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Hollands glorie gaat Europees

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SUMMARY

Economic growth, be it not all of it, services public welfare. Investments are engines for economic growth. A growing number of Dutch firms feel obliged to grow by investing abroad. Although mostly European countries are at stake, corresponding investment processes soon get complex. The contribution of financial management function in the process is underscored. This research study addresses the financial management of foreign direct investment in Europe by Dutch firms. This study aims to gain knowledge of and insight in the subject just referred to. The *central research question* of this study thus reads as follows: "*How can the financial management at European investments be described and which patterns in the investment process can be discerned?*" In this respect, four sub-questions are distinguished here:

- 1) Which strategic analyses are made to assess European investments?
- 2) How does the financial investment selection at European investments occur?
- 3) What role do risk and financing aspects have in European investments?
- 4) How does the organisational behaviour look like at European investments?

The contents of this book was set up as follows. The introductory chapter resulted in the research questions. The methodology was described in chapter 2. The research strategy chosen, the case research method, was underpinned and filled in. The chapters 3, 4, 5 and 6 discussed literature on issues related to the respective sub-questions. Next, the conceptual framework was constructed in chapter 7. Chapter 8 concluded part 1 by handling with developments on Dutch foreign direct investments in Europe. The chapters 9 up until 15 constitute part 2. They described the field research executed at seven Dutch firms from 1999 up until 2001. This research concerned, as a cross-section of the Dutch trade and industry, investors experienced in Europe. A case description was made for every firm separately. Finally, part 3 followed. Firstly the results of the field study were made comparable and were analysed on aspects of the conceptual (main) model, after which in chapter 17 patterns in similarities and differences were looked for. Chapter 18 concluded with the answers to the research questions, the final model of the investment process and the recommendations to practitioners and scientists.

Methodology, theoretical background and conceptual model

The research strategy formulated in chapter 2 is characterised by a largely qualitative approach. Several quantitative surveys already partially dealt with distinctive aspects. However, qualitative research may offer deeper and broader knowledge. Case research is a suitable method then: research can be carried out real-time partly, the delineation between the research and its context may change, the number of variables may get high and information may be tapped from various sources. The case selection and a small questionnaire added a limited survey character here. A case research study can be divided into three phases. In this study's preparation phase, the problem statement was formulated and put in a conceptual framework. Also, a test case of a non-European investment was worked out. In the execution phase, seven cases were studied in various ways, largely led by personal contact with a key informant. The pre-designed conceptual model was filled in during the analysis phase. Patterns were searched for, the final model came into being and advices were formulated.

According to chapter 3, the literature deals with strategic analysis of foreign direct investment by looking at the internationalisation of the firm. Cost differences, market powers, or combinations of both (including organisational behaviour aspects) can explain the developments. A market entry and expansion strategy as well as a country portfolio strategy can be distinguished here. Investment motives may have strategic, financial, commercial and organisational/ behavioural virtues. This study is on market seekers. A description of research evidence supplemented the theoretical discussion. A review of four strategic schools, the design school, the planning school, the positioning school and the value management school revealed relevant strategic techniques. Applications on (foreign direct) investments were included too. The limited field study evidence was taken into account as well. Finally, the discussions on the development of the internationalisation of the firm and the related strategic techniques were paralleled.

The literature discussion in chapter 4 on capital investment selection distinguishes between four views: an accounting approach (postulating profit analyses), a financial planning approach (devoted to financial modelling), an economic approach (focussing on present value methods) and a shareholder value analysis (combining strategic considerations with all views just dealt with). The field research on general aspects of capital investment selection discerns both financial modelling aspects and capital investment selection methods. Aspects concerning greenfields and acquisitions can be distinguished. The literature hardly separates between the local and international capital investment selection. An impressive list of problems eventually occurring when dealing with financial modelling and capital investment selection in foreign direct investments justifies an in-depth research study in itself. Especially the issues touching upon organisational and behavioural aspects call for special mention, however:

In discussing relevant aspects of financial risk and financing of (foreign direct) investments two kinds of views were used in chapter 5: an institutional approach (focusing on rules and habits) and an economic-theoretical approach (postulating economical analyses). As to the last one, considerations from capital markets theory and the agency theory were applied. Otherwise, the theoretical discussions were especially limited to financing techniques that firms may apply when investing. Foreign and Dutch field studies were discussed as well. Besides the recognition and management of eventual financial risk, special notice was given to its incorporation in the capital investment selection. As to the financing, the attention remained of a more general nature. Investors include those aspects in, among others, financial plans, cash flows, solvency ratio's and stock exchange multiples. The APV method called to mention has met little response in Dutch firms as of yet.

