities of a rich country will not be the same as those of a developing country. Indeed, the way CSR is understood and practised differs for each country (considering the size of the country, its population, its resources, etc.).

One of the main difficulties though comes from the national interpretations (and even preferences) with respect CSR. Such interpretations may be called "implicit-explicit dimension" of CSR practices. "Explicit CSR" is used to describe CSR actions carried out in the form of corporate activities, through voluntary policies, strategies and other initiatives. These actions are essentially motivated by perceived expectations of different stakeholders of the company. "Implicit CSR" consists of values, norms, and rules, usually codified and mandatory, emerging from the society itself, the legislations, and the expectations of the role of the corporation by the society. CSR actions are driven and shaped by the society itself. In national business systems that favour the explicit element of CSR, it is relatively common that corporations actively report their CSR initiatives and through a common language (that is a common framework). On the other hand, corporations within business systems with strong implicit elements of CSR – often, the requirements for which are codified in laws and regulations – less commonly report such CSR-related activities – perhaps because compliance is not regarded as noteworthy.[117]

For instance, France is a country of 64 million people which has to deal with different social and environmental problems (especially unemployment and energy transition). On the other hand, New Zealand is a 4.6 million people nation with a strong "green" image. That is why it might be difficult to legislate about CSR.

*b) Why Regulating about CSR?*

Countries should consider implementing CSR in law as it would provide some guidance to companies, which seem having difficulties to establish what CSR is and includes. Because of that, corporations only focus on some parts of CSR (donating to charities) while some other

[117] Stephen Brammer and Stephen Pavelin "Corporate Governance and CSR" (March 2013) in *The Oxford Handbook of Corporate Governance*, edited by Douglas Micharl Wright, Donald S. Siegel, Kevin Keasey, and Igor Filatotchev, Oxford University Press.

things are more urgent (for example, donations from an oil and gas company is honourable but finding more ecological sources of energy is the real stake).

Furthermore, implementing CSR in law might prompt companies to take even more initiatives as companies would regard these constraints of rules as an opportunity to gain a competitive advantage. From a broader perspective, CSR rules might act as incentives as these new regulations might be perceived as a signal for even-harder future constraints. Anticipation can then lead companies to adopt sustainable policies in the fear of future constraints. In this sense, promoting CSR might have the "capacity to enhance firm reputation and survival."[118]

*2 The Current Regulations With Respect to CSR*

It is necessary to be honest about one thing: you will not find any legislation obliging companies to take initiatives with respect to sustainability. CSR relies on a voluntary basis and companies only act by themselves when they identify an economic purpose.

In fact, the regulations deal with CSR reporting, or non-financial reporting. In Europe, for instance, companies attaining a certain minimum threshold are obliged to disclose about their environmental and social impact.

Non-financial reporting is a tool that encourages greater transparency by requiring corporations to reveal information on the environmental, social and societal consequences of their activities in their annual management reports.

*a) The European Framework*

Within the European Union, Directive 2014/95/EU of October 22nd, 2014 on the disclosure of non-financial information sets up a regulatory framework for CSR reporting. The purpose of this Directive is to respond to "the need to raise to a similarly high level across all Member States the transparency of the social and environmental information provided by undertakings in all sectors".[119] The European Union put a particular emphasis on "the importance of businesses divulging information on sustainability such as social and environmental factors, with a view to identifying sustainability risks and increasing investor and consumer trust" as:

[118] Stephen Brammer and Stephen Pavelin "Corporate Governance and CSR" (March 2013) in *The Oxford Handbook of Corporate Governance*, edited by Douglas Micharl Wright, Donald S. Siegel, Kevin Keasey, and Igor Filatotchev, Oxford University Press,
[119] Directive 2013/34/EU, preamble, paragraph 1.

> "*Disclosure of non-financial information is vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection. In this context, disclosure of non-financial information helps the measuring, monitoring and managing of undertakings' performance and their impact on society*."[120]

Therefore, the aim is to harmonise non-financial reporting across the European Union.

The Directive obliges "large" companies to disclose their non-financial impact on society. Large companies refer to corporations with more than 500 employees.[121] Such companies must:

> "*include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters."*[122]

In other words, the non-financial report of one company must cover all non-economic impact of the business activity including the policies and their impacts in this regard.

