Corporate Reputation in Mergers and Acquisitions

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Table of Contents

List of Figures 1
Abstract i
Preface i
1 Introduction 1
1.1 Background of paper 1
1.2 The Resource Based View 2
2 Theoretical background 4
2.1 Mergers and Acquisitions 4
2.1.1 Motives behind mergers and acquisitions 5
2.1.2 The merger process 5
2.1.3 Documentation in mergers and acquisitions 7
2.1.4 Merger acquisition outcome 12
2. 2 Due diligence 13
2.2.1 The content of a due diligence 14
2.3 Intangible assets 15
2.3.1 The value of intangible assets 16
2.3.2 Intangible assets and financial reporting 17
2.4 Corporate reputation 18
2.4.1 A good reputation 18
2.4.2 Reputation and goodwill 19
2.5 Corporate reputation in mergers and acquisitions 21
2.5.1 Deriving value from corporate reputation 22
2.5.2 Including corporate reputation in financial reporting 23
2.6 How to value corporate reputation 24
2.6.1 Valuation approaches 24
2.6.2 Valuing intangible assets/corporate reputation in mergers and acquisitions 25
2.6.3 Valuation method 28
3 Problem statement and research questions 31
3.1 Research questions and framework for dissertation 31
4 Methodology 33
4.1 Research design 33
4.2 Data collection 35

4.2.1 M&A documentation 37
4.2.2 The price paid by the acquiring company 38
4.3 Validity 38
4.4 Reliability 39
4.5 M&A deal 1. 39
4.5.1 Hewlett-Packard and Opsware Inc. 39
4.5.2 The merger/acquisition between Hewlett-Packard and Opsware Inc. 40
4.6 M&A deal 2. 41
4.6.1 Dell Inc and Perot Systems 41
4.6.2 The merger/acquisition between Dell Inc. and Perot Systems 41
5 Findings 42
5.1 Case 1. Hewlett-Packard and Opsware Inc. 42
5.1.1 Form 8-K 42
5.1.2 Form 10-K 43
5.1.3 The price paid by the acquiring company 49
5.2 Case 2. Dell Inc. and Perot Systems 50
5.2.1 Form 8-K 50
5.2.2 Form 10-K 50
5.2.3 The price paid by Hewlett-Packard for Opsware Inc. 56
6 Discussion 57
6.1 The role of corporate reputation in mergers and acquisitions 57
6.1.1 Merger and acquisition documentation 57
6.1.2 Price content of mergers/acquisitions 60
6.2 Why include an assessment of corporate reputation in M&A’s 62
6.2.1 Importance in mergers and acquisitions 62
6.2.2 Importance in due diligence 64
6.2.3 Importance accounting wise 66
6.3 How to include corporate reputation in mergers and acquisitions 68
7 Conclusion 70
8 Bibliography 71

List of Figures

Figure 1 “The relationship between resources heterogeneity and immobility, value, rareness, imperfect imitability, and sustainability, and sustained competitive advantage”. (Barney, 1991, p. 112).. 3
Figure 2. Global M&A volumes annually. (Thomson Reuters, 2013, p. 3).............................. 4
Figure 3 “The acquisition process flow diagram”. (DePamphilis, 2008, p. 143). 6
Figure 4. Breakdown of Global Enterprise Value (US$ billion, 2001-2008). (ima, 2010, p. 5). 20
Figure 5. “Reputation Quotient; Pillars & Attributes”. (Fombrun & Gardberg, 2000, p. 14). 29
Figure 6 Formula derived by Bowd and Bowd (2002, p. 15) 30
Figure 7 proposed Formula. (Bowd & Bowd, 2002, p. 22). 30
Figure 8. Contextual Overview 32
Figure 9. Consolidated balance sheet (Hewlett-Packard, 2007, p. 76) 45
Figure 10. HP’s purchases intangible assets associated with completed acquisitions. (Hewlett-Packard, 2007, p. 102)... 47
Figure 11. Goodwill allocated to HP’s business segments (Hewlett-Packard, 2007, p. 101).. 48
Figure 12 Consolidated statements of financial statements (Dell Inc., 2010, p. 50)................ 52
Figure 13. Dell’s intangible assets associated with completed acquisitions. (Dell Inc., 2010, p. 76).. 55
Figure 14. Consideration paid for Perot Systems. (Dell Inc., 2010, p. 73). 56

Abstract

The purpose of this master thesis is to uncover the role of corporate reputation as an intangible asset towards a sustainable competitive advantage in mergers and acquisitions. Identifying corporate reputation as an individual asset that generate future economic benefits, can provide as a basis of including corporate reputation in financial balance sheets and due diligence. If corporate reputation contributes with long-term financial and non-financial benefits, inquiring into corporate reputation as a vital source of a sustainable competitive advantage might be beneficial for both parties in a merger/acquisition.

The thesis is conducted by a qualitative “multicase” study, where two merger/acquisition deals serves as illustrative examples of current merger/acquisition practice regarding transfer and management of intangibles and corporate reputation. The merger/acquisition between Hewlett-Packard and Opsware Inc. and the merger/acquisition between Dell Inc. and Perot Systems represent the two M&A deals. The chosen design reflect the contextual nature of this thesis, as well as it is possible to build upon existing theory. Two analytical sources were chosen in order to examine the role of reputation in current practice and theory in the two M&A deals. Respectively, required merger/acquisition *documentation* by the federal authorities, and the *price paid* for the acquired company. These variables provides behavior-related information of the companies, perspectives expressed by the companies as well as financial information concerning the company’s health, valuation of assets and pricing techniques. Theoretical background serves as a secondary source of information in this thesis, supplementing the empirical research, especially in the search of uncovering the role of corporate reputation, and the possibilities for measuring and valuing this asset.

The analyses indicate that corporate reputation is overlooked as a valuable intangible resource in mergers and acquisitions. Although the chosen illustrative companies describe reputation as a critical source of financial revenue and increased competitive abilities, it is not included in any financial balance sheets or the companies merger/acquisition documentation regarding management. Furthermore, the intangible asset is not present in the price paid for the acquired company, nor is it represented in the annual report as a separate asset.

My research of corporate reputation in mergers and acquisitions contributes to the field of strategy and business, more precisely mergers and acquisitions, in several ways. First, it suggests new theoretical perspectives. Secondly, the thesis provides a framework as to how to include reputation in mergers and acquisitions. Third, it uncovers the ambiguous relationship between what the company disclose as important, and what actions actually reflect. Fourth, it is suggested that attributing attention to corporate reputation will enhance future, and long-term financial revenue. Fifth, and last, it is suggested that the calculated price of target companies, will be more accurately when an assessment of corporate reputation is included, thus having an influence on the decision to merge or not, as well as the agreed upon price.

Preface

The background for studying this subject began at my exchange semester at the University of California, Berkeley. My professor in “organizational strategy” was specializing in the field of “corporate reputation”, and during a talk with her, I became interested in the field. After reading up on the subject of “corporate reputation”, I noticed that there were limited number of scholarly articles on corporate reputation in mergers and acquisitions. This inspired me to analyze the “transferability” of corporate reputation, and whether the asset was deemed crucial in mergers and acquisitions. As my research progressed, I uncovered limitations concerning measuring, categorization and valuation, that keep the asset away from financial balance sheets. How can shareholders know the true value of the companies about to merge?

This thesis is written at the University of Stavanger, Norway. Thomas Laudal provided me with helpful guidance and constructive comments throughout this thesis, which is greatly appreciated.

1 Introduction

1.1 Background of paper

Corporate reputation is a relatively new field of study within business strategy, consequently turning the subject somewhat understudied. (Fombrun C. , 1996). The following examination address the role of corporate reputation in mergers and acquisitions, where the fundamental assumption is that corporate reputation is an intangible asset that represent a core value towards a sustainable competitive advantage. The thesis is based on mergers and acquisitions being a strategy towards a sustainable competitive advantage. I chose mergers and acquisitions because they are strategies and transactions of great significance to a range of constituencies, this, combined with the high failure rate of mergers and acquisitions triggered this thesis. Although companies and management ascribe a positive relationship between reputation and financial revenue, organizational performance and long-term benefits (Roberts & Dowling, 2002), the asset seem to be overlooked as a transferable competitive advantage in mergers and acquisitions. This thesis serve as an incentive for management conducting a due diligence, to implement and perform a sufficient evaluation of the role and value of corporate reputation in mergers and acquisitions. This is beneficial because it might help increase the high failure rate of mergers and acquisitions, as well as numerous benefits regarding correct information, distribution of knowledge etc. Because this paper address a subject with limited preliminary research, some of the theoretical connections are relatively new. The lack of systematic attention to corporate reputations can be traced to the diversity of relevant academic and practitioner literatures that explore different facets of the construct. (Fombrun & Rindova, 1996). The growing interest in corporate reputation contributes to bring this field of study into new directions.

I start my examination by theorizing mergers and acquisitions, due diligence, intangible assets and corporate reputation as well as the role of reputation in M&A’s and the valuation of this asset. Presented theory serve as comparative and supportive when analyzing the role of corporate reputation in mergers and acquisitions. Two mergers/acquisitions serves as illustrative examples when uncovering the role of corporate reputation. After presenting the two mergers/acquisitions, a two-part analysis is used to uncover the role of corporate reputation in the two cases; (1) the *documentation* requested by the government (SEC), and an examination of the content of the (2) *price paid* for the acquired company. Relevant documentation in a merger/acquisition, as well as documentation containing information regarding management of assets in mergers/acquisitions will be analyzed. By inquiring into the content of the price paid by for the target company, it might be possible uncovering the role of intangible assets, and preferably corporate reputation. After examining the role of reputation in the two analytical sources, a discussion of the reputational position follows, and is supplemented with comparisons with presented theory and possible explanations of practice.

The thesis is based on mergers and acquisitions being a strategy towards a sustainable competitive advantage. Jay Barney's "resource based view" provides the idea of assets providing companies with core competencies towards sustainability and competitiveness. This advantage is achieved, among others, through intangible assets. Within the framework of intangible assets, we find corporate reputation. What is corporate reputation and what role does it play in mergers and acquisitions? Is it possible to categorize, measure and value this asset and is there a reputational-transferability? The following thesis focuses on the complexity of corporate reputation in mergers and acquisitions, primarily how to manage this asset through recognition, categorization, measurement and valuation, thus bringing the newly formed company to a sustainable competitive advantage. Jay Barney's (1991) perspective contribute with support, as of concepts and identifying underlying causes of current practice. The selection of perspective is based on chosen theory, and are deemed particularly relevant in order to answer the research question.

1.2 The Resource Based View

"The resource based view" is a theory presented by Jay Barney, and suggest that a company can make use of its internal resources in order to achieve a sustainable competitive advantage. (Barney, 1991). According to Barney (1991, p. 99) "*…firms obtain sustained competitive advantages by implementing strategies that exploit their internal strengths, through responding to environmental opportunities, while neutralizing external threats and avoiding internal weaknesses."* The Resource-Based View deals with the creation of a competitive advantage, that through internal capabilities (Barney, 1991), can be facilitated by integrating and generating synergies in M&A. (Santos, Ferreira, Reis, & Serra, 2011). In order to achieve a comprehensive understanding of Barney's resource based view, it is important to understand three key concepts; firm resources, competitive advantage and sustained competitive advantage. *Firm resources* include all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc. controlled by a firm that enable the firm to implement its strategies. *Competitive advantage* refers to when a firm is implementing a value creating strategy, not simultaneously being implemented by current or potential competitors. (Barney, 1991). *A sustained competitive advantage* refers to the possibility of competitive advantage, and not the calendar time that the firm enjoys a competitive advantage. A sustained competitive advantage does not imply that it will last forever, rather that it will not be competed away through the duplication efforts of other firms (Barney, 1991). In order for resources to generate a sustained competitive advantage they need to possess four attributes; being *valuable* in that it can to exploit opportunities and/or neutralize threats, must be *rare* among competitors, must be *imperfectly imitable* and there cannot be strategically equivalent *substitutes* for this resource. (Barney, 1991).

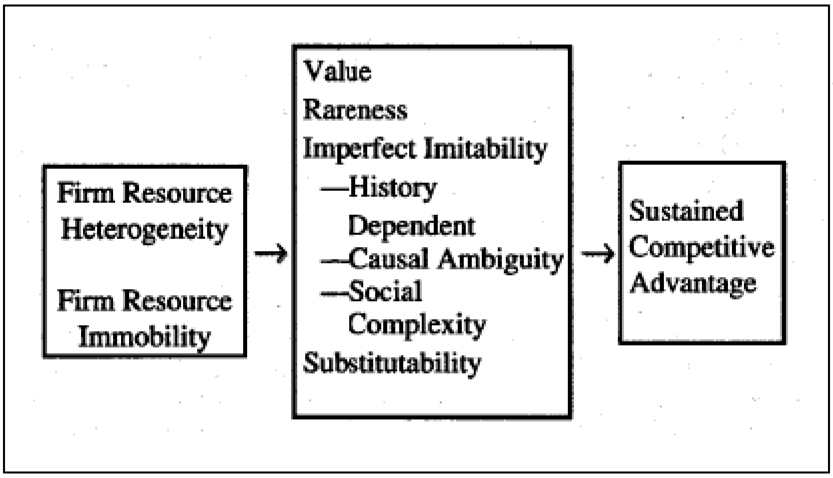

Firm Resource Heterogeneity
Firm Resource Immobility
Value
Rareness
Imperfect Imitability
—History Dependent
—Causal Ambiguity
—Social Complexity
Substitutability
Sustained Competitive Advantage

FIGURE 1 "THE RELATIONSHIP BETWEEN RESOURCES HETEROGENEITY AND IMMOBILITY, VALUE, RARENESS, IMPERFECT IMITABILITY, AND SUSTAINABILITY, AND SUSTAINED COMPETITIVE ADVANTAGE". (BARNEY, 1991, P. 112).

RBV does not distinguish between tangibles and intangibles, however, the most influential ones seem to be intangible (Barney, 1991).

2 Theoretical background

The following section provides a theoretical background that serves as the foundation for further examination and analysis, as well as a secondary source of information. In order to answer the proposed research question, this theoretical review examines five subsequent themes, respectively, *mergers and acquisitions*, *due diligence*, *intangible assets*, *corporate reputation* and *valuation*.

2.1 Mergers and Acquisitions

Mergers and acquisitions can be a strategy in order to achieve a sustainable competitive advantage, however this advantage depends upon the command of and access to effective utilization of the organizations resources and knowledge. (Porter, 1980; Barney, 2001; Hamel & Prahalad, 1994). “Strategy is used to develop and sustain current and competitive advantages for a business (D'Aveni, Harrigan, & Gunther, 1995), as well as to build competitive advantages for the future. (Hamel & Prahalad, 1994). One way of achieving a competitive advantage is through mergers and acquisitions, they involves transactions of great significance to the company as well as workers, managers, competitors, communities and the economy. (Sudarsanam, 2003, p. 1). Mergers and acquisitions make up a big part of the corporate finance world. Determining the advisability of a potential merger requires a broad analysis of the factors involved. Strategies are altered, consequently broadening, strengthening or refocusing product lines, as well as changing management systems and personnel. (Giddy, 2006). The figure below is a graphic depiction of merger and acquisition volumes, as well as monetary significance, from 2000 and up until 2013. (Thomson Reuters, 2013, p. 3).

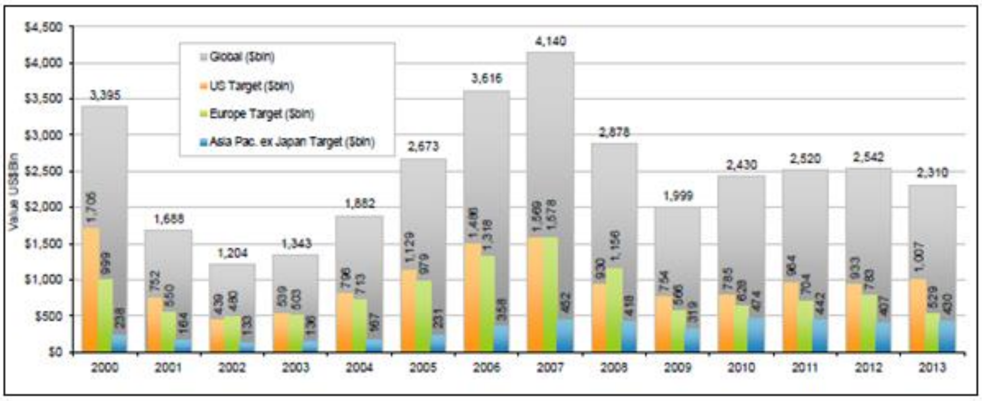


FIGURE 2. GLOBAL M&A VOLUMES ANNUALLY. (THOMSON REUTERS, 2013, P. 3).

The above figure shows a peak in number of mergers/acquisitions in 2007, followed by a significant low in 2009. This can be explained by a wave of mergers in a particular industry, due to exogenous factors, for instance like the financial crisis of 2008. Although consolidation is an important, and popular, restructuring initiative, the majority seem to fail achieving their objectives. (Cartwright, 2006). Based on Cartwright's (2006) study of mergers and acquisitions over 30 years, only 56 per cent of the acquisitions were considered successful against the original objectives set for them. Acquisitions appear to provide, at best, a mixed performance to the stakeholders involved. (Cartwright, 2006). What is the under underlying explanations to the merger and acquisition activity?

2.1.1 Motives behind mergers and acquisitions

Merger motives are complex, diverse and they change over time, which lead to each merger being individually assessed (Goldberg, 1983). Actors are motivated for and against mergers in many ways, for instance as a business growth strategy (Goldberg, 1983), or as a means of implementing a business strategy, and not a business strategy in itself (DePamphilis, 2008). Mergers and acquisitions may also be a means of creating shareholder value by exploiting synergies, increasing growth, replacing inefficient managers, gaining market power, and extracting benefits from financial and operational restructuring. (Giddy, 2006). Operational- and/or financial synergies is another motive behind mergers and acquisitions, where instead of operating two companies separately, one can create greater shareholder value combined. (DePamphilis, 2008). Diversification, market power, strategic alignment, tax benefits cross-selling, resource transfer, hiring, and access to assets are also prominent motives behind mergers and acquisitions. (Goldberg, 1983). When companies merge, they seek to minimize uncertainty to a given level of expected profit, minimizing uncertainty is therefor also a merger motive. (Goldberg, 1983).

2.1.2 The merger process

DePamphilis (2008) divide the merger and acquisition process in two stages, where each stage consists of different phases that make up a holistic operation. The first stage, *planning*, contain two phases, while the second stage, *implementation* consists of eight phases. The figure below illustrates this merger and acquisition process proposed by DePamphilis (2008, p. 143).