Interest in the extent to which decisions are well-considered, leads to a distinction between organisational and behavioural aspects of investing in chapter 6. Organisation is about facts: who does what and how. A link to (investment) control concepts can be laid. Budgeting and reporting aspects of investments are thus of importance. The phasing of activities during the process, the labour of different kinds of internal and external officers and the division of responsibilities when investing deserves attention as well. The second "soft" aspect discussed relates to the behaviour of investors: why do

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they carry out something or else leave it undone. A number of aspects can shed light upon the rationality of the decision-making process. In continuity with the chapters 3 to 6, the conceptual framework of this study was developed in chapter 7.

According to chapter 8, Dutch European investments especially occur in the EU. Its common market, policies on growth, free markets and competitiveness and large influence in Central and Southeast Europe were described. Harmonisation of financial reporting and disclosure eases the capital investment selection. The advent of the euro lessens the importance of financial risk management. Liberalisation and deregulation of European banking is important when financing. Local competition is fuelled by a harmonisation of corporate law, preventive supervision on concentration and decreasing fiscal competition. The Dutch foreign direct investments in European countries do not follow exceptional trends. Mergers and acquisitions, peaking in 2000, have had a larger volume than greenfields. At a European level, a restructuring was put in place in several sectors. In the changing and growing Europe, industries attractive to Dutch investors can be discerned. The cases studied were reasonably spread over these sectors and concern various European countries. The firms strive for European market development, attach ample value to financial considerations and have made at least three European investments from 1995 up until 2000.

The seven cases studied

Royal Numico provided the first case. The acquisition of the Milupa activities, which enlarged the then Nutricia in 1995 by about two thirds, marked the development of Numico to a large European player in baby food. A few striking elements of this investment include:

- 1) The large size of the acquisition, safeguarding the continuity of Nutricia,
- 2) the importance attached to economic-technical explorations,
- 3) a painstaking financial modelling, resulting in the financial selection,
- 4) the enthusiasm and speed at which informally, taking into account clear-cut responsibilities, the acquisition was worked on effectively and
- 5) the strive towards good mutual communication, especially with Milupa.

Also, it is remarkable that cultural factors are repeatedly referred to at Numico. The cultural differences with the "detached" Germans were large and proved to be partially insurmountable. At an operational level, there were no large problems, though.

The temporal work firm Randstad undertakes both greenfields and acquisitions. Although the discussions at the site where largely done in broad terms, the case itself mostly refers to the set up of offices in Italy as from 1999 on and a large acquisition (Time Power) in Germany in 1999. Some notable issues include:

- 1) Randstad's self-chosen guide function and market directed strategic choices,
- 2) a clear preference for greenfields over acquisitions,
- 3) standardised financial modelling, grounded in value management principles,
- 4) especially at greenfields the financial valuation is, more than at a correct valuation, devoted towards the mapping of eventual risks, as well as
- 5) the open communication and willingness to learn from mistakes in the past.

It is also remarkable to Randstad's approach that much weight was given to a good strategic market analysis.

NNZ Beheer took over the grocery firm Kreuz in 1997. It is still the largest acquisition by the firm. It concerned a country and a firm that the NNZ Group had already been conversant with. Also, a small acquisition in Italy and a mid-sized one in Austria (with a Hungarian subsidiary) were described. Some interesting issues here are:

- 1) the clear-cut strategic choices and multiple strategic analyses,
- 2) the financial modelling provides profits and cash flows, but expected present values are preferably not determined, however,
- 3) a planned large acquisition in Germany brings about a reconsideration and later a restructuring of the financing of the whole Group,
- 4) an accent on assembling information, thereby using third-party knowledge and
- 5) a personal approach of acquisitions by the board of NNZ.

As to differing views between NNZ and its merger partners, the firm refers to objective factors, such as the volume of the firm and the local regulation.

Royal Boskalis Westminster bought the mid-sized Swedish dredging firm Skanska Dredging in 2000. Thus, a new home country was added to the activities of the firm. Some characteristics of the case description worthwhile mentioning are:

- 1) the concept of home markets, enabling efficiencies of scale and stability,
- 2) a per case and user specified, multiple and uncomplicated, "going concern" or "break up" financial valuation of acquisitions,
- 3) the sometimes forsaking of present values techniques to prevent overpaying,
- 4) an accent on hedging financial risks of take-overs by virtue of guarantees and
- 5) the weight given to a proper structuring and controlling of the acquisition process and the conversations (without fear for the negotiation game).

