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NEGOTIATED ACQUISITIONS OF SHARES AND ASSETS IN MEXICO: COMMON PITFALLS AND HOW TO AVOID THEM

PABLO RIÓN*

I will focus on problems in transactions and situations where mergers and acquisitions fall apart, rather than on the law that governs them. Mergers and acquisitions in Mexico can fail for a variety of reasons. To understand why some mergers succeed while others fail, it is important to understand how Mexico's economic and political cultures differ from the United States. By looking at recent examples of mergers and acquisitions, I will explain how to avoid the common problems that hinder mergers and acquisitions in Mexico.

MACROECONOMIC AND POLITICAL INFORMATION ABOUT MEXICO

Mexico has a population of 104 million people and a gross domestic product of U.S. $6,300 per person. The Mexican economy is finally growing after three slow years following the beginning of President Vicente Fox's term. Inflation and interest rates are under control. For about the last five years Mexico's foreign debt has been classified as investment grade, which has helped Mexico capture foreign investment in Mexican debt.[1]

In Mexico there are approximately 13 million people saving for retirement every month, which is something Mexico has never seen before. Starting in 1993 private pension funds began growing very fast. Each person who is a registered worker has a portion of his or her salary saved. This form of savings is done through private financial companies called "*afores*" that invest pension funds for the long term (regulations limit the amount that is invested in fixed income securities and equities). Mexico has a tremendous amount of money available for long-term investment. This has led to a boom in the financing of low-income and middle-income housing. Construction of low-income housing is at a record pace. Likewise, foreign direct investment has been increasing and is around U.S. $16 billion per year.[2] Furthermore, the Central Bank is independent from the government and has

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1. Investment grade is a select financial classification given by Moody's Investor Service. Mexico achieved this status on March 7, 2000. Being investment grade allows Mexican businesses to have to have greater access to foreign capital at lower financing costs. *See* http://www.shcp.gob.mx/english/docs/pr000308.html (last visited Apr. 24, 2005).

2. *World Watch: The Americas: Foreign Direct Investment in Mexico Jumps 46%*, Wall St. J. (USA), Feb. 22, 2005, A12.

been very disciplined. All of these factors make the future of the Mexican economy bright.

Recently, *Urbi*, *Homex* and *Sare* (three low-income housing construction companies) executed an Initial Public Offering to list their shares on the Mexican Stock Exchange. The response of the market by domestic and foreign investors was very positive, with oversubscription of all three equity issues. Two other low-income housing construction corporations, GEO and ARA, listed their shares three to five years ago, and have produced excellent returns for investors.

Government Institutions and Democracy

Since President Fox was elected in 2000, democracy in Mexico is no longer controlled solely by the *Partido Revolucionario Institucional* (PRI).[3] But this has also led to the problem with the current political situation in Mexico; there are three contentious political parties who cannot agree on legislation. To complicate the matter, a constitutional change in Mexico needs a 66% approval vote in Congress, which is practically impossible to achieve.[4] People are wondering if the situation would be better with a very strong President as in the old days. In the past, Mexican politics allowed some extremely powerful Presidents and their corrupt supporters to take advantage of the system. Now that we have a transparent and open system, it is more difficult for decisions to be made.

Although no one knows how the elections will go in 2006, there will be movement in Mexican politics. In the past, people would vote for a President from one party and a Congress from the other party, so the Congress could keep tabs on the President. Mexican society is recognizing that it does not always work this way. Mexico needs a government that can make decisions and take action.

DEMOGRAPHIC PREMIUM

The population in Mexico is in a state of demographic premium.[5] This will have and is having beneficial impact on the Mexican economy. The demographic situation in Mexico is very similar to what happened in the U.S. during the "baby boom" in the late 1940's and early 1950's. Soldiers returned home from World War II and a population boom followed. A similar group was born in Mexico in the 1970's. Currently the population growth rate in Mexico is 1.2% per year, while in the 1970's the population was growing at 3.3%. In the 1970's women had six to seven children, while they now have only two. Therefore, Mexico does not need more investment in additional kindergartens or hospitals for kids. Instead, what Mexico now needs is more universities and employment opportunities.