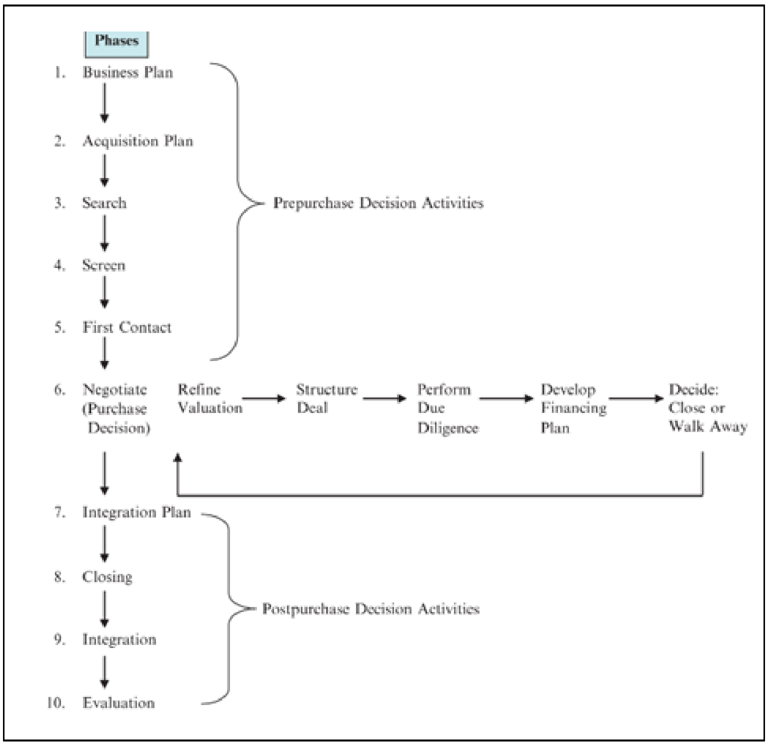

Phases
1. Business Plan
2. Acquisition Plan
3. Search
4. Screen
5. First Contact
Prepurchase Decision Activities
6. Negotiate (Purchase Decision)
Refine Valuation
Structure Deal
Perform Due Diligence
Develop Financing Plan
Decide: Close or Walk Away
7. Integration Plan
8. Closing
9. Integration
10. Evaluation
Postpurchase Decision Activities

FIGURE 3 "THE ACQUISITION PROCESS FLOW DIAGRAM". (DEPAMPHILIS, 2008, P. 143).

Stage one: planning

A planning-based acquisition process consist of a business plan and a merger/acquisition plan (Form 8-K), which drive all subsequent phases of the acquisition process. (DePamphilis, 2008). While the business plan state the vision and business strategy for the company, the merger/acquisition plan specifies the implementation strategy and describes the motivation for the acquisition, and how, and when it will be achieved. (DePamphilis, 2008). If it is deemed necessary to complete a merger/acquisition in order to fulfill the business strategy, a merger/acquisition plan is required, moving us over to phase two of the merger/acquisition process, *building the merger/acquisition implementation plan.* The acquisition plan focuses on short-term issues and defines criteria's used to select potential acquisition candidates, such as size, profitability, industry and growth rate. (DePamphilis, 2008). When the firm has developed a viable business plan that requires an acquisition to realize the firm's strategic direction, one can move on to the next stage, the implementation stage.

Stage two: implementation

Stage two, begins with the third phase, *the search process*, and illustrates the search for potential acquisition candidates. (DePamphilis, 2008). This process is divided in two procedures; establishing, screening and selection criteria, and developing a search strategy. (DePamphilis, 2008). Phase four, *the screening process* reduces the list of candidates by identifying market segment, product line, profitability, degree of leverage and market share. (DePamphilis, 2008). Phase five, *the first contact* phase, involves approach strategies, where the parties aim to provide an estimation of value, as well as negotiate a confidentiality agreement, term sheet, and letter of intent (LOI). (DePamphilis, 2008). Phase six, *a negotiation phase* is, unlike the previous phases, an interactive, iterative process. The purchase price for the target firm is determined. This phase consist of four concurrent activities: refining valuation, deal structuring, due diligence and developing a financing plan. (DePamphilis, 2008). *Developing the integration plan* is the seventh phase and includes earning trust and creating earnouts in order to ensure that goals are achieved. (DePamphilis, 2008). Phase eight, *the closing phase* includes obtaining shareholder, regulatory, third-party consents, and completing the definitive agreement of purchase and sale (DePamphilis, 2008). *Implementing postclosing integration* is the ninth phase, often viewed as the most crucial phase of the acquisition phase. The activities consist of; implementing an effective communication plan, retaining key managers, identifying immediate operating cash-flow requirements, employing the best practices of both companies and addressing cultural issues. (DePamphilis, 2008). The last phase, number ten, *conducting postclosing evaluation*, helps determining if the acquisition is meeting expectations, to determine corrective actions (if necessary), and to identify what was done well and what should be done better in future acquisitions. (DePamphilis, 2008). These phases demand documentation prior, during and after mergers and acquisitions, which make this an important source of information that we will take a closer look at.

2.1.3 Documentation in mergers and acquisitions

The type of documentation needed in a merger/acquisition, as well as their content is described and upheld by the “U.S. Securities and Exchange Commission” (SEC). The SEC is an agency of the United States federal government. The agency hold primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation’s stock and options exchanges, and other activities and organization including the electronic securities market in the United States. The documentation in a merger or acquisition often begins with a letter of intent (LOI), as mentioned in phase five. This letter do not bind the parties to commit to the transaction, but bind them to a confidentiality so the transaction can be considered through a due diligence. After the due diligence is completed, the parties draw up a definite agreement, called a merger agreement. All important, financial, operation, legal, and transactional elements should appear in the merger/acquisition agreement. (Lajoux & Elson, 2010). The merger agreement focuses on the following subjects (U.S. Securities and Exchange Commission, 2010):

- Information about the merger
- Representations and warranties by the seller with regard to the company.
- Covenants, which govern the conduct of the parties, both before the closing and after the closing.
- Representations and warranties of parent and merger sub
- Conduct of business pending the merger
- Additional agreements
- Conditions to the merger
- Termination
- General provisions

According to the SEC issuers in a merger or acquisition must file documents that provide sufficient information, for instance, an issuer must announce a definitive merger agreement on a document called “Form 8-K”. Material information about the merger, including the agreement itself, will be included as exhibits to the Form 8-K or quarterly report filed on Form 10-Q. Schedules to a merger agreement may not be part of the exhibit if they are not considered material to investors. (U.S. Securities and Exchange Commission, 2014).

2.1.3.1 Form 8-K requested by U.S Securities and Exchange Committee

Form 8-K is a broad form used to notify investors and shareholder of any material event that is important. The content of Form 8-K is information deemed relevant to shareholder and the SEC, by the acquiring company. After a significant event, for instance an merger/acquisition, a public company, must file a “Current Report” on Form 8-K within four business days to provide an update to shareholders and the SEC. (U. S Securities and Exchange Commission, 2014). The “Current report” serve as an update to previously filed “Quarterly Reports” on Form 10-Q and/or “Annual Reports”, Form 10-K. The form typically consist of two major parts, namely the name and description of the event, as well as all information deemed relevant to shareholders and the SEC, and secondly any relevant exhibits as attachments. The merger agreement is an example of relevant exhibits. The content of Form 8-K serve as an indication to what type of information the government deem important, as well as the extent of information. Below is an overview of the content SEC require companies to disclose in Form 8-K. (U. S Securities and Exchange Commission, 2014).

- Section 1. Registrant’s business and operations
    - Item 1.01 – entry into a material definite agreement
    - Item 1.02 – termination of a material definite agreement
    - Item 1.03 – bankruptcy or receivership
    - Item 1.04 – mine safety – reporting of shutdowns and patterns of violations
- Section 2. Financial information
    - Item 2.01 – completion of acquisition or disposition of assets
    - Item 2.02 – Results of operations and financial condition
    - Item 2.03 – creation of a direct financial obligation or an obligation under an off-balance sheet arrangement of a registrant
    - Item 2.04 – triggering events that accelerate or increase a direct financial obligation or an obligation under an off-balance sheet arrangement.
    - Item 2.05 – costs associated with exit or disposal activities
    - Item 2.06 – material impairments
- Section 3. Securities and trading markets
    - Item 3.01 – notice of delisting or failure to satisfy a continued listing rule or standard; transfer of listing
    - Item 3.02 – unregistered sales of equity securities
    - Item 3.03 – material modification to rights of security holders
- Section 4. Matters related to accountants and financial statements
    - Item 4.01 – changes in registrant’s certifying accountant
    - Item 4.02 – non-reliance on previously issued financial statements or a related audit report or completed interim review
- Section 5. Corporate governance and management

  - Item 5.01 – changes in control of registrant
  - Item 5.02 – departure of directors or certain officers; election of directors; appointment of certain officers; compensatory arrangements of certain officers.
  - Item 5.03 – amendments to articles of incorporation or bylaws; change in fiscal year
  - Item 5.04 – temporary suspension of trading under registrant's employee benefit plans
  - Item 5.05 – amendments to the registrant's code of ethics, or waiver of a provision of the code of ethics
  - Item 5.06 – change in shell company status
  - Item 5.07 – submission of matters to a vote of security holders
  - Item 5.08 – shareholder director nominations
- Section 6. Asset-backed securities
  - Item 6.01 – ABS informational and computational material
  - Item 6.02 – change of servicer or trustee
  - Item 6.03 – change in credit enhancement or other external support
  - Item 6.04 – failure to make a required distribution
  - Item 6.05 – securities act updating disclosure
- Section 7. Regulation FD
  - Item 7.01 – regulation FD disclosure
- Section 8. Other events
  - Item 8.01 – other events
- Section 9. Financial statements and exhibits
  - Item 9.01 – financial statements and exhibits

2.1.3.2 Form 10-K requested by U.S Securities and Exchange Committee

The annual report, referred to as Form 10-K, includes information regarding company history, organizational structure, executive compensation, equity, subsidiaries and audited financial statements among other information. (U.S Securities and Exchange Commision, 2014). Below is an overview of the content requested by the SEC. (U.S Securities and Exchange Commision, 2014).

PART I

- Section 1. Description of Business
  - Item 1A – Risk factors
  - Item 1B – Unresolved Staff Comments
- Section 2. Description of Properties
- Section 3. Legal Proceedings
- Section 4. Mine Safety Disclosures

PART II

- Section 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities
- Section 6. Selected Financial Data.
- Section 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.
  - Item 7A – Quantitative and Qualitative Disclosures About Market Risk
- Section 8. Financial Statements and Supplementary Data.
- Section 9. Changes in and Disagreements with Accountant on Accounting and Financial Disclosure.
  - Item 9A – Controls and Procedures
  - Item 9B – Other Information

PART III

- Section 10. Directors, Executive Officers and Corporate Governance
- Section 11. Executive Compensation
- Section 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.
- Section 13. Certain Relationships and Related Transactions, and Director Independence
- Section 14. Principal Accounting Fees and Services

PART IV

- Section 15. Exhibits, Financial Statement Schedules Signatures

Companies must follow the above when disclosing information regarding their company. For instance, "Item 6", that concerns "selected financial data", combined with the S-K regulation (§229.301) emphasizes the following; "*The purpose of the selected financial data shall be to supply in a convenient and readable format selected financial data which highlight certain significant trends in the registrant's financial condition and results of operations.*" (Cornell University Law School, 2014). It is then up to the company to maintain the S-K regulation and provide sufficient information to the SEC as well as shareholders. Moreover, item 7, requires information regarding "management's discussion and analysis of financial condition and results of operations", and according to Regulation S-K (§229.303) the company should disclose information concerning "off balance sheet arrangements" (Cornell University Law School, 2014). This applies to off-balance sheet arrangements that have/likely to have a future effect on the financial condition. Corporate rreputation is not mentioned in the S-X regulation or in item 9, 10, 11, 12, 13, 14 and 15 of the 10-K form.

Form 8-K and Form 10-K is useful for integrational activities pre- and post-merger, as well as contributing with relevant information to both parties in the consolidation, which is beneficial for a positive merger/acquisition outcome. However, the failure rate of mergers and acquisitions are high, which creates the need to look closer at merger and acquisition outcome.

2.1.4 Merger acquisition outcome

A successful merger or acquisition provides several benefits; creates new wealth, returns value to investors, minimizes negative impacts to people and the environment and makes a positive contribution to local communities and societies. (Sudarsanam, 2003). However, many research studies conducted over the decades clearly show that the failure-rate is at least 50 percent, consequently destroy instead of enhance value for shareholders. (Sudarsanam, 2003). According to Weber, Tarba and Öberg (2013) the percentage of companies that failed to achieve the goals of the merger reached as much as 83 percent. Some argue that overpayment and poor strategy are some of the common reasons mergers and acquisitions fail. (DePamphilis, 2008). Their success or failure has critical consequences for shareholders and lenders, as well as the company itself, employees, management and the economy, however they hold different perspectives to whether a merger is successful or not. Sudarsanam (2003) emphasizes that if the shares of the shareholder increase as a result of the acquisition, the merger is deemed successful. However this poses some problems, one would not know the value of the two firms had they not merged. (*Business week*, 1995; Coopers & Lybrand, 1996; Marks, 1996; McKinsey Company, 1987). Operating performance provides additional insight to the merger/acquisition. (Sudarsanam, 2003), moreover one need to understand the economic and regulatory environment and the process and systems in merging organizations to define the limits of success. Epson (2005) on the other hand, puts emphasize on an incomplete due diligence as one of the reasons merger and acquisitions fail.

2. 2 Due diligence

Due diligence is defined as "*the diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation.*" (Lajoux & Elson, 2010, p. 4) The due diligence process refers to the review of a target company to make sure that the purchase do not pose any unnecessary risk to the acquirers shareholder. (Lajoux & Elson, 2010). By inquiring into all relevant aspects of the past, present, and predictable future of the target firm, one clarifies benefits and liabilities in a proposed acquisition. (Lajoux & Elson, 2010). The key participants in due diligence is often in-house expertise as well as retained consultants and advisors. Lajoux and Elson (2010) emphasize that an acquirer cannot discover every possible risk, since this would bankrupt the acquirer and alienate the seller. In order to provide an appropriate bid for a target company, it is important to value the target company accurately through the due diligence process. (Lajoux & Elson, 2010). There are no substitute for conducting a due diligence on the target company. Refining a valuation based on new information uncovered during due diligence affects the determination of the total consideration to be paid to the seller. Moreover, a due diligence is not limited to the buyer; the seller should perform a due diligence on the buyer to ensure that it will be able to finance the purchase price as well as if the ownership and/or employment will continue after the sale of the business. The seller should also perform a due diligence on its own operations to ensure that its representations in the definitive agreement are accurate. (DePamphilis, 2008). Performing a due diligence provides two distinct benefits to the acquirer. First individuals who have had hands-on involvement in the due diligence process will gain insight into the financial, operational, and legal areas that they studied. (Lajoux & Elson, 2010). Second, in the event of a claim by the buyer or the seller against the other, the resolution of the claim may go back to a due diligence issue – that is, whether or not one party disclosed certain facts or made certain documents available (Lajoux & Elson, 2010).

2.2.1 The content of a due diligence

The content of the due diligence should be broad, but not overly ambitious. The seller will not welcome any request for information that requires the creation of new documentation. When drawing up a merger/acquisitions agreement acquirers should focus on areas particularly relevant to the transaction (Lajoux & Elson, 2010). The stages of due diligence begin in the search, valuation and financing processes, where the acquirer asks questions that form the basis of the merger/acquisitions agreement. The merger/acquisition agreement serve as the driving force throughout a due diligence process, and the two should parallel each other (Lajoux & Elson, 2010). The merger/acquisition agreement reminds the buyer of what types of issues they should investigate, however this might change as the investigation continues.

The due diligence occurs throughout the acquisition process, which can last from a few weeks to a year or more. Legally set, a due diligence must be *reasonable*, not necessarily perfect. (Lajoux & Elson, 2010). Below is a list of what the due diligence should cover, at minimum, arranged in order from what is normally easiest to uncover first, towards the less accessible information last. (Lajoux & Elson, 2010, p. 35).

- *A financial statements review* that determines the financial health of the company based on the income statement and cash flow statement. The financial analysis vary by industry, and one would have to use different tools depending upon the industry.
- *A management and operations review* that provides insight to factors beyond the financial statements.
- A *legal compliance review* that uncovers any potential future legal problems arising from the candidates past.
- *A document and transaction review* is needed in order to ensure the paperwork of the deal. Here the managers focus on risks that might arise from the transaction in itself.

Lajoux and Elson (2010) argue that classic due diligence is somewhat limited. *"Traditional due diligence does not take into account the many issues that can arise from both the companies being combined."* (Lajoux & Elson, 2010, p. 81). However, thorough due diligence can lessen mutual trust between the buyer and seller, where the seller can feel disregard in the disruption, as well as fear adverse consequences for the business, and future sale to other, if the deal does not close (Lajoux & Elson, 2010). In addition, it can increase pre-transaction costs and absorb attention of key employees. How far a buyer is willing to go in the due diligence process often depends upon how much time and money the buyer has. Lajoux and Elson (2010) emphasizes important reasons when determining how far one should go in the due diligence process; the status of the company, the number of years it has been in business, whether it has been audited by a major firm for some years among other. The due diligence can also vary depending upon the type of company (Lajoux & Elson, 2010). A large, diversified, global company in a highly regulated industry is more extensive than the work involved for a small, single-product, domestic firm in a relatively unregulated sector. In addition, stock purchases trigger more due diligence responsibilities than do asset purchases. (Lajoux & Elson, 2010).

The main phases of closing a due diligence are preclosing (reherseal of closing, e.g. three days prior to closing), closing (review documents, recheck documents against checklist and wire funds) and postclosing (document distribution and cleanup), however the due diligence effort should extend beyond closing. (Lajoux & Elson, 2010).

2.3 Intangible assets

A company’s economic resources consist of tangible- and intangible assets. Anything tangible or intangible that is owned or controlled in order to produce value, and is considered providing positive economic value to the firm, is considered an asset. (Grant Thornton, 2013). There are numerous definitions of intangible assets, and so far, no universally agreed-upon definition (Sveiby, 1997; Bontis *et al*, 1999; Andriessen, 2004; Mjølberg-Jørgensen, 2006). This lack of a common understanding serve as a hindrance in the research progress. (Kristandl & Bontis, 2007). Intangible assets confines to items that lack physical substance but provide long-term benefit to the company and have economic reality. Kristandl and Bontis (2007) argue that RBV and intangibles can be positioned in a natural hierarchy, since the latter connects to a company’s strategy, and both contribute to sustained corporate performance and competitive advantages. Connecting the resource-based view to intangibles provides the following definition: *“Intangibles are strategic firm resources that enable an organization to create sustainable value, but are not available to a large number of firms (rarity). They lead to potential future benefits which cannot be taken by others (appropriability), and are not* *imitable by competitors, or substitutable using other resources. They are not tradeable or transferable on factor market (immobility) due to corporate control…"* (Kristandl & Bontis, 2007, pp. 1518-1519).