*i. The Disclosure of the Business Model of the Company*

Firstly, the report must include "a brief description of the undertaking's business model", which the European Directive Guidelines describe as an overview of one company's business, the rationale of its structure, and how it transforms inputs into outputs through its business activities. "In more simple terms, what a company does, how and why it does it."[123] Such description may also include the corporation's objectives and strategies as well as main trends and factors that may affect its future development.

Secondly, the report must include "a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented". Such disclosure covers the company's management and board's responsibilities and decisions, and how resource allocations relate to objectives, risk management and intended outcomes. Besides, the report on due diligence processes relates to policies, to risk management and to outcomes. It is

[120] Directive 2013/34/EU, preamble, paragraph 3.
[121] Directive 2013/34/EU, article 1(1).
[122] Directive 2013/34/EU, article 1(1).
[123] Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information) C/2017/4234.

about ensuring that one company delivers against a concrete objective (e.g. to ensure that carbon emissions are below a certain level or that supply chains are free from trafficking in human beings). Such due diligence processes help identify, prevent and mitigate existing and potential adverse impacts.

Thirdly, the non-financial report must include "the outcome of those policies", that is the result of companies' non-financial policies. The European Guidelines state that "relevant disclosures on outcomes of policies may provide useful information on the company's strengths and vulnerabilities". Such non-financial information might help investors and other stakeholders understand and monitor the company's performance.

Fourthly, the non-financial report needs to tackle:

> "*the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks*."[124]

In other words, corporations need to reveal the principal risks related to their business model and on how these risks are managed and mitigated. Those risks might concern their operations, their products or services, their supply chain and business relationships, to name but a few. This assessment should also examine the risk on both short and long-terms. Moreover, undertakings are expected to explain how these risks impact their decisions, policies, operations, financial performance, etc.

Fifthly, the non-financial report must cover "non-financial key performance indicators relevant to the particular business". [125] The non-financial statement should include material narratives and indicator-based disclosures, commonly referred to as key performance indicators (KPIs). That includes all the elements necessary to understand the company's development, performance, position and impact of its activity.

One must bear in mind that in any case, such non-financial report must relate to "environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters". This is the second part of the non-financial report, which is related to thematic aspects.

[124] Directive 2013/34/EU, article 1(1)(d).
[125] Directive 2013/34/EU, article 1(1)(e).

*ii. The Thematic Aspects of the Non-Financial Report*

First of all, the corporation is expected to disclose relevant information on the actual and potential impacts of its operations on the environment, and on how current and foreseeable environmental issues might impact the company's development, performance or position. The report might include the environmental efforts of the company such actions about reducing carbon footprint, management of natural resources, etc.

Then, companies need to report on their social and employees' impact including compliance with labour law, well-being of the staff and other human resources management, community relations, etc.

On a larger scale, companies need also report on their respect of human rights. Such report should include the commitments of the company with respect to human rights (generally in a code of conduct or on the website of the company). But it should also include the concrete actions of the company with respect to human rights. Obviously, every report shall depend on the business's activity. An IT company will focus on the protection of personal data of its users (privacy being a human right) while an industrial corporation will more likely focus on their actions with respect to local communities that might be impacted by their operations.

Lastly, companies need to report on anti-corruption and bribery aspects. Such report covers the way corporations manage anti-corruption and bribery matters and occurrences, which instruments they set up to fight against corruption, what initiatives to prevent or mitigate adverse effects, etc. In short, this part of the report aims to disclose all the instruments ensuring that the governance of the company is viable and uncorrupted.

*b) The New Zealand Framework*

*i. The Current CSR Practices in New Zealand*

In spite of its "clean" image[126], New Zealand has not developed any legal imperatives regarding CSR. As there is no law concerning CSR, there is no consensus in New Zealand is this matter and it has been up to the companies to develop such programmes. In short, companies do what they want as long as their initiatives can be tied to the definition of sustainability. In this

[126] "State of CSR report released" (July 2, 2015), Sustainable Business Council <https://www.sbc.org.nz/news/2015/state-of-csr-report-released>.

context, CSR in New Zealand is a "catch-all" category and CSR reports are rarely the same (some companies focus on their environmental impact, some others on their donations). In short, the non-financial reporting by New Zealand corporations often lacks in balance, objectivity and transparency.