Despite any problems in the government, the Mexican economy is growing. Sales of houses, cars and clothing are seeing large increases. The next thirty years are going to be very impressive. People are consuming, which makes it a good time to

3. The Institutional Revolutionary Party (PRI) was Mexico's ruling party for approximately seventy-one years. Further information about the PRI is available at its official website *at* http://www.pri.org.mx/ (last visited Apr. 24, 2005).

4. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS tit. VIII, art. 135.

5. Population pyramids for the years 2000 and 2025 show how the average age of Mexico's population will be increasing. U.S. Census Bureau, International Database Summary Demographic Data For Mexico, *available at* http://www.census.gov/cgi-bin/ipc/idbsum?cty=MX (last visited Apr. 24, 2005).

invest in Mexico. Mexico will have very good years, similar to what the United States had from the 1960's to the 1990's. The population group from thirty to sixty years old, which is about 22 to 25 million people, is going to grow older and mature.[6] This will have a correlative and positive effect on the Mexican economy because all of these people are in the age group that produces, saves and consumes.

MERGERS AND ACQUISITIONS

Organic Growth and Business Alliances

A company has choices in the way it plans its growth. It may grow organically or through business alliances. Companies grow organically when they invest in their own business and develop with their own internally generated funds, rather than buying a third-party company or making an alliance to have a different distribution channel. The organic growth strategy is less risky because the business already knows what it is doing so the strategy represents "more of the same." However, organic growth is much slower and takes more time to produce results.

Instead of organic growth, the trend is now toward long-term business alliances. This type of contract is rather complicated to enter into and has its own drawbacks. One of the potential drawbacks is that the sharing of confidential information will tempt one company to take the other company's people, customers or technology. Because of this risk, more and more business alliances between companies in the same industry are breaking down. Businesses are starting to learn that alliances cannot be created with competitors. For example, the alliance between Dell Computers and Hewlett Packard went sour when Dell began selling printers, which is the number one product of HP.[7] More successful alliances are formed when one company specializes in distribution and the other specializes in production or warehousing because fewer conflicts of interest result.

Mergers

Within a year of a merger, the absorbed company (the minority party) commonly suffers layoffs of up to 80% of its people. Layoffs are normally very bad news; the larger company enters the merger because of the capacity and talent of the same people who are laid off. Because of this, the new company (the acquirer) has to protect the most valuable employees. A good way to do this is to promote these employees as department heads, because if the valuable employees from the smaller company leave, then the talent and knowledge that made the company worth buying in the first place leave with them.

Acquisitions

In acquisitions it is clearer which company has the upper hand. When I advise my customers in the middle market, I never advise them to do acquisitions of 51% to 49%. When there is no clear majority party, nobody feels responsible for anything that may fail or go wrong. Major problems can arise because of this uncertainty.

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6. *Id.*

7. Sridhar Hamur, *HP Ends Dell Deal—No More Printers from HP; Dell to Find Other Sources*, HP World vol. 5, *available at* http://www.interex.org/hpworldnews/hpw209/news1.jsp (last visited Apr. 24, 2005).

Personally, I recommend acquisitions of 80% to 20% because when something does go wrong, the majority shareholder has to put up the money to remedy the problem—this is especially true with foreign companies. When a problem arises, the company with the minority percentage can rely on its partners, who have the money and responsibility to fix it. If there is a partnership of 51% to 49%, it is not always clear who is responsible for fixing problems. The minority party will oftentimes remain silent (which can cause even more problems), and eventually cause the company to die.

Franchises

The popularity of franchises is declining in Mexico. The old franchise contracts would normally outline with specificity all details of the business and the owner of the franchise would learn how to do everything according to the model created by franchise headquarters. When this system failed, for whatever reason, a lot of franchises had legal problems with the parent corporation (the franchisor) due to contracts that required a standard approach. Because of resulting litigation, companies are now entering into license agreements for businesses instead of the standard franchise contracts. In Mexico, certain business licenses allow owners of the franchises more freedom from the parent company. This has come about because the parent company of the franchise was not concerned about the privately owned franchises. The company would give the franchisees the manual, a one-month management course, and send them on their way.