Boskalis extends its leading position in the global dredging market evermore. The firm does not feel to have reached its optimal size yet: there are still opportunities for growth in the still closed part of the global market.

At Bollegraaf Beheer Appingedam (a producer of sorting systems) especially the build up of a base in Spain as from 1999 onwards came to the fore. The new subsidiary has a lot of unique characteristics, but otherwise resembles the other ones in Europe. Striking elements of this foreign direct investment include:

- 1) the belief attached to the market potential of Bollegraaf systems,
- 2) the weight given to enthusiast entrepreneurship and manoeuvrability,
- 3) the clear goals, but informal sales/cost/profit/liquidity planning, of a new unit,
- 4) the standardised, risk limiting, structuring of the investment (the manager gets a large share and several contracts are closed) and
- 5) the attention given to financing aspects in a broad sense (watching out for abrupt liquidity changes and looking sharply at relationships with banks).

Bollegraaf's priority on internationalisation is further evidenced by the large maps in the hall at the headquarters in Appingedam. For important countries it is marked where activities have been carried out or are being undertaken.

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Drie Mollen Holding took over the Swiss coffee roaster Rost in 2000. This purchase fits well into the pattern of regularly acquisitions by the Group. Striking issues include:

- 1) the links between strategy, control philosophy and operational activities,
- 2) a willingness to get to the bottom of the financial value of acquisitions,
- 3) a deepening out of financial modelling and selection techniques per case,
- 4) a strive to understand financial risks and handle their hedging per case and
- 5) an emphasis on managing take-overs via business plans that the local management stands for, including regular strategic controls.

Drie Mollen has grown to be Europe's largest private label coffee roaster. It wants to be viewed as a firm encompassing several separate local units. In its business dealing with cultural differences has to do with a local style of management.

The Nutreco Group, in 1994 spun-off from British Petroleum (but with a long history of several of its units), made several European acquisitions in 2000. A few important characteristics from the case description include:

- 1) an explicit corporate strive for growth necessitating acquisitions,
- 2) a combination of an emphasis on strategic fit and a requirement to underpin this with consequent and thorough financial-administrative modelling,
- 3) the preference for the net present value method in investment selection,
- 4) both business and country risks are specified financially and
- 5) a structured approach of the take-over process with acquisition teams, whereby the proposers are held accountable for the results afterwards.

Partly because of takeovers looked at in this last case, Nutreco grew to be an important European (or even global) player in the food production chain of fish, poultry and pork.

Results, analysis, conclusions and recommendations

In order to attain reliable conclusions and recommendations that matter, the cases were in chapter 16 firstly compared on characteristics of the relevant environment and the own firm. The comparison continued on the aspects of the model: strategic analysis, financial analysis, risk and financing, as well as organisation and behaviour. The comparisons normally revealed two or three sub-aspects per variable modelled. Several rigorous observations could be drawn:

- 1) corporate and environment characteristics influence the way of investing,
- 2) in testing an investment, financial value creation is postulated,
- 3) financial modelling precedes the financial investment selection,
- 4) when testing and thereafter, financing aspects may get a distinct place,
- 5) strategic and organisational aspects frame the valuation of an investment,
- 6) risk and behaviour aspects often do not play an independent role in the process,
- 7) before investing, the internationalisation of the firm is largely fixed and
- 8) aspects of culture and communication are made explicit while investing.

In searching for patterns in the European investments studied, according to chapter 17 the similarities and differences between the cases can be traced to six factors:

- 1) market entry and expansion strategies (greenfields vis-à-vis acquisitions),
- 2) the size of the investor (small, mid-size, or large),

- 3) the size of the investment (also: small, mid-size, or large),
- 4) the corporate governance style (Continental European or Anglo-Saxon),
- 5) the management of culture and communication (professional or loose), as well as
- 6) the assimilation of regional differences (implicit versus explicit).

Other than being true for the first four factors discerned, the characteristics of the last two factors were not explicitly studied. The subdivisions made here are therefore especially meant to help the cultivation of thought. The first three factors prove to have more explanatory power than the latter three.