Intangible assets falls into two categories; those that are recognizable and have an attributed value in the company's financial statements, and those that are unrecognizable and are kept away from financial reporting. (ima, 2010, p. 1; Cohen, 2005). In order for an asset to be classified as identifiable, it needs to be assigned a fair value and can be reasonably expected to provide a benefit for the purchasing company in the future. Assigning the asset a fair value, allows for a purchasing company to include the value in the balance sheet. (Cohen, 2005). Unidentifiable assets are firm assets that remain hidden, (accounting wise), until a transaction, for instance an acquisition give rise to their identification, for instance goodwill. (Cohen, 2005).

2.3.1 The value of intangible assets

Rising percentages of company value and revenue evolve from intangible assets. *"65 per cent of most company's value, sources of revenue, and building blocks for growth and sustainability today evolve directly from intangible assets"* (Moberly, 2012). According to the "Association of Accountant and Financial Professionals in Business" (2010), there is a growing impact of the unrecognized portion of intangible corporate assets. These items have become an important source of value to corporations. Moreover, they contribute to competitiveness and organizational sustainability in the future. (ima, 2010).

According to a study by Deutsche Bank Research a range of factors have contributed to the silence on intangible assets. (Salinas, 2009, p. 41). Among them we see, "limitations imposed by accounting regulations that do not allow intangible assets to be capitalized", except in cases of mergers and acquisitions, and "corporations' reluctance to disclose competitive advantages by publishing information on their intangible assets". (Salinas, 2009, p. 41). Companies do not want to share information on organizational processes, methods of production of models of consumer retention, with their competitors. Moreover, we see the lack of generally accepted vocabulary in the field of intangible assets valuation and evaluation. In cases where companies are willing to publish more information on intangibles, there is no common language in the communications between companies and capital markets, nor among capital market players. (Mackie, 2009). According to Mackie (2009), a number of serious adverse consequences in capital markets can arise because of deficiencies of information about intangible assets. Investments like software tend to be buried in larger cost items; therefore, measurement of intangibles should be considered essential information for resource allocation within companies. (Mackie, 2009, p. 44).

2.3.2 Intangible assets and financial reporting

The "Statutory Board Financial – Reporting Standard 38" (2013) hereby referred to, as "SB-FRS 38" (2013) is a conceptual framework in financial reporting. The Financial Accounting Standards Board is the major standard setter for corporate reporting. Their mission is to "*establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports."* (Financial Accounting Standards Board, 2014). According to "Statutory Board Financial – Reporting Standard 38" it can be difficult to decide whether an intangible asset qualifies for recognition. For instance, it may be difficult to identify if the asset will generate expected economic benefit, and determining the cost. Some intangible asset cannot be distinguished from the cost of running the day to day operations of the firm, consequently creating difficulties of asset valuation in mergers and acquisitions.

International Accounting Standard 38 *Intangible assets* (issued 2004, amended 2008, para. 8) defines intangible assets in accordance with the previous stated definition; as an "*identifiable non-monetary asset without physical substance*". According to SB-FRS 38 the price a firm pays to acquire an intangible asset is a reflection of the expectations of future economic benefits, that will credit the receiving firm. The foundation which financial accounting standards are founded excludes many intangibles from being incorporated into traditional financial statements. (ima, 2010, p. 18).

According to the International Accounting Standard (IAS) 38 (para. 21) "*an intangible asset shall be recognized if and only if, (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and (b) the cost of the asset can be measured reliably."* While unrecognizable assets fail to meet the criteria for recognition under current reporting standards, identifying, assessing, managing, controlling and nurturing these intangibles is necessary in order for an organization to maintain the capacity to operate. (ima, 2010, p. 1). Accounting methods that do not recognize intangible assets, might prevent business from knowing their true value. (Brooking, 1996). Supplementing a traditional accounting method with an intangible asset model might be beneficial in order to uncover to true value of a company. According to Green and Ryan (2005) there is a need to define and standardize the accounting of intangible assets.

2.4 Corporate reputation

At this time, a clear, universally accepted definition of the term “corporate reputation” is still awaiting, partly due to the resent emergence of the term. Fombrun (1996, p. 72) defines reputation as *“a perceptual representation of a company's past actions and future prospects that describe the firm's overall appeal to all its key constituents when compared to other leading rivals”*. Using this definition, “*reputation is a global perception of the extent to which an organization is held in high esteem or regard.”* (Weiss & Anderson, 1999, p. 75). The above definition also emphasizes that reputation is an intangible asset, as mentioned previously this implies no physical absence, but contribute to a long term value creation. Before further review, it is important to distinguish between reputation and brand. Brand is the sum of perceptions held by a firm’s current and potential customers or clients, regarding the firm’s specific product/service or line of products/services. Reputation on the other hand, is the sum of perceptions about a company’s corporate actions held by the public in the areas where the company operates. (Zandan & Lustina, 2013). Having a reputation can have positive effects on an organization, that is, as long as it is a good reputation.

2.4.1 A good reputation

A good reputation is preferably a reputation that drives the company in the preferred direction, as well as improving performance. A good reputation is important because of the ability to create value for the organization, as well as the possibility of sustaining a superior profit. (Roberts & Dowling, 2002). The intangible character of reputation makes it difficult for rivals to imitate it, which enables the possibility of creating a sustainable competitive advantage. In addition, good reputations can increase financial return, by inhibiting other actors from entering the market. (Caves & Porter, 1977; Wilson, 1985). Fombrun (1996) ascribe a good reputation additional value when arguing that a good reputation enhances profitability because it attracts customers to the company’s products, investors to its securities, and employees to its jobs. Roberts & Dowling (2002) is supportive of ascribing profitability as an important factor in a “good” reputation. Furthermore, Fombrun (1996) argues that a good reputation gives an organization credibility, reliability, trustworthiness and responsibility. This in turn, enhances the organizations ability to produce tangible benefits, for instance; premium prices for products, lower costs of capital and labor, improved loyalty from employees, greater latitude in decision making, and accumulated goodwill when crisis hit. (Fombrun C. , 1996). A good reputation turns intangible perceptions into tangible benefits (Bowd & Bowd, 2002), which can be highly beneficial for corporations. A good reputation is valuable in that it increases one’s expected payoff in the future (Pfeiffer, Tran, Krumme, & Rand, 2012).

In order for firms to achieve a good reputation, managers need to invest in building and maintaining good relationships with employees, investors, customers and communities. A strong reputation creates a strategic advantage. Since companies are constantly competing for the support of customers, investors, employees and local communities, a good reputation creates an intangible obstacle that lesser rivals will have a tough time overcoming. The financial benefits arising from a good reputation, is reflected in the excess value investors are paying for a company’s shares. (Fombrun C. , 1996). This excess value is by Fombrun (1996) referred to as the company’s “reputational capital”. Where the financial value of reputation could be an organization’s market value (MV) minus its tangible assets (A). (Fombrun C. , Corporate Reputation, 1996). Fombrun (1996) argue that this method “has some merit” over a long time period, in addition to accounting for the costs to reputation from “*unexpected incident that damage a company’s reputation”.* (Fombrun C. , 1996, p. 93).

Reputation can also have a negative value, for instance when employees don’t make suggestions, there is a high employee turnover, there is poor vendor responsiveness or major customer disappear. Moreover a drop in stock value, poor government relations, reporters seldom call for opinions and infrequent business referrals are signs of a negative reputation. (Young, 1995).

2.4.2 Reputation and goodwill

For legal reasons and reasons related to accounting it is important to distinguish the difference between goodwill and reputation. When separating intangible assets in recognizable and unrecognizable, goodwill falls into the second category, and thus is kept away from financial reporting purposes. According to Gugeshashvili (2009) goodwill is a combination of the company's positive characteristics, among them we find reputation. Goodwill is an intangible asset with a particular value (Gugeshashvili, 2009), and a purchaser of goodwill obtains all of the privileges and benefits which the vendor had. It is not possible to sell or transfer goodwill separately from the business with which it is associated. (Gugeshashvili, 2009). Which is consistent with the definition of corporate reputation.

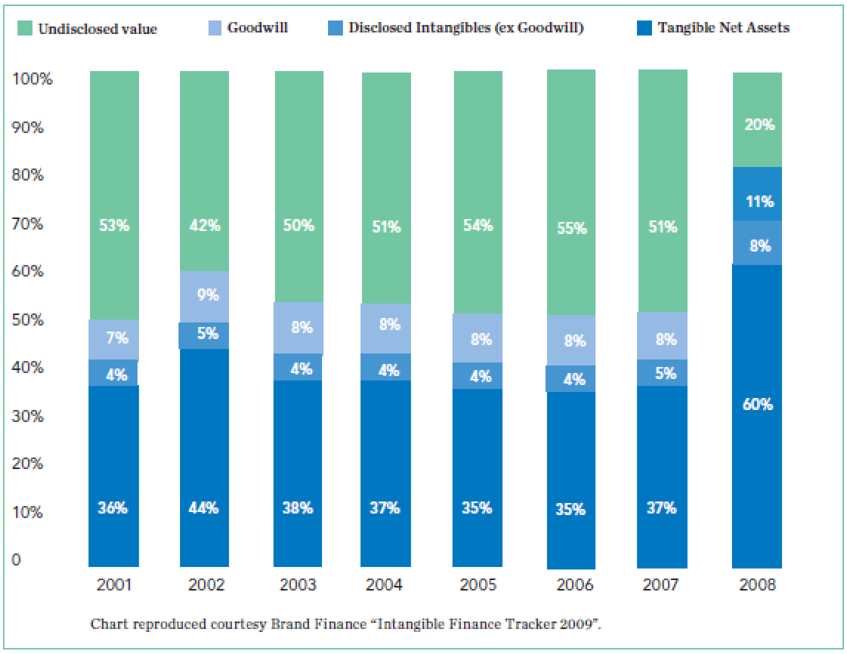


Chart reproduced courtesy Brand Finance "Intangible Finance Tracker 2009".

Figure 4. Breakdown of Global Enterprise Value (US$ billion, 2001-2008). (ima, 2010, p. 5).

The figure above published by "Brand Finance" reviews a sample of the world's largest publicly-traded companies. They uncovered that 75 per cent of corporate value is not reflected in statutory financial disclosure. (ima, 2010). Moreover, the figure depicts the comprehensive role goodwill portraits in companies, and consequently in mergers and acquisitions.

Today, goodwill is only recognized under current regulation when a company is acquired. (Wagenhofer, 2005), and goodwill is then calculated as the premium, or excess, of purchase price over value of individual assets. (van Triest, 2008). Van Triest (2008) argue that goodwill only exists because we cannot identify and measure all intangible assets correctly. Using a perspective like this is convenient for accountants who do not accurately identify and value all assets of a firm or business combination. (van Triest, 2008). Moreover, calculating goodwill as the price premium, is actually a way of measuring it. (Falk & Gordon, 1977). There is a need for breaking down goodwill into different categories, in order for the asset to reflect their true value. (Salinas, 2009). According to Gu and Lev (2011) share-overpricing is strongly and positively related to the intensity of acquisitions and the growth of accounting goodwill. (Gu & Lev, 2011). Van Triest (2008) argue that excess profit should be seen as goodwill, since part of the excess profit is attributable to certain firm characteristics, and these firm characteristics may be recognized as separate intangible assets.

2.5 Corporate reputation in mergers and acquisitions

"*Reputation is a corporation's most important competitive asset."* (Corporate Watch UK, 2003). Fleishman Hillard (2000) notes that reputation can enable a "*stronger ability to attract and retain good employees, better margins, more attractive partners for mergers and acquisitions and more customers"*. (Toth & Leuven, 2004, p. 357). Saxton and Dollinger (2004) found that "*various facets of a target firm's reputation were positively related to acquirer assessment of the success of the acquisition".* (Lange, Lee, & Dai, 2011, p. 173). This implies a positive effect of reputation on partnering in the context of mergers and acquisitions. The importance of a corporate's reputation is confirmed by a range of different empirical studies. For instance, U.K managers rated firms' reputation as the most important of thirteen intangible resources. (Hall, 1992).

A reputational consideration play an important role in firm's decision to merge. (Costa & Vasconcelos, 2011). Reputational incentives to merge range from associating high value projects with high reputations, to benefit from spillover effects of the performance of some projects of the merged firm on other projects of that firm, or to benefit from the fact that the decision to merge constitutes a signal of high quality. (Costa & Vasconcelos, 2011).

Corporate reputation play a role in mergers and acquisitions in several ways; (1) by engaging in mergers, firms partially associate their reputations to the projects of the merged firm. (Costa & Vasconcelos, 2011). (2) The announcement of the decision to merge affect firm's reputations. (3) The performance of a given unit of the merged firm affect the reputation if that unit and, depending on the level of integration of the activities of the merged firm, of other units of that firm. (Costa & Vasconcelos, 2011). Fombrun (1996) argues that corporate reputation have bottom line effects, and a good reputation enhances profitability. Roberts and Dowling (2002) show that firms with relatively good reputations are better able to sustain superior profit outcomes over time. Pfarrer, Pollock and Rindova (2010) refers to reputation as "the firm's demonstrated ability to create value", moreover, reputation is a source of sustainable competitive advantage and above normal returns. (Dierickx & Cool, 1989; Fombrun & Shanley, 1990; Roberts & Dowling, 2002; Porter, 1980).

2.5.1 Deriving value from corporate reputation

If reputation as a resource fulfills the conditions of Barney's (1991) theory of the resource based view, it might be a resource towards a sustainable competitive advantage. Going through the requirements posed by Barney (1991) we see that corporate reputation is in accordance with Barney's (1991) framework; (1) reputation is a *valuable* asset in that it can enhance financial performance (Roberts & Dowling, 2002) (2) if only a few competing firms have a reputation that fulfills Barney's attributes, they are considered *rare*. The development of a positive reputation depends upon specific, difficult-to-duplicate historical settings. (Barney, 1991). If a firm's positive reputation depends upon such historical incidents, it may be imperfectly imitable. (3) Kllein & Leffler (1981) view positive reputations as informal social relations that are socially complex, and thus *imperfectly imitable*. (4) *Substitutes* for a positive reputation might be presented as guarantees that reassure customers or suppliers. Guarantees as a substitute for reputation is debated, since the implicit psychological contract between the two are different. In addition, firms invest in both guarantees and reputation, making them a substitute is an ambiguous subject. Based on this we see that reputation is able to serve as an intangible asset towards a sustainable competitive advantage.

According to the "US Reputation Dividend" report form 2012, reputation is an active source of value growth. Reputation is a major repository of shareholder value and also a means to grow it. "*The average yield from a 5 per cent improvement in reputation is a little over 2.5 per cent of market capitalization.*" (Reputation Dividend, 2012, p. 7). In addition, according to a report by Marcellis-Warin and Teodoresco (2012) reputation is the single most important driver in value creation. Their findings are based on studies conducted over the last 12 years, highly emphasizing the importance of corporate reputation. Reputation buffers a company's financial results to prevent loss of value during periods of market decline and economic turmoil. Marcellis-Warin and Teodoresco (2012) argue that a one-point decrease in reputation is associated with an average market loss of about US$5 billion if the methodology is applied to the top 50 listed companies in the U.S. Furthermore, the authors argue that there is an 80 percent chance of a company losing more than 20 percent of its total value at least once during a five-year period. Marcellis-Warin and Teodoresci (2012) conducted an exploratory study with 80 major companies in Quebeq, and uncovered that none of the companies that mentioned reputation as an important asset, had a formal system to measure and manage reputation. Should corporate reputation be measured and managed, consequently including the asset in financial reporting?

2.5.2 Including corporate reputation in financial reporting

According to Moberly (2012) companies tend to stress the due diligence process in mergers and acquisitions, consequently negatively inflicting the assessment of intangible assets. Therefore, recognizing the importance of intangible resources is an essential factor in order to achieve the desired successful outcome. Moberly (2012) emphasizes that *"intangible assets are increasing the value of the company and consistently in play as requisites to a transaction's projected returns and achieving the anticipated competitive advantages, synergies, efficiencies, and enhancing value following deal consummation"*.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS 141(R)"). SFAS 141 (R) establishes principles and requirements for how an acquired recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired in connection with business combinations (U.S Securities and Exchange Commision, 2014). All companies are required to uphold the requirements of FASB which will be reflected in, among others, the 10-K filing. In addition, SFAS 141(R) establish disclosure requirements to enable the evaluation of the nature and financial effects of the business combination.

Based on IAS 38 (para.21) requirements of including intangible assets in financial reporting, corporate reputation must fulfill two conditions. If future economic benefits are expected to flow to the entity, and the cost of the asset can be measured reliably, corporate reputation fulfill the requirements. The problem is *how* to measure this asset. If we can measure reputation correct, it should be possible to include this asset in financial balance sheets.

2.6 How to value corporate reputation

Valuation is a process of determining the current worth of an asset or company. The value of a company is equal to the value of its assets, and the value of assets is equal to debt and equity thereby: assets = D + E

In order to value a company, one needs insight in some accounting concepts. The most basic concepts is the balance sheets, income statements, statements of cash flows and statement of retained earnings. This information is published by public companies through the annual reports, referred to as “Form 10-K” by the SEC. Participants in a valuation process range between many different actors, among them we find analysts, corporations, lenders (who accept intangible assets from borrowers as credit guarantees) and fiscal authorities (handle sales, purchases, internal or external licenses).

To help understand what drives performance, we need better measures of reputation. (Davies, 2003). The use of valuation models in investment decisions, for instance decisions where assets are undervalued/over-valued are based upon perceptions that market are inefficient and make mistakes in assessing value. (Damodaran, 2012). In addition, it is based upon an assumption about how and when these inefficiencies will get corrected. (Damodaran, 2012). In an efficient market, the market is the best estimate of value. The purpose of any valuation model is then the justification of this value. (Damodaran, 2012). The cost of neglecting measuring intangible assets can be very high. How can corporate purchasers set an objective value for companies based on intangible assets that do not appear on their balance sheets?

2.6.1 Valuation approaches

Confusion over defining reputation, adds to confusion over measurements methods in the reputation literature. (Chun, 2005). The chosen method of valuing reputation is often a result of the background of the one valuing. There are three basic valuation approaches; cost approach, market approach and income approach. (Salinas, 2009). *The cost approach* refers to valuing an asset based on the cost of developing it. There are several options to choose from when taking this approach, for instance historical cost, replacement cost, reproduction cost or capitalization of attributable expenses. (Salinas, 2009). When using this approach, it might be difficult to determine the intangible assets initial moment of development, making historical cost of creation inaccurate. *The market approach* includes recent transactions like sales, acquisitions and licenses that have involved similar assets, where one can compare the transaction price. One can choose between two options, sales transaction or royalty savings. (Salinas, 2009). The market approach is highly relevant when valuing assets that are not unique, and when there are sufficient transactions to compare the asset. This approach is also beneficial when the transaction is conducted among independent parties and the transaction is effected on a relevant date. (Salinas, 2009). *The income approach* requires the identification of future income, profits or cash flow relevant to the asset over the expected time-period, and discounting or capitalizing them to present value. Some of the options relevant to this approach is; price premium, royalty savings, cash flow or income differential with a benchmark company (subtraction approach), incremental cash flow (value of the company with and without the intangible), excess earnings, firm value negative value of net tangible assets and real options. (Salinas, 2009).