In particular, the big franchises such as McDonald's or Burger King have not been very successful in Mexico. When McDonald's started going to Mexico, there were 5,500 McDonald's in the United States where there was a population of approximately 250 million people. In Mexico, there were 90 million people, so the corporate headquarters reasoned they could easily open 1,000 McDonald's in Mexico in a relatively short period of time. After being in Mexico for fifteen years, McDonald's has approximately 300 restaurants rather than 1,000.[8] This is due to the inherent market and cultural differences between the United States and Mexico. It is important to remember the size of the market and the local preferences in Mexico. When McDonald's opened its 100th franchise in Mexico, it was ready to close two or three of the franchises because they were bankrupt, but it still kept them open to maintain an image of success in Mexico. This is partially due to eating preferences in Mexico. Not surprisingly, Mexicans eat Mexican food, not American food, and they are aware of the health dangers of fast food, which has fewer vegetables and more fat than Mexican food.

The other factor to consider is the purchasing power of the Mexican population. The per capita income of the United States is around U.S. $40,000 per year,[9] and in Mexico it is U.S. $9,600.[10] The population that can purchase goods such as cars or

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8. McDonald's corporate website states that there are 304 McDonald's in Mexico. For more information see http://www.mcdonalds.com.mx/ (last visited Apr. 24, 2005).

9. For more information regarding the United States' economic and political landscape, see the Central Intelligence Agency's Factbook, *available at* http://www.cia.gov/cia/publications/factbook/geos/us.html (last visited Apr. 24, 2005).

10. For more information regarding Mexico's economic and political landscape, see the Central Intelligence Agency's Factbook website, *available at* http://www.cia.gov/cia/publications/factbook/geos/mx.html (last visited Apr. 24, 2005).

cruises accounts for not more than 4% of the Mexican population, and therefore the market for expensive goods is small. Mexico's larger market is for products intended for poor people (what consumer studies refer to as classes C and D).

MERGERS AND ACQUISITIONS IN MEXICO

Our firm has a newsletter that we issue every two months in which we list the significant transactions taking place in Mexico.[11] In the newsletter there are examples of recent developments in Mexican mergers and acquisitions. The buyers are mainly U.S. companies, although some are European. In particular, Spanish companies have been investing heavily in Mexico in the last few years, especially in banking, telecommunications and infrastructure.

In general, there are no more than twenty transactions exceeding U.S. $50 million in Mexico in any year. Our firm receives requests from U.S. companies that want to buy a company of a certain size—normally one that has more than U.S. $50 million in annual sales, national presence, coverage, brand names, talented people, and technology. Unfortunately, the only companies in Mexico that meet these qualifications are already owned by American or other foreign corporations. This is because when a Mexican company reaches U.S. $20 to $25 million in annual sales, a foreign company comes in and buys it out. Nestlé buys four or five such companies a year.[12] However, there are very solid Mexican companies with sales from U.S. $10 to $20 million a year in certain niche markets that could be bought and could help a foreign investor acquire a platform to develop its business in Mexico. Rather than looking for large companies to buy, a better approach is to purchase small to mid-size companies and develop them, because they have the talent and ability to grow even faster than the large companies.

EXAMPLES OF RECENT MEXICAN MERGERS AND ACQUISITIONS

Coca-Cola-Femsa[13]

An interesting acquisition that occurred recently involved Coca-Cola-Femsa and Panamco. Coca-Cola-Femsa is based in Monterrey, Mexico and is the second largest Coca-Cola bottler in the world after Coca-Cola, U.S.A. An interesting fact is that people drink more Coca-Cola per capita in Monterrey than in any other place in the world. People in Monterrey drink an average of five Coca-Colas a day.

When Coca-Cola-Femsa bought Panamco, a public company that had accrued U.S. $3.6 billion in debt, there were numerous problems.[14] Panamco was acquired like a private equity company, with the goal of quickly merging the companies. Everything looked fine but there was a lack of in-depth due diligence in the

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11. For more information about Pablo Rión y Asociados, see http://www.pablorion.com/ (last visited Apr. 24, 2005).

12. For more information about Nestle's business activities in Mexico, see http://www.nestle.com.mx/ (last visited Apr. 24, 2005).