As a matter of fact, some companies do not know that they are actually doing CSR. They will take measures but will not report them under the label "CSR" but "sustainability" (such as Westpac NZ[127]).

The absence of consensus regarding CSR hinders visibility over CSR actions in New Zealand. As a consequence, only 52% of the New Zealand companies were reporting on their non-financial impact. This number rose to 69% in 2017 but it is still lower than the global average (which is 72%).[128] It is then difficult to review and assess CSR (but it does not mean that New Zealand corporations do not take any initiatives).

### *ii. The New Zealand Framework with Respect to Non-Financial Reporting*

However, we should expect a grow of CSR reporting in New Zealand. In December, the New Zealand Exchange (NZX – that is the entity supervising stock exchange in New Zealand) introduced, through its Corporate Governance Code, guidance note relating to environmental, social and governance (ESG).[129]

The NZX Corporate Governance Code aims to "promote good corporate governance, recognising that boards are in place to protect the interests of shareholders and to provide long-term value". One of the recommendations of the Code is to encourage non-financial reporting related to environmental, social and governance factors. In this regard, the Guidance Note states:

> "*Financial reporting should be balanced, clear and objective. An issuer should provide non-financial disclosure at least annually, including considering material exposure to environmental, economic and social sustainability risks and other key risks. It should*

[127] "Sustainability Performance", WestPac <https://www.westpac.co.nz/who-we-are/sustainability-and-community/how-we-re-tracking/sustainability-reports/>

[128] "KPMG Survey of Corporate Responsibility Reporting 2017" (page 16), KPMG <https://home.kpmg.com/xx/en/home/campaigns/2017/10/survey-of-corporate-responsibility-reporting-2017.html>.

[129] "Environmental, Social and Governance – NZX Guidance Note" (December 11, 2017), NZX <https://www.nzx.com/regulation/nzx-rules-guidance/corporate-governance-code>.

*explain how it plans to manage those risks and how operational or non-financial targets are measured*."[130]

By saying this, the NZX clearly recognises the benefits of non-financial reporting. The equation is summarised as: "there are two parts to the equation – the impact a business has on the environment and the impact the environment has on a business. ESG reporting requires a business to consider both."

This Guidance Note is expected to "act as a catalyst for better business reporting by raising the bar on what is expected".[131] Indeed, although it is not mandatory, such Guidance Note may serve as basis for New Zealand businesses, which could use it as a guide and then adapt it.

*iii. The Non-Financial Content in New Zealand*

The non-financial reporting framework of the NZX is constructed around the three classic pillars of Environment, Social and Governance as well as 14 other themes to reflect their impact on businesses.

As per the NZX, environmental issues include the protection of the environment, air and water pollution and sustainable procurement while the social issues cover human rights, supply chain management and community relations. But the most developed area concerns the governance of the issuer. The reporting should indeed cover the executive remuneration, the shareholder rights, the proxy voting the business ethics, the board composition, the risk management and the capital reorganisations, to name but a few.

The reasoning is: what is the impact of one business on ESG issues? And vice-versa: what is the impact of ESG issues on one business? A good reporting needs to consider both questions.

To conclude, we need to remember that non-financial reporting is still new to New Zealand. The NZX Guidance Note definitely provides for some basis but it is still rather short (a 19-pages guide is better than nothing but it is not sufficient to implement it into a business). Therefore, it will be incumbent on New Zealand companies to develop some clear and structured methods to report on ESG issues.

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[130] Recommendation 4.3 of the NZX Corporate Governance Code, NZX <https://www.nzx.com/regulation/nzx-rules-guidance/corporate-governance-code>.
[131] "KPMG Survey of Corporate Responsibility Reporting 2017" (page 17), KPMG <https://home.kpmg.com/xx/en/home/campaigns/2017/10/survey-of-corporate-responsibility-reporting-2017.html>.