2.6.2 Valuing intangible assets/corporate reputation in mergers and acquisitions

There have been a tendency to overlook intangible assets as a vital source of competitive advantage in corporations. In addition, there has been a silence on valuing intangible assets. In order to manage reputation, companies need a strategy for measuring corporate reputation. Consistent measurement leads to a better management through a more accurate picture of performance. (Zandan & Lustina, 2013). The following section provide a method for accounting for corporate reputation.

Intangible assets are the principal source of value and risk in global economies that are knowledge based. (Mackie, 2009). Nir Kossovsky provided intangible asset-valuation insights to Mackie’s research (2009), he argue that the reason for the term “intangibles” are due to difficulty of putting them in well-defined boxes, as would typically be the case in the accounting world. Intangibles are interconnected, where each piece build enterprise value. (Mackie, 2009). Financial statements can be informational, although not always fully convey the underlying value of a company. Financial statements do not always include information about the drivers of value and the sources of risk. If one element is missing, the company may not function as profitable. According to Reilly (2013) there are a number of reasons to value intangibles; fair value financial accounting, tax compliance and controversy, sales and license transaction opinions, financing collateralization, bankruptcy solvency and reasonably equivalent value analysis, not-for-profit entity private inurement opinions, and litigation damages analysis.

The accounting of intangible assets needs to be defined and standardized. (Green & Julie, 2005). Whether it is in evaluating M&A synergies or simulating their post-merger impact on financial statements, intangible asset valuation and due diligence are key to the success or failure of M&A deals. In view of this, intangible asset valuation over the course of an M&A transaction needs to include three major components: comprehensive planning at the initial stage, full and accurate evaluation and due diligence leading up to the deal, and effective post-merger integration. (Yu, 2014). *Initial planning*: one need to understand the company's core value, the nature of its intangible assets, and the implications of the merger/acquisition. (Yu, 2014). Regarding *valuations* it is necessary to integrate technical, legal, financial, tax and industrial consulting, and to understand intangibles, as well as to carry out an assessment of potential intangible assets (that is, a preliminary purchase price allocation), and to develop a good understanding of the sources of intangible asset values and their impact on future financial reports. (Yu, 2014). *Post-merger integration*, it is necessary to implement an integration plan, together with a regular tracking consolidation performance and improvement plans. (Yu, 2014).

Kossovsky argue that if a company manages its intangibles well, the markets will reward them. The owner of the company "Steel City Re" (Kossovsky) found that companies that manage their intangibles in a superior way, tend to outerperform the market. "*Companies ranking in the top 10 percent in the intangible asset management (reputation) index returned 19 percent to shareholders in the 28-month period ending February 2008. Those in the bottom 25 percent lost 29 percent. An increase in dividend might be a result of the good reputation, thus increasing the existing reputation, creating higher dividend the subsequent year. Having a good reputation therefore might serve as a generator for increased dividend.*" (Mackie, 2009, p. 54). According to Lev, stock shares of intangible intensive companies are systematically undervalued. Why these difficulties sin valuing intangibles?

According to the financial advisory company, PwC, it can be difficult to value intangibles since they have no physical form. PwC list the following common reasons for incorrect valuations (Yu, 2014):

- Failure to understand the enterprise's core value and the special characteristics of its intangible assets;
- Neglect of external industrial and technological competition, such that the service lives of intangible assets are incorrectly estimated;
- Inability to extract intangible asset values individually, so that values are counted twice;
- Asymmetric information making it impossible to get complete information;
- Insufficiently rigorous analysis of the earnings-related utility from future use, underestimation of the deal's costs and risks, or overestimation of the expected synergies;
- Inappropriate valuation methods, or use of unrealistic numbers for comparisons when doing valuations;
- Insufficiently thoroughgoing on-site due diligence, where there is a failure to carry out comprehensive due diligence on the technological, legal, financial and other aspects of intangible assets.

The Accounting Standards Board document “Financial Reporting Standard Ten: Goodwill and Intangible Assets” from 1997 express that intangibles should be accounted for. The newly amended Statement of Financial Accounting Standards No. 25, "Business Combinations", and the recent SFAS 37, "Intangible Assets", determines that the price premium in a corporate acquisition must be divided into goodwill and identifiable intangible assets. This puts into practice the purchase price allocation method. This method reflects the underlying composition of a transaction's value. (Yu, 2014). The purchaser in an merger/acquisition must recognize, on the acquisition's effective date, the fair value of the acquired intangible assets. (Yu, 2014). Identifiable intangible assets with limited useful lives must be amortized in line with their estimated future consumption patterns. (Yu, 2014). On the other hand, identifiable intangible assets with indefinite useful lives will be treated the same as goodwill; that is, with annual testing for impairment. This accounting treatment for intangible assets will have an impact on operating results by post-M&A enterprises. The importance of intangible assets in those results will continue to grow. (Yu, 2014). With perfected due diligence and valuation procedures, it is possible to make sure that the benefits of intangible assets are realized, consequently adding value to the shareholders equity. (Yu, 2014).

Bowd and Bowd (2002) argue that establishing reputation as part of an organizations value, would help companies assess the value of their corporations or increase value through effective reputation management. Should the positive (or negative value) of reputation be expressed as financial value?

2.6.3 Valuation method

Not all academics support a financial valuation of reputation in the reporting statements. The lack of use of a complex valuation method is due to costs in time and resources or practitioner’s latent fears of having their work quantifiably, rather than qualitatively, assessed by clients or employees (Bowd & Bowd, 2002). This make up the need for asserting a financial method to intangible assets. Below is a proposed formula of providing a financial value to corporate reputation. “Accounting standards codification (ASC) only presents identifiable intangible assets that are valued at fair value for acquisition accounting purposes”. (Reilly, 2013).

According to Bowd & Bowd (2002) reputation does make up part of a corporate entity’s financial value. A correct valuation of reputation will help organizations assess the value of their corporation and increase value through effective reputation management (Bowd & Bowd, 2002). Bowd and Bowd (2002) argue that reputation belong in the Reporting Statements of a company. These statements do no need to be all-financial like fixed assets, but could be categorized as a “current asset”, since perceptions can change. Bowd and Bowd (2002) propose a conceptual formula in order to ascribe a value to reputation. Fombrun (1996) has already introduced the concept of “reputational capital” where the value of reputation could be an organization’s market value (MV) minus its tangible assets (A).

$$MV - A = \text{Financial Value for Reputation}$$

The reputational capital approach has been critiqued for being too simple, as well as not distinguishing what percentage is reputation, therefore this method need to be revised (Bowd

& Bowd, 2002). By using Fombrun and Gardberg's "Reputation Quotient" (see figure) as a quantifiable value, it is possible to incorporate a comparative method of valuation in the formula. The "reputation quotient" serve as the most comprehensive quantifiable non-financial valuation of reputation (Bowd & Bowd, 2002). *The measurement draws from methodology of political polling, but adds additional layers of complexity*. (Fombrun & Gardberg, 2000, p. 13). This quotient do not only uncover the popularity rating, but also why the company is popular. According to Fombrun and Gardberg (2000) this is done by examining how a group of stakeholders perceive companies on 20 underlying attributes, that consist of what they have defined as "the six pillars of reputation" (see figure below). Furthermore, the attributes are scored on seven point scales that describe how the company is perceived, which again is turned into a percentage rating" (Bowd & Bowd, 2002).

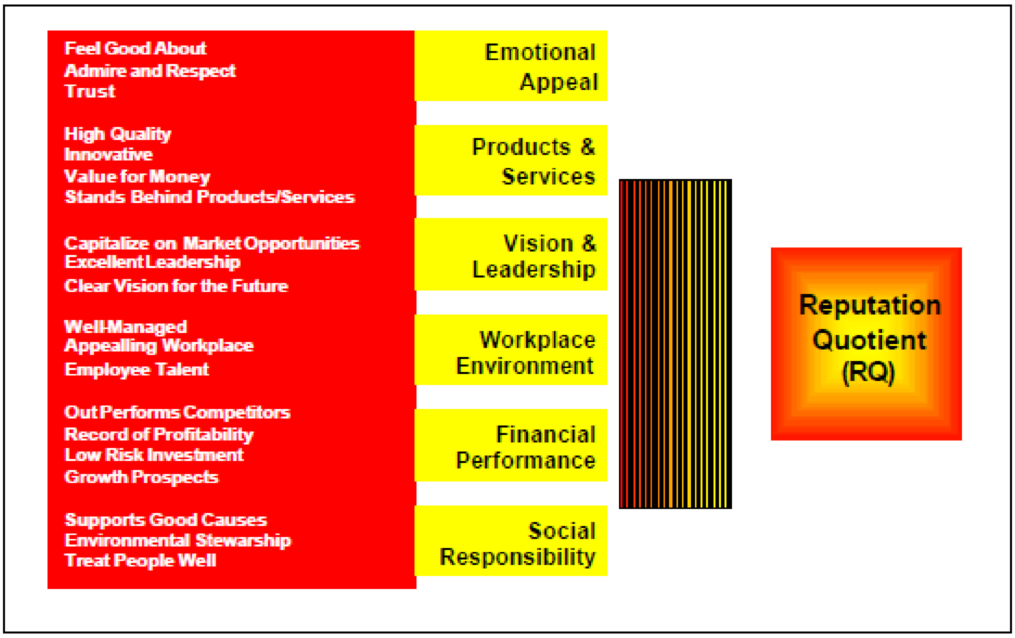
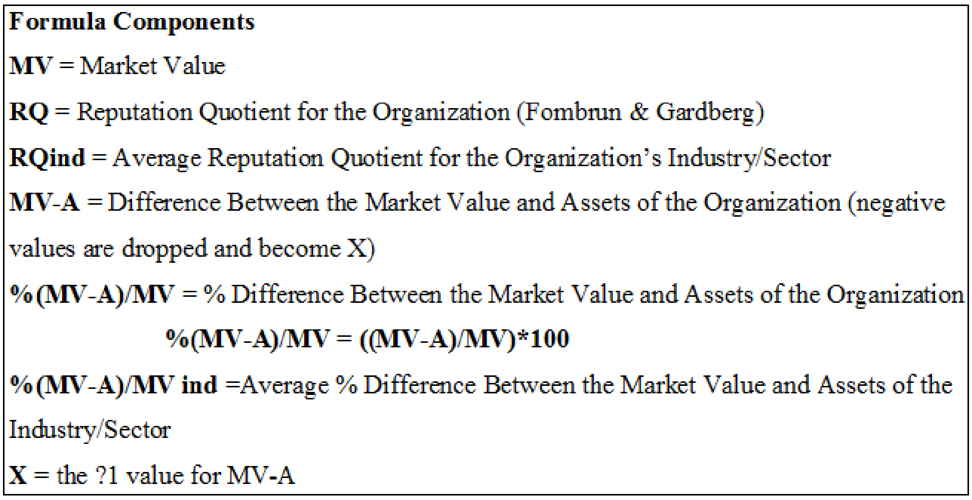

Feel Good About
Admire and Respect
Trust
Emotional Appeal
High Quality
Innovative
Value for Money
Stands Behind Products/Services
Products & Services
Capitalize on Market Opportunities
Excellent Leadership
Clear Vision for the Future
Vision & Leadership
Well-Managed
Appealing Workplace
Employee Talent
Workplace Environment
Out Performs Competitors
Record of Profitability
Low Risk Investment
Growth Prospects
Financial Performance
Supports Good Causes
Environmental Stewardship
Treat People Well
Social Responsibility
Reputation Quotient (RQ)

FIGURE 5. "REPUTATION QUOTIENT; PILLARS & ATTRIBUTES". (FOMBRUN & GARDBERG, 2000, P. 14).

Bowd and Bowd (2002) use a comparison within the same industry. From this, they reached the following; "*using percentage values of (MV-A)/MV [i.e. %(MV-A)/MV] and the Reputation Quotient (RQ) as well as industry averages for both (RQind & % (MVA)/ MV ind) a percentage value of reputation could be derived in relation to MV"* (Bowd & Bowd, 2002, p. 21).. This was based on the professional assumption that "essentially reputation is what differentiates you from your competitors". (Bowd & Bowd, 2002). Based on the above, Bowd and Bowd (2002) developed a formula, below we see the components present. As we see Fombrun’s (1996) reputational quotient is present.



Formula Components

MV = Market Value

RQ = Reputation Quotient for the Organization (Fombrun & Gardberg)

RQind = Average Reputation Quotient for the Organization’s Industry/Sector

MV-A = Difference Between the Market Value and Assets of the Organization (negative values are dropped and become X)

%(MV-A)/MV = % Difference Between the Market Value and Assets of the Organization

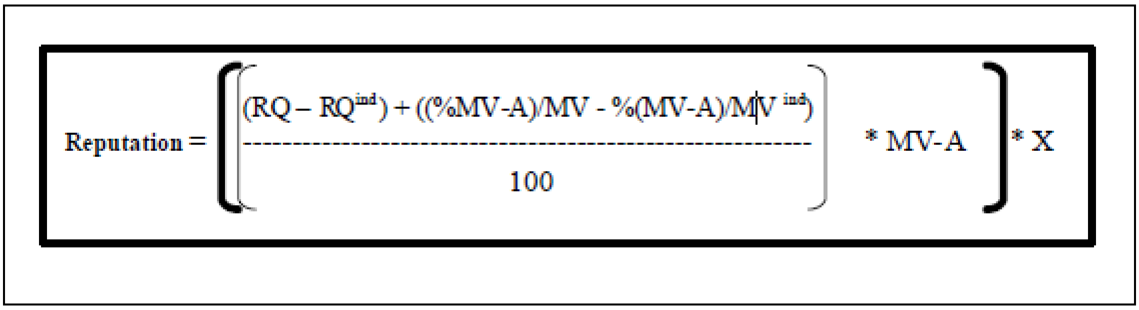
%(MV-A)/MV = ((MV-A)/MV)*100

%(MV-A)/MV ind =Average % Difference Between the Market Value and Assets of the Industry/Sector

X = the ?1 value for MV-A

FIGURE 6 FORMULA DERIVED BY BOWD AND BOWD (2002, P. 15)

Based on the above, the following formula was derived by Bowd and Bowd (2002).



$$\text{Reputation} = \left[\left(\frac{(RQ - RQ^{ind}) + ((\%MV\text{-}A)/MV - \%(MV\text{-}A)/MV^{\ ind})}{100} \right) * MV\text{-}A \right] * X$$

FIGURE 7 PROPOSED FORMULA. (BOWD & BOWD, 2002, P. 22).

The above formula account for both tangible and intangible aspects of financial values and reputation. Since this formula only provides information on a given time, it could be useful for reporting reputation in the balance sheets for annual reports (Bowd & Bowd, 2002). The stock market changes daily and perceptions change constantly the value could quickly become outdated, this formula might also prove beneficial in recurring valuations.

The theoretical background presented should be sufficient for further examination and analysis of corporate reputation in mergers and acquisitions. The following section provides a problem statement as well as three interconnected research questions that will guide this thesis towards an understanding as well as possible solutions.

3 Problem statement and research questions

The problem to be studied concerns the role of reputation in mergers and acquisitions. Current practice of due diligence seems to overlook reputation as an intangible asset toward a sustainable competitive advantage. Emphasizing reputation might increase economies of scale and synergies, making the probability of a successful merger/acquisition more likely. Since the main purpose of any acquisitions is to increase shareholder value, not including value creating assets may serve as long-term issues. My proposed research question summarizes this ambiguous relationship as follows:

«Including corporate reputation as an intangible asset in mergers and acquisitions improve accuracy and contributes to a sustainable competitive advantage"

A globalized economy requests the identification of drivers of sustainable competitive advantages in the field of intangible assets. Most US executive considers corporate reputation to be one of the most substantial drivers of success (Schwaiger, 2004). "*There are no general agreement on how to measure it, but there is a general agreement that it is important*." (Sobol, Farelly, & Taper, 1992). Including an assessment of reputation in a knowledge based, de-materialized economy, can prove essential in order to generate future profits as well as achieving a sustained competitive advantage.

Shedding light on the proposed research question might serve as an incentive in future mergers and acquisitions to include reputation in their due diligence, thus uncovering hidden possibilities for profit maximization as well as increased advantages of the combined firm. This thesis take it as given that corporate reputation is something transferable and purchasable in mergers and acquisitions.

3.1 Research questions and framework for dissertation

In order to answer the main research question, some guiding research questions is introduced. I will consider the following questions:

(1) What is the role of corporate reputation in mergers and acquisitions,

(2) Why should companies include an assessment of reputation in mergers and acquisitions,

and,

(3) How to include corporate reputation in due diligence

Few studies is conducted on the integration of corporate reputation in due diligence/mergers and acquisitions. The following section examine the assessment of corporate reputation in due diligence, with the aim of better accommodate accounting principles and correct valuation of assets. Current accounting practice categorize reputation as an indefinite lived asset, thus preventing the asset from occurring in fiscal balance sheets. By avoiding the inclusion in financial data, one also prevent "correct" valuation of a company's value, thus driving the price of a target company up/down. The following figure serves as the framework for this dissertation:

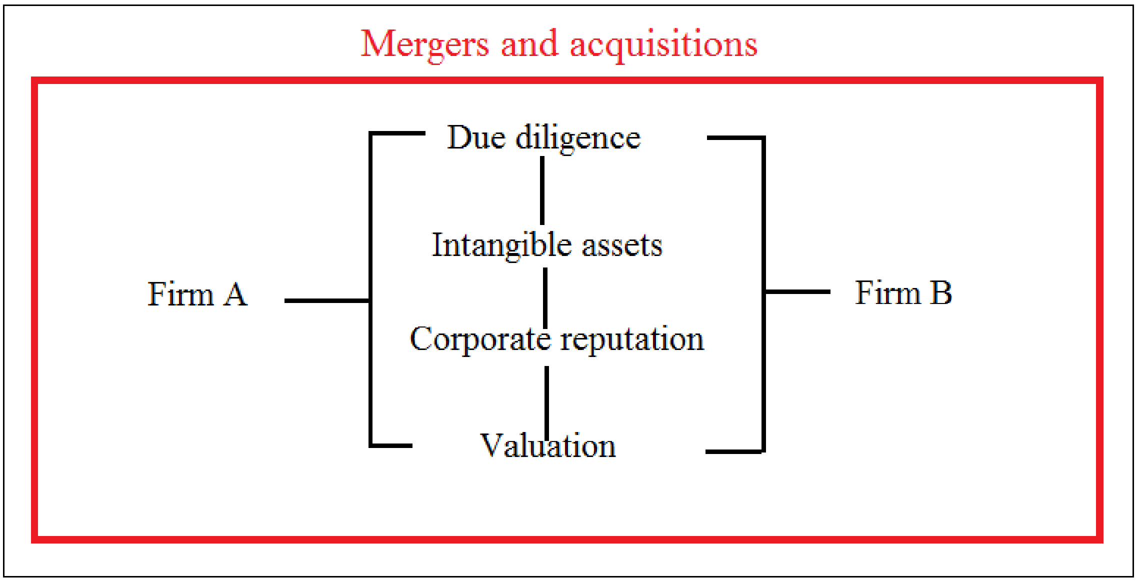

Mergers and acquisitions
Due diligence
Intangible assets
Corporate reputation
Valuation
Firm A
Firm B

FIGURE 8. CONTEXTUAL OVERVIEW

4 Methodology

The chosen research problem is located in a field of limited preliminary research, consequently turning some of this work to pioneer work. The data collection need to draw on primary sources, or secondary sources that had another motive than this paper. In order to answer the proposed research question, I needed to collect information from mergers and acquisitions, which led to selecting two M&A deals serving as illustrative examples. The scientific theoretical basis is a combination of inductive and deductive method. When examining the two mergers/acquisitions, two guiding variables led the analysis; (1) the role of reputation in M&A *documentation* and (2) the role of reputation in the *price* paid for the target company. Presented theory is used to compare and contrast information from the two merger/acquisition cases, aiming to uncover if reputation is accounted for as an intangible asset towards a sustainable competitive advantage. If reputation is considered vital in the value creating of the companies, it should be present in the merger/acquisition documentation/content of price, as well as the due diligence conducted pre-merger. The section regarding documentation received more attention due to the scope of his area. I have chosen mergers and acquisitions that date at least five years back in time in order to gain enough time-span that documentation and information exist. This allow me to analyze events that have changed over time. This chapter consist of methodological choices taken in order to enhance the quality of this thesis, namely choice of design, data collection as well as a review of validity and reliability. Last is a review of the two cases. A brief overview of each company is provided, before a review of each merger/acquisition.