13. For more information about Coca-Cola Femsa, see http://www.coca-colafemsa.com/kof/ (last visited Apr. 24, 2005).

14. Elizabeth Malkin, *Latin American Coca-Cola Bottlers in Giant Merger*, N.Y. Times, Dec. 24, 2002, at W1.

acquisition. Internally, Panamco was a mess due to accounting and production problems. Coca-Cola had to fire half of the management in order to protect its solid reputation with the Coca-Cola shareholders. Coca-Cola-Femsa has good analysts and public relations people but they did not look at the actual day-to-day functioning of Panamco's production plants. Despite the problems, it should turn out to be a beneficial acquisition due to the market leverage Coca-Cola-Femsa obtained through the acquisition. And there is always the option of selling part of the beer division to then capitalize the debt incurred to finance Panamco. The beer division is comprised of the *Tecate*, *Dos XX*, *Sol*, *Superior*, *Indio* and other well-known brands.

Grupo Carso[15]

A typical acquirer of companies has been the holding company *Grupo Carso*, controlled by Mr. Carlos Slim. *Grupo Carso* has very bright and capable management and Mr. Slim himself is a very bright man. One of the reasons Mr. Slim is so successful is because he knows when to buy; his timing is impeccable. He buys companies cheap and then works with the real estate and other management aspects of the companies to make them succeed. An example of this occurred in his dealings with Sears in Mexico. Instead of buying Sears outright, he bought the five shopping centers that Sears owned—all of which had much more value than Sears itself. *Carso* then negotiated a separate transaction to keep the Sears brand for several years.

Another reason for *Grupo Carso's* success is that Mr. Slim always buys companies that have a synergy with his other businesses. This was evident in *Grupo Carso's* acquisition of *Telmex*, the largest phone company in Mexico.[16] It has had very tough competition but continues to be the best company in Mexico and is growing in South America through *América Móvil*, which buys local cellular phone companies. *Telmex* put together a holding company for cellular phones and has bought cellular companies in Central America, Argentina, and Brazil. *Telmex* was a good acquisition because Mr. Slim acquired a bright and impressive company focused on synergy, savings, and cost reductions. However, there is a general hope that *Telmex* will not grow too big because Mexican customers need competitors to *Telmex*, which controls more than 85% of the fixed-line market and more than 75% of the cellular market.

Grupo Salinas[17]

Grupo Salinas, led by Mr. Ricardo Salinas, is another group that has been growing recently. One of the holdings of *Grupo Salinas* is *Grupo Elektra*,[18] a retailer with almost 800 stores that sells durable goods to the low-income market. It has a successful program of providing expensive credit to low-income people. *Grupo*

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15. For more information about *Grupo Carso*, see http://www.gcarso.com.mx/ (last visited Apr. 24, 2005).
16. For more information about *Telmex*, see http://www.telmex.com.mx/explorer/home.html (last visited Apr. 24, 2005).
17. For more information about *Grupo Salinas*, see http://www.gruposalinas.com (last visited Apr. 24, 2005).
18. For more information about *Grupo Elektra*, see http://www.grupoelektra.com.mx/elektra/English/default.asp (last visited May 23, 2005).

Elektra operates a bank (*Banco Azteca*) from within its stores, which makes loans to its low-income customers.

Another holding of *Grupo Salinas* is *Televisión Azteca*.[19] Recently, Mr. Salinas bought the Vodaphone/Verizon cellular telephone subsidiary in Mexico called *Iusacell*. The company had U.S. $800 million in debt and he bought the debt at a deep discount for U.S. $8 million. Salinas has no expertise in this telecommunications market and is focusing the company on the business sector. What Mr. Salinas is doing is using *Televisión Azteca* to advertise his two telephone companies, *Iusacell* and *Unefon*[20] (that he cannot merge because he has another major partner in *Unefon*). But Mr. Salinas is very aggressive and in the past he has made mistakes by not being very transparent in his dealings. Because of this, the Securities Exchange Commission (SEC) is watching him closely.[21] The SEC is already looking into Salinas' purchase of *Unefon* debt at a discount since there was no benefit to all the small investors of *Televisión Azteca* or *Unefon* (*Unefon* is listed on the Mexican Stock Market).