*3 The Impact of CSR Regulations on M&A*

### a) The General Benefits of CSR Regulations

#### i. Consistency Between CSR Reports

As stated above, there is no consensus on reporting standards globally. The different frameworks are numerous (United Nations Global Compact, Global Reporting Initiative, etc.) but indeed, it is up to the disclosing company to the framework that better fits its business. Lack of common framework means that it can be hard to compare data between companies.

Standardising non-financial reporting practices provides for a clear framework as well as some guidance to companies, which seem having difficulties to establish what CSR reporting is and includes. Currently, there definitely lacks consistency among the various reporting standards and frameworks and the international reporting landscape is quite fragmented. Greater alignment of reporting frameworks will help continue growth. This would make reporting easier for companies and, ultimately, continues growth in reporting rates.

#### ii. Encouraging Companies to Consider the Global Impact of their Activities

In this regard, back in 2014, the European Union had stated in its Directive: "Over the years, we have seen the limits of a voluntary approach. Today, around 2 500 large EU companies disclose environmental and social information regularly, which is less than 10% of the EU large companies." Statistics are adamant: reporting rates jump, driven by regulatory change.[132]

#### iii. Enhancing Visibility and Transparency of Corporations' Activities

Non-financial reporting obligations helps the measuring, monitoring and managing of organisations' performance and their impact on society. That enables more clarity. CSR reporting enables to identify key risks and strategies to minimise these risks, and to maximise opportunities. This might, in turn, lead to better returns for investors.

Another advantage of legal requirements with respect to non-financial reporting is that it prevents companies from hiding information. Companies might be tempted to focus on

[132] "KPMG Survey of Corporate Responsibility Reporting 2017" (page 15), KPMG <https://home.kpmg.com/xx/en/home/campaigns/2017/10/survey-of-corporate-responsibility-reporting-2017.html>.

favourable information and to hide unfavourable data. CSR reporting obligations make the reporting more objective and even-handed.

*iv. Social Pressure on Businesses*

Transparency obligations make companies aware that their actions are scrutinized by everyone: politics, citizens, consumers, investors, shareholders. This has the potential to make them more responsible. On the other hand, CSR reporting is a way for companies to retain or regain public trust, especially when there have been corporate scandals.

Going further, implementing CSR in law might prompt companies to take even more initiatives as companies would regard these constraints of rules as an opportunity to gain a competitive advantage. From a broader perspective, CSR rules might act as incentives as these new regulations might be perceived as a signal for even-harder future constraints.

There is caveat though: CSR reporting does not mean that there are actual improvements: transparency is good but it does not mean that the company takes any concrete initiatives with respect to sustainability. For the moment, the reports are only statistic without any meaning, information on context and impact. "Reporting is only an instrument; the benefits will come once Corporate Reporting objectives and practices are fully embedded in the business, which reporting can demonstrate but cannot achieve on its own."[133]

For instance, the French chemical company Arkema has been complimented by rating agencies for its CSR management[134] and is notably proud to announce that it reduced its carbon footprint by 48% between 2012 and 2017.[135] But ARKEMA does not specify that in 2013, the company divested KEM ONE, its most polluting branch, which explains this remarkable decrease. Again, CSR results always need to be questioned and construed in a broader context.

*b) The Benefits of CSR Regulations on M&A Operations*

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[133] Oiliver Boutellis-Raft "Full effect of EU Directive will be seen in 2019 or 2020" in *KPMG Survey of Corporate Responsibility Reporting 2017* (page 12), KPMG <https://home.kpmg.com/xx/en/home/campaigns/2017/10/survey-of-corporate-responsibility-reporting-2017.html>.

[134] Arkema recognized for its Corporate Social Responsibility performance (Arkema Press release) (November 25, 2017), arkema.com <https://www.arkema.com/en/media/news/news-details/Arkema-recognized-for-its-Corporate-Social-Responsibility-performance/>

[135] ARKEMA 2017 Reference Document, arkema.com <https://www.arkema.com/export/sites/global/.content/medias/downloads/investorrelations/en/finance/arkema-2017-reference-document.pdf> (see page 7 for environmental results).

### *i. A Clear Overview of the Target's Strengths and Weaknesses*

Non-financial reports point out how environmental, social and governance issues may affect one company's business model (though legislation, reputational harm, employee turnover, licence to operate, legal action or stakeholder relationships) and how these impacts might affect the corporation's strategy and financial and operational performance.