4.1 Research design

The following section describes the design undertaken in this thesis.

"*A research design describes a flexible set of guidelines that connect theoretical paradigms first to strategies of inquiry and second to methods for collecting empirical materials*". (Denzin & Lincoln, 2008, ss. 33-34). The research question is closely related to context, consequently making it highly relevant to study actual cases, through a qualitative data collection method. This helps answer the research questions through an in-depth research and analyze the complex area of study. By employing a qualitative research method, this thesis might grasp an understanding of corporate and managerial actions influencing previous and current practice of mergers and acquisitions.

This study make use of two cases in order to reach an understanding/solution to the proposed research question. Schramm (1971) argues that the essence of a case study is to grasp an understanding as to why decisions where taken, how these decisions where implemented and what this result in. Based on the definitions of case studies, a qualitative case study is the right approach in order to answer the research question in this thesis. However, the choice of using cases, serve as a supplement to secondary sources presented under the theoretical framework. Moreover, Yin (2009) argues that the decisions being made are the main focus of case studies, thereby relating it to the proposed research question of practice in mergers and acquisitions.

Because this study has little/non preliminary research for support, an explorative design is beneficial. An explorative research design is often used when little knowledge exists in the field of study, and the researcher aim to achieve a better insight to the topic. (Gripsrud, Olsson and Silkoset 2006).This design is therefore beneficial when exploring a complex and limited covered subject. This definition is consistent with the aim of this paper, and is therefore chosen as the preferred design. Presented theory serves as secondary sources of information, aiming to contribute with insight and possible explanations of previous and current practice in merger and acquisitions, supplementing the information provided by the companies themselves. Empirical studies conducted by researcher before me, have proven important, even though their main objective have been different than that of this study.

This study focuses on a field of study that requires an examination of more than one company, thus introducing us to a multiple case method. (Yin, 2013). I have chosen to use two mergers and acquisitions, thus introducing four different companies. It is beneficial to focus on more than one case because it increase the probability of better performance. (Yin, 2013). "*Multiple case studies may, based on the variety between the phenomenon and contexts, contribute both to a better understanding of the interfaces between phenomenon and contexts and also to identification of different patterns in the interplay between them"* (Aaboen, Dubois and Lind 2012, p. 236).

Each case is carefully selected, aiming to uncover any differences in merger and acquisition practice. Some criteria's were set in order to obtain similarity within scope and document-accessibility of the companies; (1) of considerable size (publicly traded) and, (2) at least five years back in time. These two criteria ensure similarity in information retrieval. Moreover, (3) the two mergers/acquisitions should be in the same industry and (4) they should originate from the same time period. In order to maintain a common theme throughout this paper, I chose the IT industry due to the high degree and importance of intangible assets. The chosen mergers/acquisition is Hewlett-Packards acquisition with Opsware Inc. dated 2007, and Dell's acquisition with Perot Systems in 2009, which coincide with the previously proposed criteria for selection.

4.2 Data collection

This study collects data from secondary sources presented under "theoretical background", as well as documentation provided by the two cases. This study focuses on an area of limited preliminary research, where not much documentation or secondary sources exists to corroborate, consequently making the process of screening and analyzing correct documentation and academic literature a comprehensive process. Using documentation as a source of evidence is beneficial in several ways; study can be repeated, specific and exact, as well as being broad, in that it can cover a long time span and many events. (Yin, 2013). On the other hand, it can be difficulty retrieving relevant documentation which in turn can result in a biased selectivity. (Yin, 2013). Another critical factor is the access to documentation, as it might be deliberately withheld. (Yin, 2013). For instance we see that the ideal situation in a study like this, is being able to examine the due diligence of each company. However, not surprisingly, this is withheld, and kept highly secret.

Documentation provided by the companies consist of two variables that will give some indication as to what role reputation plays in mergers and acquisitions. Represented as (1) *documentation* provided by the companies in M&A's (Form 8-K, Form 10-K) and (2) the *price* paid for the target company in mergers and acquisitions. The variables are interrelated in that they all coexist and affect the value and presence of each other. These variables were chosen based on several considerations. First, documents provided by the companies says something about the type of information the companies disclose information about. This in turn, might say something about what the company deem important we well as the type of information, requested from the government. The price paid for the acquiring company says something about how much reputation is valued by the two companies through the due diligence process. An agreed upon price, means that one has the same understanding of how valuable corporate reputation is. The interrelated relationship is shown in several ways. For instance, the documents e.g. merger agreement and merger plan include the price paid for assets, as well as an overview od the valuation of different type of assets. After analyzing the role of these variables in the two M&A deals from the IT business, I compare and contrast information with presented theory. Yin (2011) argue that the use of documents may be important to supplement fieldwork. In addition, the use of combining data collection methods is typical in case studies. (Eisenhardt, 1989). Yin (2009) also argue for this data combination, by arguing that one of the strengths of case studies is the possibility of combining several different sources of evidence. The downside of selecting a method based on documentation is the accessibility to the “right” documentation. For instance, a due diligence contain a complete review of the company’s assets and value, and would therefore be ideal in an examination like this paper, however, this is the very reason it is kept highly secret from competitors, forcing researchers to analyze other types of information. The content of Form 8-K and Form 10-K is required by the federal government of the U.S, thus providing insight on the company’s current state. The price-content of both mergers/acquisitions might be difficult to attain, especially since the government do not demand a full disclosure of this subject.

The academic perspective guiding this paper, Jay Barney’s (1991) RBV and his work within competitive advantages is frequently cited by other leading academics. All secondary sources presented are thoroughly investigated as valid sources of information, by examining number of citations, origin of research as well as the recognition from the institute/company information originates.

The following sections provide information concerning the documentation selected in this thesis as well as the information concerning the price content.

4.2.1 M&A documentation

Documentation demanded by the government serves as an indication as to what is deemed relevant to assess in a merger/acquisition, both by the company and the federal government. If an assessment of reputation as an intangible asset is demanded in these documents, it is reason to believe the government (SEC) regard corporate reputation as an important intangible asset with value in the company. However, if not recommended by the government (SEC), it is reason to believe corporate reputation is not deemed important. The company can still choose to provide information on the reputational role of the company, thereby implying that reputation is deemed important by company themselves. Since this analysis concerns merger/acquisitions documentation, it is necessary to evaluate each company separately. Differences in management concerning measuring, valuation and categorization of intangible assets/reputation in mergers and acquisitions will be highlighted.

Documentation used in this paper mainly concerns Form 8-K and Form 10-K. Requirements regarding content and filing principles is guided by the SEC. The federal securities laws require publicly traded companies to disclose information on an ongoing basis. The issuer must file documents relating to merger agreements, for instance a definite merger-agreement on Form 8-K, and annual reports on Form 10-K, quarterly reports on Form 10-Q. (U.S Securities and Exchange Commision, 2014). The companies follow “Regulation S-K” when disclosing information. Regulation S-K is a prescribed regulation under the US Securities Act of 1933 that provide reporting requirement for a number of SEC filings. Each of the sections in Form 10-K require a set of information to be included. When analyzing and examining the form, a regulation called “S-X” will be used to disclose what kind and how extensive the information in Form 10-K, required by the government must be. The content on Form 8-K consist mainly of information directed towards shareholders concerning a material event related to the company. While, the content of Form 10-K pertain information regarding assets deemed important by the company, as well as financial status of acquired assets. Searching for the role of reputation in these reports is therefore beneficial in uncovering the role it plays in mergers and acquisitions.

In order to answer the proposed research question the analysis will examine the subsections of relevancy in the two SEC filings. If a subsection is deemed relevant or not, is based on the content provided by the company/information required by the SEC. Relevancy entails information regarding mergers and acquisitions, intangible assets, transfer of assets or corporate reputation. Information regarding these factors/themes might help answer the research question.

4.2.2 The price paid by the acquiring company

The second source of information involves analyzing and decomposing the price paid by the acquiring company in order to uncover the distinct elements being paid for. This in turn, will give an indication of the role of corporate reputation. This analysis will also be performed with each company separately. This analysis also considers each company separately, any differences in practice between the two companies will be highlighted.

Examining the components of the price paid for the target company can reveal what type of assets is regarded valuable by the selling company, as well as the monetary value put on them. The price is agreed upon by both companies, thus including the target firms own due diligence of its assets that contribute to a sustainable competitive advantage. examining the content of the price paid for the target company, might uncover what exactly is being paid, thus revealing the company's own estimation of asset value. This in turn, also focuses on the selling company's position in including the role of reputation in mergers and acquisitions. I seek to uncover if there has been as assessment of reputation in the price paid by the acquiring company. The two companies might provide different scope of information regarding price content.

4.3 Validity

According to Yin (2011) the key quality control issue of a study and the results it presents, relates to validity. In order to uncover if this examination has measured what it intended, one has to undergo an evaluation of the measures undertaken. Bryman and Bell (2007) emphasizes that generalization is one of the main problem areas in qualitative studies. This study do not aim to generalize results, rather explore if there is a recognition of certain organizational assets, as well as achieve an understanding of previous and current practice of managing corporate reputation in mergers and acquisitions.

When conducting this thesis, the majority of information where conducted from documentation from two companies as well as secondary sources presented in the theoretical background. The thesis would have been able to draw significantly more information from an actual due diligence from the two companies.

4.4 Reliability

Reliability concerns if the results of this paper are repeatable. If doing the same research over again would produce, somewhat, the same results. (Gripsrud, Olson and Silkoset 2006; Yin 2009). It would be possible for future researchers to conduct the same research in this paper, since all examination is done by analyzing publicly available documentation and information.

4.5 M&A deal 1.

This section provides information about each company in the merger/acquisition, as well as an overview of the conducted merger/acquisition. This information form the basis for further analysis. The following M&A deal is between Hewlett Packard and Opsware Inc., dated 2007. This acquisition is conducted in a so-called merger wave presented in the theoretical background.

4.5.1 Hewlett-Packard and Opsware Inc.

Hewlett Packard

Hewlett-Packard (HP) is an American multinational information technology corporation, formed by Bill Hewlett and Dave Packard in 1939. The company provides hardware, software and services to consumers, businesses and large enterprises, within the IT industry. HP is among the world's largest IT companies, with revenue totaling US$97.1 billion for the fourth fiscal quarters ended April 30, 2007. (Hewlett Packard, 2007). HP is the world’s leading PC manufacturer, since 2007, and the largest technology company in terms of revenue, as of 2010.The company specializes in developing and manufacturing computing, data storage, and networking hardware, designing software and delivering services. HP has made numerous mergers and acquisitions throughout the years, strengthening their position in the software business. (Hewlett-Packard, 2008).

Opsware Inc

Opsware, Inc is an American software company, formed in 1999 by Marc Andreessen. The company offers products for server and network device provisioning, configuration, and management targeted toward enterprise customers. The company was a market leader in data center automation, with a revenue of 101.7 million as of 2007. The company's software, the Opsware System, automates the data center, from provisioning to patching, configuration to compliance and discovery to deployment, turning data center operations into a competitive advantage for business. (Hewlett-Packard, 2014). Opsware's technology was used by hundreds of companies worldwide including banks, service providers, retailers, manufacturers and Internet companies with IT environments ranging from hundreds to tens of thousands of servers, network devices, storage devices and IT processes.

4.5.2 The merger/acquisition between Hewlett-Packard and Opsware Inc.

The merger agreement between HP and Opsware were submitted July 20, 2007. The agreement pertained the interest of HP acquiring Opsware for US$14.25 per share (90% of common shares), a total of US$1.6 billion. The purchase price is represented by a 68% price premium. The acquisitions with Opsware is the latest in a series of strategic software acquisitions, categorized as the third biggest in HP’s history. (Hewlett-Packard, 2008). The acquisition were conducted by a tender offer for all the remaining outstanding shares of Opsware on Sepetember 17, 2007, integrating Opsware into the HP software segment, becoming an HP subsidiary. (Hewlett Packard, 2007). The aggregate purchase price of approximately US$1.7 billion consisted of cash paid for outstanding stock, the fair value of stock options assumed and direct transaction costs.The acquisition positions HP to become a leader in the high-growth data center automation software market, strengthening the competitive role of HP. (Hewlett-Packard, 2007). The acquisition will enhance HP's portfolio of Business Technology Optimization (BTO) software. According to HP combining Opsware's solutions with HP's enterprise IT Management Software will deliver an fully integrated solution for IT automation.

The year following the acquisitions were characterized by strong growth in the business technology optimization (BTO) business unit resulting from revenue increases in support, growth in license revenue, partially as a result of the acquisition of Opsware Inc. (Hewlett-

Packard, 2008). HP Software net revenue increased 19.7% (14.4% when adjusted for currency) in fiscal 2008 from fiscal 2007. (Hewlett-Packard, 2008).

4.6 M&A deal 2.

The following M&A deal is between Dell Inc. and Perot Systems, dated 2009. This acquisition is conducted in a time of financial instability and uncertainty, during the financial crisis.

4.6.1 Dell Inc and Perot Systems

Dell Inc.

Dell is an American multinational computer technology company, founded by Michael Dell in 1984. The company develops, sells, repairs and supports computers, as well as related products and services. The company is one of the largest technological corporations in the world, with revenue totaling US$61.1 billion for the fourth fiscal quarter 2009. (Dell Inc., 2009). The company offer a range of products; mobility products, desktop PC's, software and peripherals, servers and networking, services, and storage. (Dell Inc., 2009). Dell has made numerous mergers and acquisitions throughout the years, strengthening their position in the computer business. (Dell Inc., 2009).

Perot Systems

Henry Ross Perot founded Perot Systems in 1988. Perot Systems provided information technology services and business solutions such as, application services and consulting services. (Bloomberg Businessweek, 2014). The company was especially strong in the health care industries with digitizing services and automating medical records. Perot Systems also delivered services to federal government, banking and insurance. The company had an annual revenue of US$2.8 billion as of 2008. (Dell Inc., 2009).

4.6.2 The merger/acquisition between Dell Inc. and Perot Systems

On September 21, 2009 it was announced that Dell Inc. and Perot Systems had entered into a definite agreement for Dell to acquire Perot Systems for US$3.9 billion. The deal closed at US$30 per share, representing a price premium of 68% over the previous closing price for Perot Systems stock. (Forbes, 2009). On November 3, 2009, Dell completed its acquisition of all the outstanding shares of Perot Systems. The acquisition were expected to provide customers a broader range of IT services and solutions, as well as a better position for Dell and immediate and long-term growth and efficiency. (Dell Inc., 2009). The acquisition enables Dell to supply more Perot Systems customers with Dell products and extends the reach of Perot Systems' capabilities to Dell customers around the world. Moreover, the deal strengthens Dells' position for immediate long-term growth and efficiency, mainly in three ways. First, providing a broad range of IT services and solutions, as well as optimizing how they are delivered. Secondly, extending the reach of Perot System's capabilities, and third by supplying leading Dell computer systems to even more Perot Systems customers. (Dell, 2014). According to Dell, the two companies share several key characteristics, and products, services and structures are complementary. Perot Systems will become Dell's services unit. After entering the acquisitions with Perot Systems, the company entered the market for IT systems.

5 Findings

The following section consist of an analysis of the two M&A cases. Each company undergo an analysis of their documentation pertaining mergers and acquisitions as well as intangible assets, before analyzing the price content of the acquired company. The terms merger and acquisition are often used interchangeably, both companies chosen as illustrative examples are by theory defined as acquisitions, however, they may address their consolidation as mergers. The first case to be analyzed is Hewlett-Packards acquisitions of Opsware Inc. in 2007.

5.1 Case 1. Hewlett-Packard and Opsware Inc.

5.1.1 Form 8-K

The merger agreement filed July 20. 2007 between Hewlett-Packard and Opsware Inc. emphasizes the expected completion before the end of HP's fourth fiscal quarter of 2007. (Hewlett Packard, 2007). Two exhibits are included in the Form 8-K submitted by Hewlett-Packard; (1) Exhibit 99.1 contains HP's press release announcing the transaction, and (2) Exhibit 99.2 contains a copy of the merger agreement. These two exhibits contain forwardlooking statements regarding risks, uncertainties and assumptions. The following analysis focuses primarily on exhibit 99.2, as the content of 99.1 only concerns the press release and is therefore of less importance.

Exhibit 99.2 is composed of nine subsections; (Hewlett Packard, 2007).

1. The offer and merger
2. Conversion of securities
3. Representations and warranties of the company
4. Representations and warranties of parent and purchaser
5. Conduct of business pending the merger
6. Additional agreements
7. Conditions
8. Termination
9. Miscellaneous

None of the above sections provide any information regarding the assessment of corporate reputation. The only intangible asset that receive attention is intellectual property (IP), in subsection three "*representation and warranties of the company*". (Hewlett Packard, 2007, p. 54). However, the definition of intellectual property do not incorporate corporate reputation, and is therefore of no relevance to this study.

5.1.2 Form 10-K

The annual report (Form 10-K) used in this analysis is dated 2007 and 2008. The report from 2007 and 2008 contributes with information as to how assets are managed in mergers and acquisitions, specifically the merger/acquisition with Opsware Inc., while the report from 2008 mainly contributes with financial information regarding the mergeroutcome with Opsware Inc. from 2007. The following analysis examines how Hewlett-Packard asses, manage, measure and value intangible assets, preferably corporate reputation, in mergers and acquisitions.