Desarrollo Económico Sociedad Civil[22]

A very large Mexican conglomerate that manages people well is *Desarrollo Económico Sociedad Civil* (DESC). DESC was a diversified company that prospered in the 1960's and 1970's and even into the 1980's when the peso was devalued. Back then diversified companies could compete well with companies that were specialized in their same business sectors. However, things have not been going as well for DESC since the 1990's. It sold its chemical division to reduce expenses and recently Mr. Slim stepped in and invested around U.S. $9 million to capitalize DESC. Mr. Slim brought his turn-around experts to DESC to fire people and reduce expenses. Apparently, since Mr. Slim's involvement DESC is making a come-back. In general, large groups from the 1970's and 1980's such as DESC are starting to concentrate solely on the markets where they can be competitive, relevant players. With globalization, a company cannot compete in several sectors like it did in the past. At most, in order to succeed in today's business world a business must be strong in two or three sectors. DESC is now concentrating mainly on real estate, food, and automotive parts.

Cydsa[23]

Cydsa is a conglomerate based in Monterrey, Mexico, which specializes in chemicals, textiles and packaging. *Cydsa* had gone into debt due to mistakes made by poor management. A group called Fintech Advisory recently acquired *Cydsa*. Fintech Advisory is led by a Mexican investor who resides in New York named

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19. For more information about *Televisión Azteca*, see http://www.tvazteca.com.mx/ (last visited Apr. 24, 2005).

20. For more information about *Unefon*, see http://www.unefon.com.mx/site/content/nav/index.jsp (last visited Apr. 24, 2005).

21. Press Release, Securities and Exchange Commission, SEC Charges TV Azteca And Its Chairman—Ricardo Salinas Pliego—with Fraudulent Scheme to Conceal Salinas' $109 Million Windfall Through Related Party Transactions (Jan. 4, 2005), *available at* http://www.sec.gov/news/press/2005-1.htm (last visited Apr. 24, 2005).

22. For more information about the Economic Development Civil Society (DESC), see http://www.desc.com.mx (last visited Apr. 24, 2005).

23. For more information about *Cydsa*, see http://www.cydsa.com/Ingles/ (last visited Apr. 24, 2005).

David Martínez. Mr. Martínez specializes in acquiring junk bonds. He bought the debt of *Cydsa* at a very low price in exchange for 60% of its equity. When, some years ago, *Cydsa* acquired *San Marcos*,[24] a company that makes bed covers, problems arose when the sellers later competed with *Cydsa*. This occurred because *Cydsa* did not include a non-compete clause in the purchase agreement. Management from *San Marcos* then started a new company two blocks away from where they used to operate, which obviously hurt *Cydsa's* new business. Most likely, *Cydsa* will have to reduce a lot of its businesses to be more efficient. I expect that David Martínez will make *Cydsa* a leaner and meaner company.

TYPICAL MERGERS AND ACQUISITIONS PITFALLS

Even though there are differences between conducting business in Mexico and the United States, the problems that typically occur in mergers and acquisitions in Mexico are similar to the problems with mergers and acquisitions in any other country.

Pitfalls Before the Merger/Acquisition Is Finalized

One problem that typically occurs is overpaying for a company. This can be avoided if the acquiring company does its homework in order to know what price to pay. Additionally, the bidding process puts the parties under a lot of pressure to negotiate the best deal, often in a very short amount of time. If the bidding process falls apart it may still be possible to negotiate one-on-one to complete the deal. To know what price to pay before closing on a purchase, due diligence is critical. It is also important to consult with lawyers in advance, before progressing very far in the negotiations, in order to ensure the company is not facing any major legal problems. However, consulting with lawyers can be counterproductive. Many times a deal will fall apart due to the concerns raised by the lawyers before all the key issues are brought to light. Local advisors can be helpful in this situation because they know more about the business than simply the numbers found in the business records; they can check local and sector references.

Finally, a company that has structural problems should never be purchased. A structural problem is the wrong product, market, marketing position, or inadequate or obsolete technology. Structural problems, no matter what others may say, are hard to fix. It is easy to fix a large debt because it can be paid. Lack of working capital can be remedied by having money put into the company. However, changing the structure of a company by replacing an old product with a new product is very difficult. A lot of people think they are magicians and can fix structural problems, but if a company has structural problems common business sense tells a buyer to beware or to buy very cheap to have the opportunity to invest enough in the turnaround. If structural problems are discovered, the buyer should redirect his efforts elsewhere.