There are more than forty similarities between the seven cases. As to a small number of variables of the conceptual model no similarities worth mentioning were found, while as to a few other variables even several characteristics of the same tenor were encountered. Some ten similarities were on corporate and environment characteristics, which may point at the high homogeneity of the population studied. The firms are over 40 years old. Being multinationals, they are not transnationals, though. They are leading in the market and co-determine the technology. They put growth and results first and foremost. This leads to prioritising internationalisation and a strive towards top positions. The central organisation governs some ten subgroups. In the population, the financial function has a central position next to others.

As to content aspects (strategic analysis, financial investment analysis, as well as risk and financing), there are several similarities. The firms carry out both greenfields and acquisitions in Europe. In principle, they build up their country portfolios concentrically. Investment motives are foremost commercial whereby there is an accent on synergy. In the checklists employed, strategic techniques are assimilated. Profits and cash flows are normalised and localised. Discount rates are smoothened, but specified per country. More than one accounting method is used. Present value methods are not common. A rise of business risks is evaded. Currency risks are hardly felt. Operational risks are acceptable. Local financing puts the translation risks down. Countries with political risks that are too high are evaded. Financial structures are determined by traditional measures, influenced by banks. Financing is done with own and banking money. Liabilities are settled according to local customs. Legally permitted structures are employed. The fiscal potential is used properly.

There are many similarities on contextual aspects (organisation and behaviour, including culture and communication). The own management control system is introduced quickly and uniformly. An investment occurs in three phases: idea, design and execution. The financial management is done by the own financial and other officers, mutually sparring and with help from external accountants and lawyers. The firm directs itself. Proposers are held accountable. Financial core competencies should be available in the own house. The financial function has a secondary role. When investing, the best for the firm is strived for. Decent manners are combined with trade spirit. Division, co-ordination and agreement bring about solutions to problems. When investing, rationality and sense go alongside. Sympathising interaction and imaginative linguistic usage fit when internally and externally going into a trajectory. Limited risks are accepted. Time pressures are hardly felt. Information shortages are covered. Information creates confidence. Investors

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While almost all similarities traced held universally, this was untrue for the fifty differences found. About half of these deserves a listing here. None of these concerns the strategic analysis. As to the financial investment, differences concern the depth and breadth of the modelling (eventually along a financial value management framework), the calculation and weighting of financial sensitivities, the handling of forecast periods and terminal values, the adapting of cash flows and discount rates, the number of selection methods used, the importance of accounting methods respectively discount methods and the eventual binding role of discount methods. Risk and financing aspects differ as to the significance attached to risks, the hedging of currency risks, the negatively or positively sensing of political risks, the financing by (deferred loans or) new shares, the developing of a legal structure, as well as the fiscal treatment.

A number of the differences encountered have to do with aspects of organisation and behaviour (including culture and communication). As to organisation, these are about structuring of the phasing of the investment, the overall division of responsibilities, the involvement of the board of directors in the process, the role of the chairman in financial management, the presence of specific M&A officers and the outsourcing of the data collection to external specialists. Differences in behaviour concern the accuracy of mental frames of investments, the initiative taken to forward the process and the style of negotiating away controversial issues.

The closing balance of this study was made up in chapter 18 by virtue of conclusions and recommendations. Firstly, the research questions posed were answered, by pointing at the similarities and differences mentioned above, as to the strategic analysis, the capital investment selection, the risk and financing, as well as the organisational behaviour. In order to satisfy the goal of gaining knowledge and insight, starting from seven propositions, an integrated model of European investments was written. The model phases aspects on organisation, strategy and finance to be passed through during the process. The general management in the "pre-phase" provides the framework for an investment to happen. Following, four phases concern the broad exploration, the assembling of data, the selection out of available alternatives, as well as the final implementation, respectively.

Extending the lines drawn in the final conclusions, various recommendations were given. The financial management at European investments already starts when making choices on the internationalisation of the firm. Strategic assessments with checklists should be imbued with a financial management perspective. Financial modelling is about the deepening of this assessment in terms of financial value creation. A fitting usage of several selection methods, not necessarily the most difficult by the way, fosters a multiform financial assessment. Risks that cannot be eliminated should be taken care of, as well as the effects of the financial structuring chosen. A solid organisation of the investment, as well as a (fitting) feeling and a (hard working) mind, should enable this. The scientific underpinning of this value management approach is not sufficiently coherent, multiform and process oriented yet. Therefore the scientific literature has got to be expanded. A multidisciplinary and interdisciplinary approach is required here.