Companies obtain and manage intangible assets in a competitive market place. Since mergers and acquisitions is carried out as a strategy in external environments, and corporate reputation is made up by perceptions from the external environment it is important to get en understanding of the competitive pressure HP faces. Hewlett -Packard has the following statement regarding the company's competitive environment; *"We encounter aggressive competition in all areas of our business activity. We compete primarily on the basis of technology, performance, price, quality, reliability, brand, reputation, distribution, range of products and services, ease of use of our products, account relationships, customer training, service and support, security and availability of application software and our Internet infrastructure offerings."* (Hewlett-Packard, 2007, p. 11). *"The competitive pressures we face could harm our revenue, gross margin and prospects".* (Hewlett-Packard, 2007, p. 12).

Moreover, the company states that *"…quality issues can impair our relationships with new or existing customers and adversely affect our reputation, which could have a material adverse effect on our operating results".* (Hewlett-Packard, 2007, p. 17). Moreover, the company states that; *If we do not effectively manage our product and services transitions, our revenue may suffer"* (Hewlett-Packard, 2007, p. 17). As we see the company ascribe reputation an operational and financial value. The company also highlight the interrelationship between reputation and operational results.

Below is a review of the attention mergers and acquisitions receive in the Form 10-K.

5.1.2.1 Mergers and acquisitions in Form 10-K

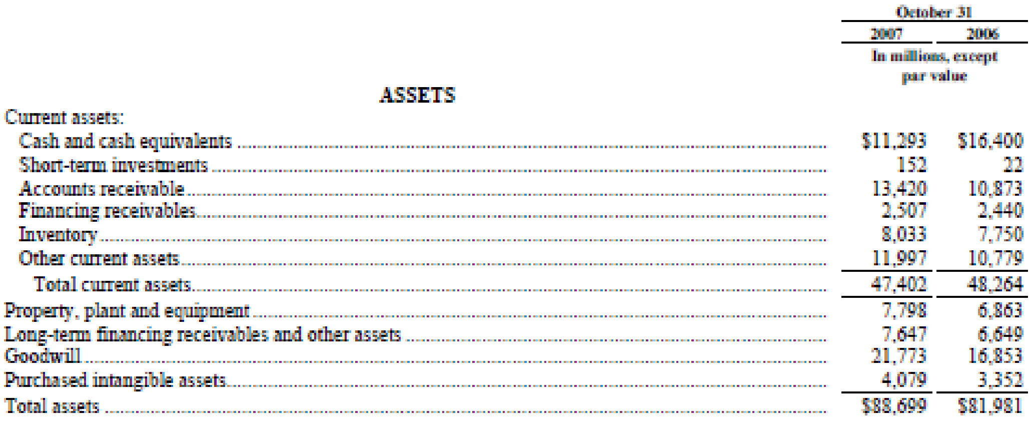
According to HP mergers and acquisitions make up an important feature of the company's existence. (Hewlett-Packard, 2007). Managing business combination and investment transactions requires varying levels of management resources, which may divert HP's attention from other business operations. *"Any failure by us to manage, complete and integrate acquisitions, divestitures and other significant transactions successfully could harm our financial results, business and prospects and may result in financial results that are different than expected"* (Hewlett-Packard, 2007, p. 27).

According to the 10-K report, HP records all acquisitions using the purchasing method of accounting, as well as the results of operations in HP's consolidated results as of the date of each acquisition. (Hewlett Packard, 2007). HP allocates the purchase price of its acquisitions to the tangible assets acquired, liabilities assumed and intangible assets acquired based on their estimated fair values. The excess purchase price over fair values is recorded as goodwill. (Hewlett-Packard, 2008). If additional information become available regarding the acquired assets, estimates associated with the accounting for acquisitions can change. (Hewlett-Packard, 2008).

5.1.2.2 Intangible assets in mergers and acquisitions

Analyzing the 10-K report submitted by Hewlett-Packard reveals their accounting- and management principles of acquired intangible assets and goodwill. Theoretical background and information by the company forms the basis of categorizing reputation as goodwill.

The following sections provides information regarding management of acquired intangible assets with indefinite lives and goodwill. Below is an overview of the company's assets at the end of fiscal year 2007.



	October 31	
	2007	2006
	In millions, except par value	
ASSETS		
Current assets:		
Cash and cash equivalents	$11,293	$16,400
Short-term investments	152	22
Accounts receivable	13,420	10,873
Financing receivables	2,507	2,440
Inventory	8,033	7,750
Other current assets	11,997	10,779
Total current assets	47,402	48,264
Property, plant and equipment	7,798	6,863
Long-term financing receivables and other assets	7,647	6,649
Goodwill	21,773	16,853
Purchased intangible assets	4,079	3,352
Total assets	$88,699	$81,981

FIGURE 9. CONSOLIDATED BALANCE SHEET (HEWLETT-PACKARD, 2007, P. 76)

HP do not disclose corporate reputation in any of their submitted documentation/reports, documentation available online or any merger/acquisition document.

Accounting for intangible assets and goodwill

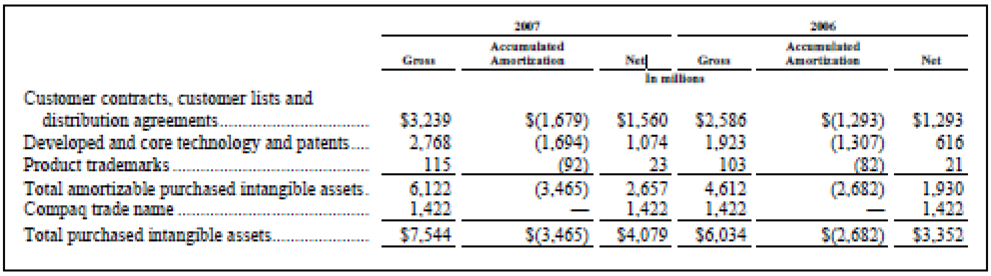
Hewlett-Packard manage the accounting for intangibles and goodwill as follows; *"We review goodwill and purchased intangible assets with indefinite live for impairment annually and* *whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets."* (Hewlett-Packard, 2007, pp. 41-42). Hewlett-Packard account for goodwill using the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). (Hewlett-Packard, 2007). Under SFAS No. 142, goodwill is considered to have an indefinite life, and is carried at cost. Goodwill is not amortized, but are assessed in an annual two-step impairment test and in between annual tests when events or circumstances indicate that the carrying value may not be recoverable. (Hewlett-Packard, 2007). In the first step of the two-step impairment test, HP compares the fair value of each reporting unit to its carrying value. Further, the company determines the fair value of its reporting units based on a weighting of income and market approaches. Under the income approach, HP calculates the fair value of a reporting unit based on the present value of estimated future cash flows. Under the market approach, HP estimates the fair value based on market multiples of revenue or earnings for comparable companies. (Hewlett-Packard, 2007). If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then HP must perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, HP records an impairment loss equal to the difference. The company base their fair value estimates on assumptions they believe to be reasonable but that are unpredictable and inherently uncertain, and the future results may differ from the proposed estimates. (Hewlett-Packard, 2007).

The annual goodwill impairment analysis, performed during the fourth quarter of fiscal 2008, did not result in an impairment charge to HP. (Hewlett-Packard, 2007). The excess of fair value over carrying value for each of HP's reporting units as of August 1, 2008, the annual testing date, ranged from approximately US$700 million to approximately US$37.9 billion. (Hewlett-Packard, 2007). In order to evaluate the sensitivity of the fair value calculations on the goodwill impairment test, they applied a hypothetical 10% decrease to the fair values of each reporting unit. This hypothetical 10% decrease would result in excess fair value over carrying value ranging from approximately US$500 million to approximately US$33.5 billion for each of HP's reporting units.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 provides guidance for using fair value to measure assets and liabilities. (Hewlett-Packard, 2007). SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, and does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is required to be adopted by HP in the first quarter of fiscal 2009. These changes will not apply to the chosen merger example, since this occurred in 2007. HP is currently evaluating the effect that the adoption of SFAS 157 will have on its consolidated results of operations and financial condition and is not yet in a position to determine such effects. (Hewlett-Packard, 2007).

Dell allocates the purchase price of its acquisitions to the tangible assets, liabilities, and intangible assets acquired based on their estimated fair values. The excess of the purchase price over the fair value of the identified assets and liabilities has been recorded as goodwill. (Dell Inc., 2009).

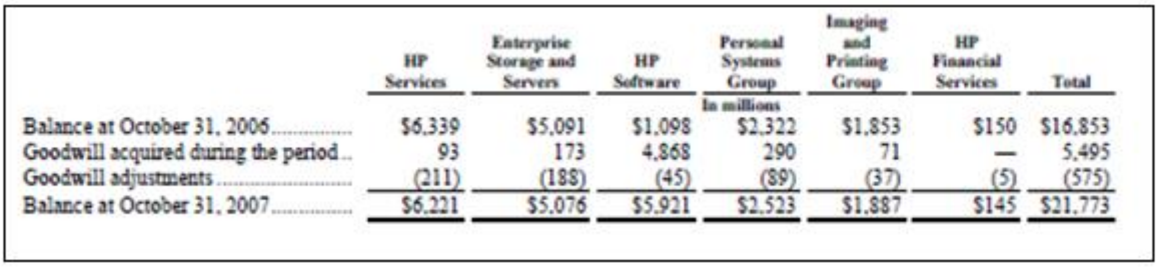
HP’s purchased intangible assets associated with completed acquisitions for each of the following fiscal years ended October 31, 2007 are composed of: (Hewlett-Packard, 2007, p. 102).



	2007			2006		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
			In millions			
Customer contracts, customer lists and distribution agreements	$3,239	$(1,679)	$1,560	$2,586	$(1,293)	$1,293
Developed and core technology and patents	2,768	(1,694)	1,074	1,923	(1,307)	616
Product trademarks	115	(92)	23	103	(82)	21
Total amortizable purchased intangible assets	6,122	(3,465)	2,657	4,612	(2,682)	1,930
Compaq trade name	1,422	—	1,422	1,422	—	1,422
Total purchased intangible assets	$7,544	$(3,465)	$4,079	$6,034	$(2,682)	$3,352

FIGURE 10. HP’S PURCHASES INTANGIBLE ASSETS ASSOCIATED WITH COMPLETED ACQUISITIONS. (HEWLETT-PACKARD, 2007, P. 102).

Goodwill allocated to HP's business segments as of October 31, 2007 and 2006 and changes in the carrying amount of goodwill during the fiscal year ended October 31, 2007 are as follows:



	HP Services	Enterprise Storage and Servers	HP Software	Personal Systems Group	Imaging and Printing Group	HP Financial Services	Total
				In millions			
Balance at October 31, 2006	$6,339	$5,091	$1,098	$2,322	$1,853	$150	$16,853
Goodwill acquired during the period	93	173	4,868	290	71	—	5,495
Goodwill adjustments	(211)	(188)	(45)	(89)	(37)	(5)	(575)
Balance at October 31, 2007	$6,221	$5,076	$5,921	$2,523	$1,887	$145	$21,773

FIGURE 11. GOODWILL ALLOCATED TO HP'S BUSINESS SEGMENTS (HEWLETT-PACKARD, 2007, P. 101)

The goodwill adjustments relate primarily to the reversal of income tax reserves of Compaq Computer Corporation ("Compaq"), which HP acquired in 2002, for pre-acquisition tax years.

Internal control over reporting

In the annual report submitted by HP in 2008 they review their own internal control over financial reporting. This internal control include; (1) *"the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of HP", (2) "provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of HP are being made only in accordance with authorizations of management and directors of HP", and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of HP's assets that could have a material effect on the financial statements."* (Hewlett-Packard, 2007, p. 73).

According to the information provided by Hewlett Packard through the annual report from 2008, critical estimates in valuing certain intangible assets consist of; future expected cash flows from customer contracts, customer lists, distribution agreements, acquired developed technologies/patents, costs expected to develop IPR&D. As well as brand awareness and market position, assumptions about the period of time the brand will continue to be used in HP's product portfolio, and discount rates. (Hewlett-Packard, 2007).

In the annual report, HP states that their external auditor supports the internal control conducted in the company. *"In our (Earnst and Young) opinion, Hewlett-Packard Company maintained, in all material respects, effective internal control over financial reporting as of October 31, 2007 based on the COSO-criteria (*framework for internal control*).* (Hewlett-Packard, 2007, p. 73).

5.1.3 The price paid by the acquiring company

On September 17, 2007, Hewlett-Packard completed its tender offer for Opsware Inc. and acquired more than 90% of Opsware's common shares for cash consideration of US$14.25 per share. On September 21, 2007, HP acquired all remaining outstanding Opsware Inc. shares. As previously stated, the consolidation between HP and Opsware Inc where the third biggest acquisition in HP's history. It is therefore reasonable to assume that there has been a thorough price estimation of every value-driving asset in the company, by both companies.

The aggregate purchase price of approximately US$1.7 billion consisted of cash paid for outstanding stock, stock options and direct transaction costs. In connection with this acquisition, HP recorded about US$1.3 billion of goodwill and US$249 million of amortizable intangible assets. (Hewlett-Packard, 2008). HP is amortizing the purchased intangibles on a straight-line basis over their estimated lives ranging from five to six years. HP did not record any IPR&D in connection with the Opsware acquisition. (Hewlett-Packard, 2008)

The purchase price of acquired companies is allocated to the tangible assets acquired, liabilities assumed and intangible assets acquired, including in-process research and development (''IPR&D''), based on their estimated fair values. (Hewlett Packard, 2007). The excess of the purchase price over these fair values is recorded as goodwill, consequently making corporate reputation a part of the goodwill portion. HP engage independent third-party appraisal firms when determining the fair values of assets acquired and liabilities assumed. Such valuations require management to make significant estimates and assumptions, especially with respect to intangible assets. (Hewlett-Packard, 2007).

The transaction-valuation was calculated by adding the sum of the offer price of US$14.25 per share multiplied by 105,811,082 shares of common stock, par value US$0.001 per share, of Opsware Inc. outstanding as of July 16, 2007. Moreover, 24,618,041 shares of common stock par value US$0.001 per share, of Opsware Inc., were subject to issuance pursuant to the exercise of outstanding options as of July 16, 2007, multiplied by the amount equal to US$14.25 minus US$6.16 (the weighted average exercise price of such outstanding options as of July 16, 2007). (Hewlett-Packard, 2007)

The price at 1.7 billion for Opsware, included a price premium of 38 %. The expected price per share were between US$12 to US$14 per share, but the deal closed at US$17 per share. The premium of 38 % consist of, is considered abnormally high, and some investors argued HP have to squeeze out substantial growth in order to justify the price. (24/7 Wall Street, 2014).

5.2 Case 2. Dell Inc. and Perot Systems

5.2.1 Form 8-K

The merger agreement emphasizes expected completion before the end of Dell’s fourth fiscal quarter of 2009. (Dell Inc., 2009). There are no financial statements attached to Form 8-K, however there are three exhibits present; exhibit 2.1, exhibit 2.2 and exhibit 99.1. Exhibit 2.1 is the agreement and plan of merger dated September 20, 2009. (U.S. Securities and Exchange Comission, 2009). Exhibit 2.2 is the First Amendment, dated September 30, 2009. Exhibit 99.1 is the press release issued by Dell Inc, November 3, 2009. (U. S Securities and Exchange Commission, 2014). The content of these exhibits consist mostly of practical information and clarifications.

5.2.2 Form 10-K

The acquisition of Perot Systems was completed in the fourth quarter of fiscal 2009. The annual report used in this analysis is dated 2009 and 2010. The report from 2009 and 2010 contributes with information as to how assets are managed in mergers and acquisitions, while the report from 2010 mainly contributes with financial information from the merger/acquisition with Perot Systems dated 2009. The following analysis will focus on how Dell asses, measure and value intangible assets in mergers and acquisitions.

5.1.4.1 Form 10-K. Mergers and acquisitions

According to the 10-K form submitted by Dell Inc, they acquire companies as a part of their overall growth strategy. (Dell Inc., 2009). During fiscal 2009, Dell Inc. acquired three companies. (Dell Inc., 2010). The acquisitions undertaken by Dell involve risks and uncertainties like distracting management attention away from current business operations, insufficient new revenue to offset expenses, inadequate return of capital, integration challenges, new regulatory requirements, and issues not discovered in the due diligence process. (Dell Inc., 2010). Dell Inc. point out that it is not possible to give assurance as to the success of acquisitions. (Dell Inc., 2009).

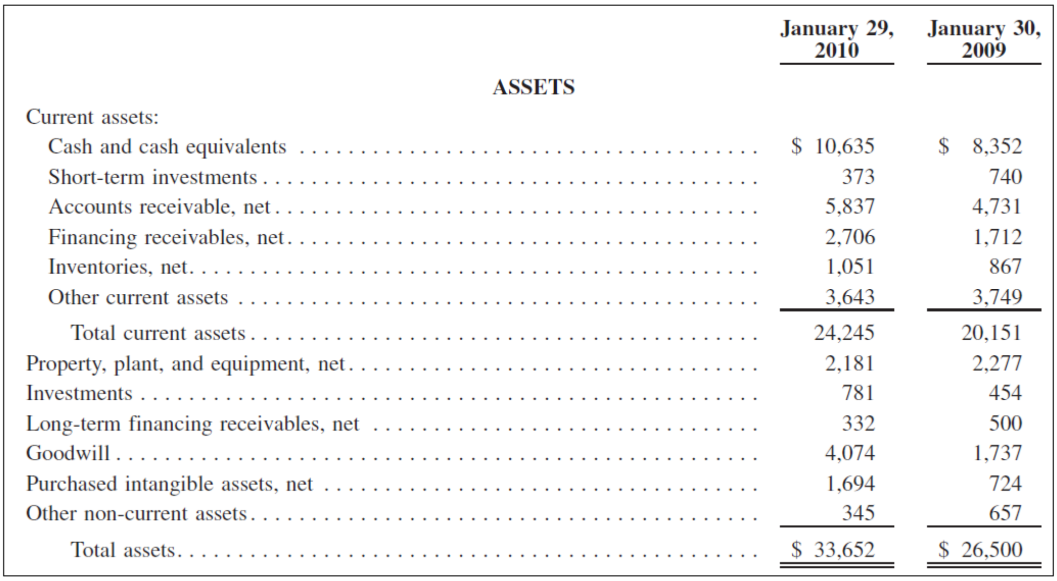
Dell has recorded all of its acquisitions using the purchase method of accounting in accordance with SFAS No. 141, "*Business Combinations*". Accordingly, the results of operations of the acquired companies have been included in Dell's consolidated results since the date of each acquisition. Dell allocates the purchase price of its acquisitions to the tangible assets, liabilities, and intangible assets acquired. (Dell Inc., 2009). The excess of the purchase price over the fair value of the identified assets and liabilities is recorded as goodwill. (Dell Inc., 2009). The fair value assigned to the assets acquired is based on valuations using management's estimates and assumptions. (Dell Inc., 2010).