24. *Id.*

Pitfalls After the Merger/Acquisition Is Finalized

After an acquisition, it is possible that many of the customers who were close to the previous owners might leave. To avoid this, a buyer has to know precisely where the profits come from, who generates the profits, and if those customers are going to stay in the future. This problem arose when *Satmex*[25] was purchased. *Satmex* was in bad shape after the buyout because its most profitable client, *Televisa*,[26] discontinued doing business with *Satmex* six months later, which was clear from the beginning. *Televisa* comprised more than 35% of the sales of *Satmex*, but there was only a six-month contract between the two companies. At the end of that contract, *Televisa* took its business elsewhere, and the buyers (Mr. Sergio Autrey and other foreign investors who had overpaid to begin with) lost their shirt.

Likewise, the purchasing company needs the key management from the new company to stay. This is essential to a successful acquisition. This can be achieved by giving the key management two-year or three-year bonuses, confirming their position in the company or by letting them know that they will be promoted. These transition periods are difficult because the purchasing company cannot bring its own management to a company that was working well. To complicate matters, the work force is not necessarily protected. Because labor contracts are complicated, employers rely on outsourced employees, similar to Manpower[27] in the United States, who can be fired at will. There is a need for labor reform in Mexico because this situation is proliferating in our country, yet labor reform is nowhere in sight. Employees are losing their rights and the government is doing nothing. While the government is sleeping, things are only getting worse.

Integration of employees from different cultures, especially American and Mexican cultures, is another classic problem. Wal-Mart[28] dealt with this problem when it came to Mexico. Wal-Mart bought 50% of *Aurrerán*, which included *Bodega Aurrera*,[29] a very successful, market-leader company owned by the Arango family.[30] Wal-Mart brought management personnel who did not have a good understanding of how *Aurrera* functioned in Mexico. To prevent the situation from causing problems, Mr. Manuel Arango proposed that Wal-Mart allow the Mexican management of *Bodega Aurrera* to continue to manage the stores. The deal was that if after five years *Bodega Aurrera* was more profitable then Wal-Mart in Mexico, Wal-Mart would pay more to purchase the company.

Five years after the proposal, *Bodega Aurrera* was more profitable then the Wal-Mart stores in Mexico. Mr. Sam Walton, after seeing the success of *Bodega Aurrera* under Mexican management, continued to have Mexican managers run *Bodega Aurrera*. This cultural integration between the corporate officers in the United States

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25. For more information about *Satmex*, see http://www.satmex.com/english/ (last visited Apr. 24, 2005).

26. For more information about *Televisa*, see http://www.esmas.com/televisahome/ (last visited Apr. 24, 2005).

27. For more information about Manpower, see http://www.manpower.com/mpcom/index.jsp (last visited Apr. 24, 2005).

28. For more information about Wal-mart, see http:// www.walmart.com (last visited Apr. 24, 2005).

29. Fore more information about the *Bodega Aurrera* division of Wal-Mart, see http://www.walmartmexico .com.mx/negbodega.html (last visited Apr. 24, 2005).

30. Patricia Ramos, *Los Dueños de América Latina II*, PODER, *available at* http://www.revistapoder.com/ NR/exeres/A9F22914-C048-407C-8E79-77586755289E.htm (describing the Arango family's rise to success and business relationship with Wal-Mart) (last visited Apr. 24, 2005).

and the store managers in Mexico has made the partnership between Wal-Mart and *Bodega Aurrera* profitable for all parties.[31]

In contrast to the integration of U.S. management with Mexican management, the dealings with the Spanish have been quite different. When the Spanish took over one of the largest Mexican banks, *Bancomer*,[32] they fired the Mexican managers and replaced them with Spaniards. The Spaniards' tendency to work until ten or eleven at night has made them unpopular with their employees. Yet despite some cultural integration problems, *Bancomer* has been successful for a variety of reasons under the tough Spanish management. Spanish-run banks refuse to make higher-risk loans that other banks routinely make. This strategy has worked well for *Bancomer*. It specializes in small loans, savings accounts and credit card accounts. The Spanish have done a good job with *Bancomer* by focusing on its financial status, reducing its expenses, and investing in Mexico's infrastructure projects. The bank is doing well, for the most part, due to the aggressive, hard-working and very impressive Spanish management.