In other words, it enables to draw the "value mapping" of one corporation's business. A value mapping is a document, analysing and improving the flow of information or materials required to produce a product or service for a customer.[136] In the context of an M&A operation, such mapping enables to understand how one company manufactures or provides goods or services and enables to identify the revenues generated by environmentally and socially beneficil products and services.

### *ii. The Target Company's Equipment to the Long-Term*

CSR reporting is becoming a standard practice for large companies. KPMG reported that in 2017, 78% of the world's biggest companies integrated non-financial data in their annual reports.[137]

In the future, it is likely that bidders will want to better understand how a target company is positioned to deliver long-term sustainable value. In this regard, non-financial reports represent a way to communicate a vision to the long-term. The NZX clearly points out the benefits of non-financial reporting on M&A operations. By being transparent, "issuers can show investors that they are equipped for the long term". ESG factors helps bidders to measure the sustainability and ethical impact of the M&A operation in the company.

Indeed, "evidence based disclosure" can help bidders make conscious choices when targeting a company. ESG information (and more broadly, any kind of non-financial information) may enable bidders to choose a "suitable" target.

In particular, bidders, but also targeted companies, have a broader view into the long-term strategy of the disclosing company: they become able to assess the current and future strategy of the issuer. ESG risks affect a company's present and future turnover. That makes non-financial reporting relevant.

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[136] "Value Stream Mapping", I Six Sigma <https://www.isixsigma.com/dictionary/value-stream-mapping/>.
[137] "KPMG Survey of Corporate Responsibility Reporting 2017" (page 4), KPMG <https://home.kpmg.com/xx/en/home/campaigns/2017/10/survey-of-corporate-responsibility-reporting-2017.html>.

In brief, "good" results with respect to sustainability might send a good signal to potential acquirers.

To conclude, why non-financial reporting, and more broadly transparency, matter? Global transparency leads to better performance. M&A tend to focus on financial information, but non-financial data such as environmental and social aspects also matter. Transparent companies perform better over time, have lower financing costs, attract and retain talented employees, and are ultimately more successful.[138]

Investors are more and more interested in non-financial information in order to have a comprehensive understanding of a company's development, performance, position and impact of its activity. They thoroughly analyse this information in their investment-decision process. In this context, investment includes M&A.

## *Conclusion: By Enacting about CSR, States Might Influence M&A*

To conclude, what can we remember of this study? To put it simply:

1. Everyone wants to pursue M&A but nobody seems to realise that it is resource-consuming (and that it will be probably a failure);
2. The ways corporations approach an M&A pursuit are clearly incomplete and ineffective;
3. Sustainability is more than the new fad of the 21st century, it is the key to understand several M&A failures;
4. Numerous M&A disasters have been caused by the lack of consideration of sustainable issues (such as environmental, governance and social aspects);
5. Sustainability is, such as, a broad concept and no one seems to know how to make it operational from a business perspective;
6. Corporate Social Responsibility (CSR) is the implementation of sustainability in the economic reality and might be an influencer on M&A pursuits;
7. Regulations regarding CSR only focus on non-financial reporting but they could still be a driver to further CSR practices among companies.

[138] "Disclosure of non-financial and diversity information by large companies and groups - Frequently asked questions" (April 15, 2014), European Commission <http://europa.eu/rapid/press-release_MEMO-14-301_en.htm>.

To sum up, CSR practices can affect both the viability and the ultimate value of M&A deals. Greater consideration of CSR issues when evaluating potential M&A transactions may help improve the likelihood of the success of the deal as well as the speed and smoothness of the integration period.

Due to the growing importance of CSR, this concept shall probably become of the utmost importance in the future. Acquiring companies will want to know whether they are taking on sustainability problems or opportunities. Divesting organizations will be willing to know whether their CSR profile will contribute to a premium or discount price (even though this is not the case for the moment[139]).

[139] Studies reveal that a firm's choice to commit to CSR does not result in a premium from M&A investors. See Ester Chen and Ilanit Gavious *Does CSR have different value implications for different shareholders?* (July 13, 2015), Finance Research Letters 14 (2015) 29-35.

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