5.1.4.2 Intangible assets and goodwill in mergers and acquisitions

According to the annual report submitted by Dell from 2010, Dell built its reputation as a leading technology provider through "listening to customers and developing solutions that meet customer needs." (Dell Inc., 2010). A disruption could cause Dell to lose customers and revenue, particularly during a period of disproportionately heavy demand, and could result in the unintentional disclosure of company or customer information and could damage our reputation. (Dell Inc., 2010). Defective parts and products from these vendors could reduce product reliability and harm our reputation. (Dell Inc., 2010).

Analyzing the report From 10-K submitted by Dell reveal their accounting- and management principles of acquired intangible assets and goodwill. According to Dell, defective parts and products can reduce product reliability and harm their reputation. (Dell Inc., 2010). Dell do not disclose any information regarding corporate reputation in any of their submitted documentation/reports, documentation available online or any merger/acquisition documentation. Based on theoretical background and information provided by the company corporate reputation falls under the category of goodwill, which forms the basis for the following review.

Below is an overview of the company's intangible assets and goodwill at the end of fiscal year 2010. (Dell Inc., 2010, p. 50).



	January 29, 2010	January 30, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,635	$ 8,352
Short-term investments	373	740
Accounts receivable, net	5,837	4,731
Financing receivables, net	2,706	1,712
Inventories, net	1,051	867
Other current assets	3,643	3,749
Total current assets	24,245	20,151
Property, plant, and equipment, net	2,181	2,277
Investments	781	454
Long-term financing receivables, net	332	500
Goodwill	4,074	1,737
Purchased intangible assets, net	1,694	724
Other non-current assets	345	657
Total assets	$ 33,652	$ 26,500

FIGURE 12 CONSOLIDATED STATEMENTS OF FINANCIAL STATEMENTS (DELL INC., 2010, P. 50).

Accounting for intangibles and goodwill

The new FASB guidance on business combinations that Dell adopted during fiscal 2010 retains the underlying concepts of the previously issued standard, in that the acquirer of a business is required to account for the business combination at fair value. (Dell Inc., 2010). As under previous guidance, the assets and liabilities of the acquired business are recorded at their fair values at the date of acquisition. (Dell Inc., 2010). The new pronouncement results in some changes to the method of applying the acquisition method of accounting for business combinations in a number of significant aspects, however, this does not apply to the acquisitions between Dell and Perot Systems because they adopted the changes in 2010.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations* ("SFAS 141(R)"). SFAS 141(R) requires that the acquisition method of accounting be applied to a broader set of business combinations and establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, any non-controlling interest in the acquiree, and the goodwill acquired. SFAS 141(R) also establishes the disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008 and is required to be adopted by Dell Inc. beginning in the first quarter of Fiscal 2010, thus the changes will be implemented after the relevant acquisition of example. All acquisitions completed prior to Fiscal 2010 are recorded using the purchase method of accounting in accordance with previous FASB guidance. Management believes the adoption of SFAS 141(R) will not have an impact on results of operations, financial position, and cash flows for acquisitions completed prior to Fiscal 2010. The impact of SFAS 141 (R) on future consolidated results of operations and financial condition will be dependent on the size and nature of future combinations. (Dell Inc., 2009). The fair value assigned to the assets acquired and liabilities assumed is based on valuations using management's best estimates and assumptions. Dell does not expect the majority of goodwill related to these acquisitions to be deductible for tax purposes. In compliance with FASB guidance on goodwill and intangible assets, Dell defines its reporting units as its reportable business segments. (Dell Inc., 2010).

Any change in the estimated fair value of the net assets, prior to the finalization of the more detailed analyses, but not to exceed one year from the date of acquisition, will change the amount of the purchase price allocable to goodwill. Any subsequent changes to the purchase price allocation that are material to Dell's consolidated financial results will be adjusted retroactively. Dell state that they are not aware of any significant potential changes to the preliminary purchase price allocation. (Dell Inc., 2010).

Internal control

According to the annual report from 2010 submitted by Dell Inc. management, is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting. (Dell Inc., 2010). Further, we see that internal control over financial reporting includes those policies and procedures which (a) "*pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets*", (b) "*provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with*

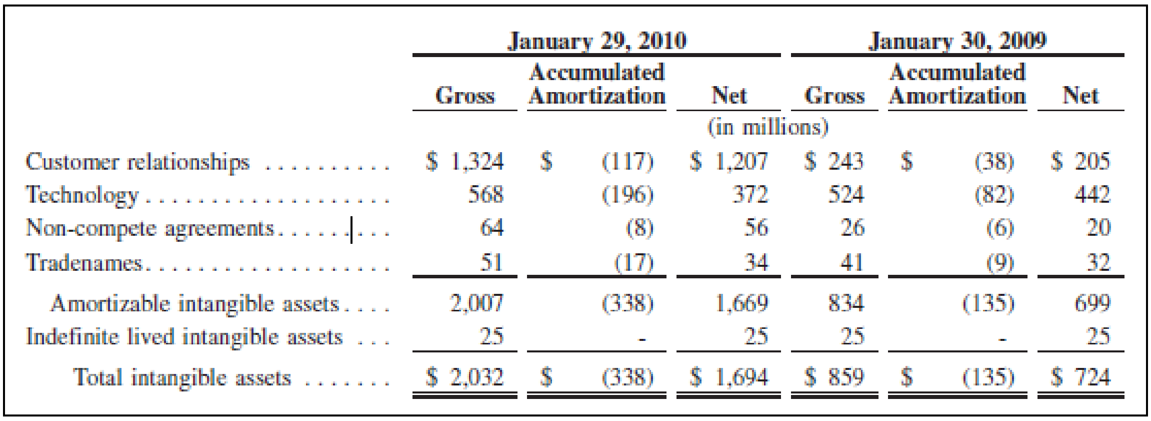
GAAP", (c) "*provide reasonable assurance that receipts and expenditures are being made only in accordance with appropriate authorization of management and the board of directors"*, and (d) "*provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of assets that could have a material effect on the financial statements.*" (Dell Inc., 2009, p. 100).

Based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, the management of Dell Inc. concluded that internal control over financial reporting was effective as of January 30, 2009. The effectiveness of their internal control over financial reporting as of January 30, 2009 has also been audited by PricewaterhouseCoopers LLP. (Dell Inc., 2009).

Goodwill represents the excess of the purchase price over the fair value of net assets, including the amount assigned to identifiable intangible assets. (Dell Inc., 2009). Given the time it takes to obtain pertinent information to finalize the acquired company's balance sheet, it may be several quarters before Dell is able to finalize those initial fair value estimates. Accordingly, it is not uncommon for the initial estimates to be subsequently revised. The results of operations of acquired businesses are included in the Consolidated Financial Statements from the acquisition date. Identifiable intangible assets with finite lives are amortized over their estimated useful lives. They are generally amortized on a nonstraight-line approach based on the associated projected cash flows in order to match the amortization pattern to the pattern in which the economic benefits of the assets are expected to be consumed. They are reviewed for impairment if indicators of potential impairment exist. Goodwill and indefinite lived intangibles assets are tested for impairment on an annual basis in the second fiscal quarter, or sooner if an indicator of impairment occurs. Given the rapid changes in the market place during the second half of Fiscal 2009, Dell Inc. updated their impairment analysis in the fourth quarter and concluded that there were no impairment triggering events. (Dell Inc., 2009).

As mentioned previously goodwill and indefinite-lived intangible assets are tested for impairment on an annual basis in the second fiscal quarter, or sooner if an indicator of impairment occurs. To determine whether goodwill is impaired, Dell determine the fair values of each of their reportable business unit using a discounted cash flow methodology and then compare the fair values to the carrying values of each reportable business unit. Dell concluded that there were no impairment triggering events during fiscal 2010. (Dell Inc., 2010).

Identifiable intangible assets include customer relationships, internally developed software, non-compete agreements, and trade names and other assets. Dell's intangible assets associated with completed acquisitions at January 29, 2010 and January 30, 2009, are as follows:



	January 29, 2010			January 30, 2009		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
			(in millions)			
Customer relationships	$ 1,324	$ (117)	$ 1,207	$ 243	$ (38)	$ 205
Technology	568	(196)	372	524	(82)	442
Non-compete agreements	64	(8)	56	26	(6)	20
Tradenames	51	(17)	34	41	(9)	32
Amortizable intangible assets	2,007	(338)	1,669	834	(135)	699
Indefinite lived intangible assets . . .	25	-	25	25	-	25
Total intangible assets	$ 2,032	$ (338)	$ 1,694	$ 859	$ (135)	$ 724

Figure 13. Dell's intangible assets associated with completed acquisitions. (Dell Inc., 2010, p. 76).

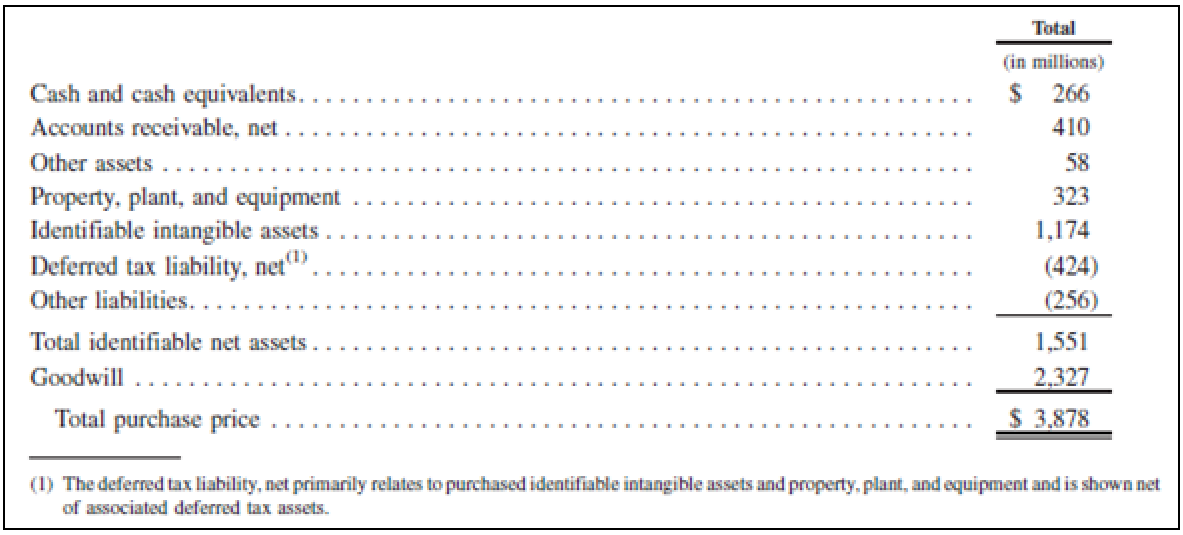
During fiscal 2010 and 2009, Dell recorded additions to intangible assets of $1.2 billion and US$64 million. The US$1.2 billion in additions to intangible assets in fiscal 2010 all relates to the acquisition of Perot Systems. Amortization expense related to finite-lived intangible assets was approximately US$205 million and US$103 million in Fiscal 2010 and in Fiscal 2009, respectively. During the fiscal years ended January 29, 2010, and January 30, 2009, Dell did not record any impairment charges as a result of its analysis of its intangible assets. (Dell Inc., 2010).

The purchase price allocations for the acquisitions undertaken by Dell Inc. are subjected to revision as more information concerning assets becomes available. Changes in the estimated value of assets, within one year of the acquisition, will change the amount of the purchase price allocable to goodwill. (Dell Inc., 2009). Goodwill and intangible assets are measured at fair value initially and subsequently when there is an indicator of impairment and the impairment is recognized.

5.2.3 The price paid by Hewlett-Packard for Opsware Inc.

September 21, 2009, Dell Inc. signed an agreement to acquire Perot Systems for US$3.9billion. Unlike the case between Hewlett-Packard and Opsware Inc. where the parties disclosed and commented the price content in the Form 10-K, Dell Inc. has provided a balance sheet that uncovers the price paid for each asset.

The table below summarizes the consideration paid for Perot Systems, and the amounts of assets acquired and liabilities assumed recognized at the acquisition date: (Dell Inc., 2010, p. 73).



	Total (in millions)
Cash and cash equivalents	$ 266
Accounts receivable, net	410
Other assets	58
Property, plant, and equipment	323
Identifiable intangible assets	1,174
Deferred tax liability, net[1]	(424)
Other liabilities	(256)
Total identifiable net assets	1,551
Goodwill	2,327
Total purchase price	$ 3,878

[1] The deferred tax liability, net primarily relates to purchased identifiable intangible assets and property, plant, and equipment and is shown net of associated deferred tax assets.

Figure 14. Consideration paid for Perot Systems. (Dell Inc., 2010, p. 73).

The goodwill of US$2.3 billion represents the value that is expected from combining Perot Systems with Dell to provide customers with a broader range of IT services and solutions as well as optimizing how these solutions are delivered. (Dell Inc., 2010). The results of operations of the acquired companies have been included in Dell’s consolidated results since the date of each acquisition. The acquisitions were represented by a 68 percent price premium. Dell paid cash, US$30 per share, a 61 per cent premium over the company’s previous closing price.

After uncovering the role of reputation, it is possible to look into whether an assessment of reputation would be beneficial and thereby could have strengthen the outcome of the merger/acquisition. However, this is dependent upon measuring standards and reliable\le valuation methods.

6 Discussion

The following section compare and contrast the totality of presented theory and empirical results. This section attempts to explain current practice as well as possibilities for future changes and improvements. The following discussion is divided in three parts, each conducting a thorough discussion of presented research questions in order to answer the main problem. The role of corporate reputation in mergers and acquisitions was uncovered using two distinct sources of information, namely documentation and price content as well as theoretical background serving as a secondary source. Although the three sources provide distinct and independent information, they seem to coincide on the role of corporate reputation in mergers and acquisitions.

6.1 The role of corporate reputation in mergers and acquisitions

Since reputation play an important role in the decision to merge (Costa & Vasconcelos, 2011), it should be an important feature throughout the merger/acquisition process. After analyzing the role of corporate reputation in merger/acquisition documents and merger/acquisition price, there are some apparent similarities in the position of corporate reputation. The most eminent similarity from these two analytical tools is the absence of corporate reputation as a source of sustainable competitive advantage. Although theory from strategic- and business literature advocate the importance of this asset, practice seem to deviate from theory.

6.1.1 Merger and acquisition documentation

There seemed to be a general perception in both merger/acquisitions examples, and throughout the analysis, that reputation is an important feature of a company. One of Hewlett-Packard's primary areas of competition is reputation, (Hewlett-Packard, 2007) and as we have seen, HP state that the competitive pressure might harm revenue, gross margin and prospects. (Hewlett-Packard, 2008). It is questionable how someone can *primarily* compete on something that is not categorized, measured and valued *visibly* as an asset of the company, nor receives any valuation or attention in financial documentation or balance sheets. Both companies emphasize the risk inherent in any merger/acquisition, though they do not mention corporate reputation as one of these risks. Which indicates that neither if the companies undergo a reputational risk evaluation of the opposing company or the two combined.

According to the annual report submitted by Hewlett-Packard (2008) and Dell Inc. (2010), the companies divide their assets in two parts, (1) tangible asset and (2) intangible assets and goodwill with definite- and indefinite lives. Corporate reputation do not play any apparent role in neither of the two acquisitions described in this thesis. Therefore, positioning the asset accordingly involves categorizing the asset is by analyzing company-statements and comparing theory. Based on the reports submitted by the companies themselves, corporate reputation do not qualify as intellectual property, which is in line with proposed theory. (Hewlett Packard, 2007; Dell Inc., 2009). Both companies disclose how the excess price of market value is defined as goodwill, consequently reputation seem to take place within this category, thus coinciding with theory that reputation is a part of goodwill. Based on the above, corporate reputation, although not formally stated nor defined, seem to appear as a subset of goodwill.

During the analysis of M&A documentation, it became apparent that the U.S government do not request any disclosure regarding corporate reputation. Despite this lack of demand, it is possible to link corporate reputation as an important feature in subjects within Form 10-K. For instance, the government demand information regarding risk factors under “Item 1A”, which relates to corporate reputation because it is an asset connected to risk of losing or damaging it. The relationship between management and reputation, is closely related to risk, since reputation is made up by perceptions and there is difficulties concerning control and management. Assessing reputation under this section could be desirable, for instance because it would provide additional information to shareholders and the “SEC”. Moreover, “Item 6”, concerns “selected financial data” and according to regulation S-K (§229.301) “*The purpose of the selected financial data shall be to supply in a convenient and readable format selected financial data which highlight certain significant trends in the registrant's financial condition and results of operations.*” (Cornell University Law School, 2014). If the objective is to uncover “trends” regarding financial condition and operations, corporate reputation would be a source of trend information, consequently reporting the financial condition of the company. Moreover, since reputation is made up of perceptions through a range of different constituencies, reputation might be able to tell the market value of the company in a different way than the usual indicators of a company’s health (for instance numbers of products sold). Measuring corporate reputation accordingly to Bowd and Bowd (2002) formula would provide an instant financial and operational indication. Moreover, according to the S-K regulation (§229.303), item 7, requires information concerning “off balance sheet arrangements” (Cornell University Law School, 2014). As we have seen from previously presented theory, corporate reputation have an impact on the financial performance of the company, which makes reputation an off-balance sheet arrangement that affect future finances. Reputation is not mentioned once in the entire S-X regulation or in item 9, 10, 11, 12, 13, 14 and 15 of the 10-K form. Neither HP nor Dell address corporate reputation as an asset in any of their documentation prevailing mergers and acquisitions. The lack of acknowledgement of corporate reputation is remarkable, especially considering we exist in a corporate world cautious of legal consequences and loss of revenue, if failing to comply the rulings by the SEC.

HP and Dell Inc. emphasizes that estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired. This is in line with reputational management as it is composed of perceptions, and perceptions change constantly, which make this asset in need of more frequent assessments. Examining the 10-K form, reveals a lack of emphasize on reputation as a *separate* intangible asset. If using Bowd and Bowd’s (2002) formula help value corporate reputation, maybe the value of reputation is higher than what the value of goodwill is currently accounted for. If this is the case, than it is an evidence in itself that reputation do not play any role in the company’s balance sheet, however this might be a stretch. It is possible to get a grasp on the totality and the value of reputation combined with other intangibles, which would be beneficial for an increased organizational understanding. Both companies undergo two impairment tests of their intangible assets twice a year, neither HP or Dell record any impairment charges during fiscal 2007/2008 (HP) or fiscal 2009/2010 (Dell). (Dell Inc., 2010). This seems odd, since reputation is based upon perceptions, and perceptions changes continuously, there should be a change in corporate reputation, or this is an indication that neither the companies account for reputation.

We see both external auditor companies (HP by Ernst & Young and Dell by PwC) agreeing upon good internal control being maintained by both HP and Dell Inc. (Dell Inc., 2009; Hewlett-Packard, 2007). This is however questionable since corporate reputation do not *seem* to be included in any assessment in neither of the companies.