LESSONS LEARNED FROM SPECIFIC MERGERS AND ACQUISITIONS

Overpaying, not engaging in full due diligence, and cultural integration issues can negatively affect mergers and acquisitions on both sides of the border. Similarly, a company that approaches a merger or acquisition aware of these potential problems has much to gain.

An example of overpaying for a company occurred when *Vitro*,[33] a Mexican glass company, purchased Anchor Glass, a U.S. glass company, more than twenty years ago.[34] Because *Vitro* wanted a presence in the United States, it paid U.S. $1 billion for Anchor Glass, which at the time was a very old and unprofitable company. *Vitro* then invested another U.S. $500 million to try to fix Anchor Glass. Ten years after the initial deal *Vitro* sold Anchor Glass to the French glass producer *Saint Gobain* for only U.S. $500 million. Because of the initial overpayment, this deal cost *Vitro* a total of U.S. $1 billion in ten years.

When the Mexican Government privatized the Mexican banks in 1991, many of the Mexican investors who purchased banks overpaid.[35] While U.S. banks such as Citibank and Bank of America were being sold at 1.5 to 2.0 times their book value, the Mexican investors paid 3.0 times the book value for Mexican banks. In an attempt to recoup some of their losses, these Mexican banks began to make a lot of loans in a short amount of time. Since the initial privatization, the situation improved until 1998-1999 due to an influx of foreign capital and foreign management. Upon the initial privatization of Mexican banks, foreigners were not allowed to invest in them; now, foreigners own at least 80% of these banks.[36] This

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31. *See supra* note 29.
32. For more information about *Bancomer*, see http://www.bancomer.com/ (last visited Apr. 24, 2005).
33. For more information about *Vitro*, see http://www.vitro.com (last visited Apr. 24, 2005).
34. Anchor Glass is now Anchor Hocking. *See* http://www.anchorhocking.com (last visited Apr. 24, 2005).
35. Numerous problems arose from the initial overpayment for Mexican banks. *See generally* Stephen Haber & Shawn Kantor, *Getting Privatization Wrong: The Mexican Banking System, 1991-2003* (Nov. 10, 2003), *available at* http://www.worldbank.org/research/projects/bank_privatization_conference/haber_kantor.pdf (last visited Apr. 24, 2005).
36. *See generally* George R.G. Clarke, Robert Cull, & Mary Shirley, *Empirical Studies of Bank*

is probably good news because of the banks' need for capital that can be provided only by foreign investors.

In contrast to these examples, *Cemex's*[37] acquisition of *Tolteca*[38] is a good story of an acquisition where overpayment was not an issue—even though it was a U.S. $600 million transaction and was double the value of *Tolteca's* book value at that time. By acquiring *Tolteca*, *Cemex* obtained an environmentally conscious company that also provided an entrance to the U.S. market through a distributor in Arizona and California. The *Tolteca* plant in Sonora allowed *Cemex* to ship to the United States and sell cement in California, the fifth largest economy in the world. This was an excellent deal for *Cemex* because 80% of its profit in those days came from sales in Mexico (the majority) and in the United States. Because of the success of this deal, *Cemex* began purchasing cement companies all over the world and is now number two or number three, after a recent acquisition of RNC, a ready-mix company in the United Kingdom.

Of course overpaying is only one potential problem. A lack of due diligence in mergers and acquisitions can wreak havoc on a deal, as exemplified by *Grupo Sidek's*[39] purchase of Mexican shipyards. *Grupo Sidek* is a tourism company that tried to enter the shipyard business by purchasing shipyards from the Mexican Government. It was a terrible mistake because shipyards in other countries, such as Korea, have the ability to manufacture lower-priced ships due to heavy subsidies from their governments. To complicate *Grupo Sidek's* problems, the employees of one of the shipyards had been on strike for over two years and another shipyard was almost broke. Because of this, *Grupo Sidek* was not competitive and had to sell the shipyards. If *Grupo Sidek* had done the proper research, it would have known about these problems before the purchase. They entered this business simply because of Mexican Government tax incentives for groups investing in fishing, shipyards and forestry in the 1980's.

For a merger or acquisition to be a success, proper due diligence is essential. Recently, a large U.S. company was buying a company that our firm, *Pablo Rión y Asociados*, was selling. For over eighteen months, the Americans requested data and analyzed the Mexican company's status. It was terribly bureaucratic but also beneficial because this due diligence showed that my customer had a lot of problems that it needed to fix.

This persistent due diligence by the Americans has allowed the Mexican company to fix the problems that were discovered. We informed the Americans that the price of the company would continue to rise (which it has) yet the Americans stayed interested and encouraged the fixes. The Americans made it clear that they would rather tell the company what to fix, have the company fix the problems, and then buy. As it turns out the deal will probably close in the next two or three months. The lesson for prospective buyers is that it is well worth the time and effort to perform

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Privatization: An Overview, Nov. 2003, *available at* http://siteresources.worldbank.org/INTFR/Resources/475459-1107978088492/ EmpiricalStudiesofBankPrivatization.pdf (last visited Apr. 24, 2005).

37. For more information about *Cemex*, see http://www.cemex.com/ (last visited Apr. 24, 2005).

38. *Cemex* now owns *Tolteca*. For more information see http://www.cemexmexico.com/ce/cpn_tol.html (last visited Apr. 24, 2005).

39. For more information about *Grupo Sidek*, see http://www.mexicobusinesscenter.com/sidek.html (last visited Apr. 24, 2005).

proper due diligence until it is understood what may be wrong with a company. In the end, if the company is really working the buyer may have to pay more but it will also have a good company.

Along with proper due diligence, consideration needs to be given to a company's strategic fit in a market. After success with acquisitions in the United States, Vodafone[40] purchased a Mexican phone company called *Iusacell*.[41] *Iusacell* was competitive in its market because of the low prices it offered. But Vodafone was interested in using *Iusacell* to compete in the same market as *Telmex*. To do this, the management from Vodafone started investing in *Iusacell* by increasing its marketing and its coverage, which raised the prices of *Iusacell's* services. This move overpriced *Iusacell* in its market, so it lost customers, thus forcing Vodafone to sell it.[42]

Despite all the possible pitfalls in mergers and acquisitions, it is very possible to succeed in this area. An example of this is Budweiser's[43] import and distribution agreement with *Grupo Modelo*.[44] Budweiser recognized that *Modelo* was the best beer distributor in sixty countries, largely due to the sales of *Corona*. Budweiser, which is a very good U.S. domestic company, worked with *Corona* to start selling Budweiser to the world. Now, everybody is winning. Mexican businessmen export Budweiser and *Grupo Modelo* benefits because Budweiser has brought more technology, lower costs, local marketing and local distribution to them.

CONCLUSION

By avoiding common pitfalls, successful mergers and acquisitions that mesh different business cultures are possible. One only has to look at the experiences of Wal-Mart and Budweiser to find success stories of mergers and acquisitions in Mexico. Investments in Mexico by private equity funds such as JP Morgan Partners Latin America[45] and Advent International[46] (which usually ask for control of the companies acquired) have added to the success stories of mergers and acquisitions in Mexico. In general, successful mergers and acquisitions are occurring, and as long as groups perform the proper due diligence, we can expect this trend to continue.

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40. For more information about Vodafone, see http://www.vodafone.com/home (last visited Apr. 24, 2005).

41. For more information about *Iusacell*, see http://www.iusacell.com.mx/ (last visited Apr. 24, 2005).

42. Noel Randewich, *Mexican Tycoon Salinas Clinches Iusacell Deal*, Reuters, July 29, 2003, *available at* http://www.silicon investor.com/readmsg.aspx?msgid=19159004 (last visited Apr. 24, 2005).

43. For more information about Budweiser, see http://www.anheuser-busch.com/ (last visited Apr. 24, 2005).

44. For more information about this business alliance, see http://www.anheuser-busch.com/overview/abiimexico.htm (last visited Apr. 24, 2005).

45. For more information about JP Morgan Partners Latin America, see http://www.jpmorgan.com/cm/cs?page name=Chase/Href&urlname=jpmorgan/jpmorganpartners/leadership/latinamerica (last visited Apr. 24, 2005).

46. For more information about Advent International, see http://www.adventinternational.com/HomePage.aspx (last visited Apr. 24, 2005).