6.1.2 Price content of mergers/acquisitions

DePamphilis (2008) argued that overpayment and poor strategy are some of the common reasons mergers and acquisitions fail. Perhaps overpayment can relate to the difficulty of assessing a reputational-consideration in M&A's? Both acquisitions is represented by a high price premium, respectively 38 per cent in the HP acquisitions and 68 per cent in the Dell acquisitions. This excess purchase price is categorized as goodwill, when the amount of goodwill is that high, there should be "reasonable" and deemed as important do disclose what this amount consist of. How is it possible that current financial practice do not demand further disclosure, especially in monetary situations of this scale. How can the shareholders be informed of what is being paid for, and how is it possible to understand if one is achieving the value paid for? If the company's purchasing price is equally distributed between tangible- and intangible assets, (or a large portion is represented by intangibles, like the HP case) not valuing all elements representing intangible assets, is misleading and presents a wrongful picture of the company. Alternatively, categorizing corporate reputation as "goodwill" might be wrong. Different measurements tools are developed in order to measure reputation, which should make mis-categorization of reputation as unnecessary.

HP and Dell allocates the purchase price of its acquisitions to the tangible assets, liabilities, and intangible assets acquired, which indicate that corporate reputation should be included in the price when acquiring new companies. However, neither the price content, the presented content of goodwill or the mention in any documents, include corporate reputation. If the target company, Opsware Inc. and Perot Systems in this case, have conducted a "due diligence" on own operations, like DePamphilis (2008) suggests, and included an assessment of corporate reputation, the price can be driven up. On the other hand, this would be an incentive for HP to *not* include corporate reputation in due diligence, because the price would be driven up, but this is only the case if reputation is deemed high. If the reputation is negative, the buyer will include it, thus pushing the price down. Including an assessment in due diligence, is therefore only beneficial for the buyer, and there is absolutely no incentive for the target company to willingly provide information about reputation if it is a negative one. If the reputation is positive, the target company should measure and value it, thus facturing it into a price they feel are sufficient. Although an assessment of reputation would be beneficial for the acquirer, the target company can feel adverse consequences, as well as increased pre-transaction costs. Why would the target company willingly conduct additional research of own operations that could potentially push the price down as well as harm future business.

After reviewing merger and acquisition practice in the two companies, there almost seem to be a common recipe of how to assess, integrate and manage mergers and acquisition activities. Even though the two companies have two separate auditors, (HP audited by Ernst and Young, 2007/2008 and Dell audited by PwC, 2009/2010) they seem to have the same procedures. Both HP and Dell follows the same policies over internal control regarding financial reporting. These policies are directed towards correct management of assets, and can therefore relate to the management of corporate reputation. We see for instance that good internal control, includes an accurate reflection of transactions and dispositions of assets, which would (arguably) be achieved to a greater extent by including an assessment of corporate reputation. Furthermore, we find the policies put in place by the federal government, that demand companies to provide reasonable assurance that transactions are recorded as necessary, do not include corporate reputation,. Consequently the financial statements prepared on this very basis, *also* excludes this intangible asset. When corporate reputation is not included in any financial statement, it is seems as if this policy is not maintained. If this is explained by legal demands imposed by the SEC, or “ignorance” by the companies is not easy to say, nevertheless a unilateral practice is not beneficial for innovation or improving in current practice. Based on the above, an assessment of corporate reputation, would increase the companies internal control, which in turn can benefit financial outcome and other revenue factors.

The lack of corporate reputation in mergers and acquisitions give rise to some question as to why the role is so limited. Difficulties regarding definitions and categorizations do not help positioning corporate reputation in the balance sheets and financial statements. Several firms (often the ones who provide due diligence services to firms about to merge) argue the need for addressing intangible assets, while at the same time ignore corporate reputation. Some firms highlight the need to hire companies (companies that provide due diligence advisory) with high reputation, but then overlooking the importance of reputation in the merger itself. This contradictory attitude towards corporate reputation seem to be a recurrent theme throughout corporate practice. Perhaps the lack of attention towards reputation in mergers and acquisitions can be attributable towards the transferability of this asset? Could there be a correlation between reputational transferability and the high rate of failure among mergers and acquisitions? That mergers and acquisitions overlook possible positive reputational synergies that might arise from M/A, or perhaps taking advantage of two distinct reputations is so challenging for a company, that it often impacts the merger negatively. So why should one assess a reputational consideration in mergers and acquisitions?

6.2 Why include an assessment of corporate reputation in M&A's

If reputation is the single most important driver of value creation (Marcellis-Warin & Teodoresco, 2012), there should be a universal need for better measurement of this asset. There is no requirements for disclosing information about corporate reputation, thus the drivers of value, and sources of risk are remained hidden.

Based on Jay Barney's (1991) resource based view, corporate reputation serve as a core competency towards a sustainable competitive advantage. Any asset that contribute to financial revenue, should be reflected in the financial statements of that company. Having a resource that generate profit, *and* is excluded from any documentation of the company seem to be misleading to shareholders and stakeholders.

6.2.1 Importance in mergers and acquisitions

Defining corporate reputation as the most important asset of the company (Corporate Watch UK, 2003), might serves as an incentive to include an assessment in mergers and acquisitions. Moreover, because mergers and acquisitions are transactions of great significance to the company as well as workers, managers, competitors, communities and the economy (Sudarsanam, 2003), including an assessment of reputation should be deemed important. Corporate reputation is in itself, made up by all these constituencies. If the companies compare the financial value of having a good reputation with the financial effect of losing it, it would be more beneficial to spend money on valuing and managing it, consequently avoiding possible reputational destructions.

Reputation might be a motive for mergers/acquisitions in order to lower risk and uncertainty. Overlooking reputation in an acquisition or merger will therefore lead to an over/under estimation of value, and could serve as an explanation to why so many mergers fail.

HP argues that a failure to integrate mergers and acquisitions properly, could harm their financial results. (Hewlett-Packard, 2007). The question then arises, would an assessment of reputation increase this integration, thus making corporate reputation serve as a transferable synergy-enhancing asset?

Mergers/acquisitions are a strategy of creating shareholder value by exploiting synergies, increasing growth, gaining market power, and extracting benefits from financial and operational restructuring. Since reputation is either a prerequisite or a consequence of these, the asset should therefore be evaluated in a due diligence. When strategy includes a range of areas, and the same areas make up reputation, it seem as if corporate reputation will have an effect on all areas concerning strategy. DePamphilis (2008) argue that there are two types of synergies in mergers and acquisitions; operating- and financial synergies. Including reputation could be ideal to both operational and financial synergies, because of the correlation between reputation and financial revenue. Using operating performance as benchmark in mergers and acquisitions, as Sudarsanam (2003) argues, could be misleading if operations do not include an assessment of corporate reputation.

The content of the documentation needed in a merger/acquisition, differ from each merger/acquisition, what type of industry and how big the company is. Consequently, there is no unified universal agreement as to what to include (not include) in a merger/acquisition plan/agreement. CEO’s and management in M&A deals, seem to defend the lack of including reputation because of valuation difficulties. However, using Bowd and Bowd’s (2002)formula (which is based on Fombrun’s (1996) reputational capital theory) it is possible to include reputation both *on* and *off* balance sheets. This all argue for including reputation in M&A deals, thus, it should be included in documentation pertaining the M&A deal.

Another reason to include corporate reputation in mergers and acquisitions, is to improve the due diligence conducted.

6.2.2 Importance in due diligence

Since strategy is vital in developing and sustaining current and competitive advantages (D'Aveni *et al*., 1995), as well as to build competitive advantages for the future (Hamel and Prahalad, 1994), there is therefore an strategic incentive to include reputation in due diligence. Competitive advantage depends upon the command of and access to effective utilization of its resources and knowledge" (Porter, 1980; Barney, 2001; Hamel & Prahalad, 1994). In order to achieve effective utilization, one have to identify reputation as well as value it, and that is why we need to include reputation in due diligence.

Lajoux and Elson (2010) argue that classic due diligence is somewhat limited, which could refer to the role and scope of corporate reputation. Expanding current practice, and tailor the due diligence to the relevant merger/acquisition could be beneficial for the acquirer, target company, shareholders and other interested actors. Proposed theory suggest a due diligence must be *reasonable* (Lajoux & Elson, 2010), though the answer to what is perceived reasonable is not fully agreed upon. This assumption gives companies an opportunity to manage each merger/acquisitions independently, with no "one size fits all" manual or recipe to follow. What is considered "reasonably" would differ from every company, however, when including an assessment of reputation.

The length a buyer is willing to go in the due diligence process often depends upon how much time and money the buyer has. Both companies illustrated in this thesis is of size, and should have the money (and time) to include corporate reputation in due diligence. If the company were to obtain measuring standards that enhance the ability to control reputation, it might be possible to avoid/enhance management of negative reputation-situations.

The main reason for including corporate reputation in due diligence and consequently mergers and acquisitions, is dependent upon companies deriving value from intangible assets. (Moberly, 2012). One should conduct a careful review of the important and influential forces that affect the possibility of achieving a sustainable competitive advantage. Since the majority of mergers and acquisitions seem to fail, changes in current merger and acquisition practice should be undergone. This can for instance mean expansion in the due diligence process, were one include factors that previously have been overlooked, like corporate reputation. Moreover, since each merger/acquisition is different and complex in its own way, it could be a solution to manage the merger/acquisition process differently. For instance if one were to uncover reputation-sensitive businesses (were perceptions change easily), an assessment of reputation should be important, thereby minimizing the risk of merger/acquisition failure.

Lajoux and Elson (2010) argue that all financial, operational and transactional elements should appear in the due diligence, so why is not corporate reputation included? Epson (2005) also argues that an incomplete due diligence is one of the reasons merger and acquisitions fail, which supports the assumption that one need to expand the classical due diligence and consequently merger/acquisition practice. In addition, the due diligence process’ primary objective is reassuring both parties that the merger/acquisition do not pose any unnecessary risks, however, by not inquiring into all material events, like reputation, this objective is not maintained. If one were to uncover a negative reputation in the due diligence process, this could affect the price paid to the target company, if not the entire determination of the consolidation. The SEC also require all material information about the merger/acquisition to be disclosed as exhibits to the Form 8-K or in the 10-Q, however, neither of the companies disclose any information about corporate reputation. It is however, important to note that, not disclosing information about corporate reputation do not necessarily mean that the companies do not recognize this asset. Perhaps, since the SEC do not formally request information about this asset, the company keep the information to themselves, much like a trade secret, thus enhancing their competitive position in the market.

When conducting the due diligence and drawing up the merger agreement, it is important to focus on areas particularly relevant to the transaction. An industry like the IT industry, consist mainly of intangible assets, a focus on these assets should therefore be prominent in any review of the company. Stressing the due diligence process, negatively affects intangible assets (Moberly, 2012), this can be one explanation to why corporate reputation possibly has been overlooked (and continues to be overlooked?) as a value creating asset towards a sustainable competitive advantage.

One reason for not including an assessment of reputation in due diligence, is because the seller will not welcome any request for information that requires the creation of new documentation. If the target company have conducted a due diligence without any assessment of reputation, or if the target company have not valued or managed their reputation, it might be difficult to include reputation in mergers and acquisitions. Which may also be a reason to why neither of the companies disclose this asset, in addition to the financial crisis of 2009.

According to Lajoux and Elson (2010) a range of factors affect how far a company should go in the due diligence process. Both HP and Dell fulfill all of the requirements that should be present in order to “go further” and expand the due diligence process (Lajoux & Elson, 2010). The status of the company, the number of years it has been in business, the size, exist in a highly regulated industry and whether it has been audited by a major firm for some years. Moreover, since the due diligence effort should extend beyond closing, it is easier to keep the value of corporate reputation “up-to-date”, since it is fluctuate. The circumstances for including corporate reputation in due diligence, and consequently in mergers/acquisitions assessment is favorable.

6.2.3 Importance accounting wise

Because intangible assets contribute with competitiveness and organizational sustainability (ima, 2010), it is important to recognize these assets in financial balance sheets. One reason for including an assessment of reputation in mergers and acquisitions is due to the current practice of financial balance sheets. It might be costly and time consuming conducting a due diligence including a corporate reputation review, however the future financial benefits might be of significance. The company need to value the cost of conducting this “extra” review, and the possible benefits of uncovering reality.

Both HP and Dell base their fair value estimates on assumptions they believe to be reasonable, but as they state themselves are unpredictable and uncertain, and future results may differ from the estimates conducted. (Hewlett-Packard, 2007; Dell Inc., 2009). Instead of basing estimations on unpredictable assumptions that are inherently uncertain and characterized by risk, it might be a solution to use a formula based on valuing corporate reputation. Using such a formula will, most likely, not be a negative addition to the valuation process of the companies. Including an assessment of reputation in mergers and acquisitions, would lead to changes accounting wise. HP and Dell currently undergo an annual impairment analysis of goodwill that should include an individual review of reputation, as well as an eventual increase/decrease. According to the International Accounting Standard (IAS) 38 (para. 21) "an intangible asset shall be recognized if and only if, (a) it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and (b) the cost of the asset can be measured reliably." By assigning corporate reputation a fair value through Bowd and Bowd's (2002) measuring formula, one can attribute the asset an expected financial future contribution, thus corporate reputation seem to fulfill IAS's requirements for accounting intangibles.

In the two acquisitions, the post "goodwill" represent a substantial amount in the asset stock as well as the purchase price. This balance sheet item should be divided in several subcategories in order to disclose the content. Companies should be required to disclose information regarding the content of goodwill, and the value of each subcategory, in order for the balance sheets to reflect reality. According to HP and Dell, their practice is to evaluate the value of goodwill once or twice a year in order to uncover any impairment. (Dell Inc., 2009; Hewlett-Packard, 2007). When possessing assets that are fully comprised of perceptions, (that are constantly changing) this time-based interval seem to inhibit the purpose. Corporate reputation should be assessed, re-evaluated and valued more frequently, or when specific events indicate a possible change in value or ownership. One suggestion is to include a re-evaluation of corporate reputation every time a Form 8-K is required.

HP argues that quality issues can adversely affect their reputation, which in turn can negatively affect their operating results and make revenue suffer. (Hewlett-Packard, 2008). By not including corporate reputation as a value creating asset in mergers and acquisitions, a company will overlook the continuously profit contribution the asset generates for the company. This in turn, manipulates the financial condition expressed to stakeholders and shareholders.

One can help but wonder *why* corporate reputation is not included in transactions in mergers and acquisitions, as well as in financial balance sheet. Beside the alleged difficulty of defining and valuing the asset, perhaps some reason might be sociocultural. The chosen acquisitions are set in a time of financial crisis, where financial spending is limited, and thus using extra financial assets in order to develop existing practice, is not of high importance.

The role of corporate reputation in mergers and acquisitions, due diligence and the financial balance sheets of the companies presented in this thesis, is of limited presence. Although theory argue the need for the intangible, and the companies presented in the cases argue the importance. Based on presented theory and empirical results, including an assessment of corporate reputation would be beneficial for a numbers of reasons; better accounting, more accurate valuation of a company's assets, increased information to shareholders and stakeholders and increased accuracy in pricing.

6.3 How to include corporate reputation in mergers and acquisitions

Current standards regarding financial reporting excludes many intangibles from being incorporated (ima, 2010). This is a problem when entering an agreement of consolidation because the company will not know the real value of its assets, as well as pricing being inaccurate. According to Cohen (2005) an intangible asset can be included in the balance sheets of the company if it is assigned a fair value, as well as being expected to provide future economic benefits to the company. If this is upheld, IAS 38 (para 21), based on IAS requirements, corporate reputation should be included in financial balance sheets. However, it might be difficult to identify the future economic contributions. As the analysis depicts in this thesis, one solution might be to decompose the price content, thus revealing the price paid for the intangible asset (thereby uncovering future economic contributions) on the presented theory and the undergone analysis. Instead of the companies basing their valuations on uncertain assumptions, future results might be more in compliant with a formula just for reputation.

Current practice calculate the excess value of price content as goodwill, thus incorporating reputation within this category. It is necessary to break down goodwill into several categories

(Salinas, 2009), one of these categories can perhaps be corporate reputation. It is questionable to not disclose the content of the excess value in an acquisition, what does this goodwill represent? How is an acquirer going to recover the extra amount it paid for a value that did not exist when the target company was a separate entity?

I suggest the following for including corporate reputation in mergers and acquisitions. The main issue seem to be as follows: companies overlook reputation as a value-driving asset of sustainable competitive advantage in mergers and acquisitions. When calculating the price of a merger/acquisition, reputation is not included, or of limited importance, in addition to pre-merger integrative activities concerning reputation. The idea is to categorize/sub-categorize corporate reputation within goodwill as an individual recognizable asset, giving this sub-category a distinct value. After distinguishing corporate reputation from goodwill, reputation is valued individually, making it possible to include this asset in financial balance sheets/price estimations, thus reflecting the corporation's real value creation. This form the basis for annually impairment-tests, as both the companies perform twice a year. However, these impairment tests should be conducted twice a year, *in addition to* an impairment test if any specific events occur that might change the value of the asset. Based on the above, it is possible/easier to include corporate reputation in due diligence, consequently positively benefitting mergers and acquisitions. Perhaps this would increase the success rate as well. Moreover, following this prescription might help companies better disclose their assets, trace the originate of organizational value, as well as the value of corporate reputation itself.

Another way of including corporate reputation in mergers and acquisitions, is by including an assessment in Form 10-K. If the SEC where to demand disclosure about this asset, more companies will become aware of its importance, as well as its correct placement. Moreover, another idea could be to include an assessment in a post-merger/acquisition report. A post-merger/acquisition report could inform its shareholder about the success/failure of the merger/acquisition, and highlight the reasons why, after all, it should be in the publics interest to obtain this kind of information. By the federal government demanding disclosure, legal sanctions could be put in place, or external auditors must consider the internal control as not satisfying.

7 Conclusion

My predetermined assumption was that mergers and acquisitions lack a focus on reputation as an important intangible asset that contribute to a company's sustainable competitive advantage. Presented theory and empirical research supports my suggestion that reputation in fact is a vital source of sustainable competitive advantage and consequently deserve recognition in mergers and acquisitions.

Using Bowd and Bowd's (2002) reputational formula it is possible to include corporate reputation in a company's balance sheets. (Bowd & Bowd, 2002). Consequently turning reputation into an identifiable asset making categorization, measuring and valuation possible, coherent with IAS requests. Numerous benefits arise from including corporate reputation in due diligence; better compliance with accounting principles, more correct valuation of asset, increased accuracy in pricing methods and overall a higher quality in organizational valuation of assets. In addition, there might be a correlation between including corporate reputation in due diligence and positive outcome for a company, thus increasing the failure rate of mergers and acquisitions. The financial and non-financial benefits of including corporate reputation in due diligence should prove more valuable than the cost of not recognizing this asset. Not including an assessment of corporate reputation can lead to catastrophic, long-term damages, and once a reputation is lost, it might be hard gaining it again.

In order to uncover the role of corporate reputation in mergers and acquisitions, it is imperative that the company pre-merger have a focus on corporate reputation. Prevailing accounting practice seem to overlook reputation as a value-driving assets towards a sustainable competitive advantage.

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