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# **NEGOTIATING INTERNATIONAL STRATEGIC ALLIANCES: EXAMPLES OF SUCCESSSES AND FAILURES**

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## Introduction

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## 1 Introduction

Strategic alliances are of fundamental importance for international business and have become an essential driver of corporate growth. At the same time, strategic alliances can include non-business partners, such as government entities, social enterprises or social sector organisations like philanthropic organisations.

Any proposed strategic alliance has to generate the potential to add value to all partners involved. Other factors include an increasing intensity of competition, a growing need to operate on a global scale, a fast-changing marketplace, and industry convergence in many markets (Das, 2016).

A strategic alliance must contribute towards the strategic objectives of the organisations involved in the alliance and the likely outcomes of the alliance must be in line with the required strategic outcomes of those organisations (Burshtein, 2001).

## 2 Research gap

Mergers and Acquisitions (M&A) – a prominent form of strategic alliance – has been researched and relevant literature informs about various factors which influence the success of M&A, for instance in regard to cross-cultural management (Weber et al., 2011b; Weber and Tarba, 2010; Haspeslagh and Jemison, 1991; Appelbaum, 2009; Dauber, 2011; Ahammad and Glaister, 2011).

Weber et al. (2011b), discussing the various factors which influence success and failures of M&A, particularly regarding the post-integration process, suggested that

*“the achievable performance potential of a merger consists of the pre-merger strategic, financial and contextual (e.g. national cultural) conditions. But the extent to which this potential is realised is likely to be determined by the negotiation process (Weber et al., 2011a) and the management of the post-merger integration process” (p.321).*

This thematic issue provides analysis of case examples of negotiation processes of strategic alliances. Negotiation theory is applied to concrete M&A as negotiations as well as to other forms of negotiations of strategic alliances, for instance between governments, between private sector companies and cross-sectoral alliance negotiations between private sector actors and other actors such as governments.

Despite a large body of literature on cultural differences in M&A accumulated over many years of research, the actual negotiation process remains poorly understood. In order to better understand the impact of strategic alliance negotiations, case examples of M&A and of multi-actor strategic alliances have been analysed below. This thematic issue applies a multi-lens approach in which a range of theories and models are selectively applied to specific cases to gain better insight into the business case, the development of the negotiations and to identify lessons for future negotiators of strategic alliances.

The following schools of negotiation theory were applied during the case analysis.

### *2.1 Rational choice and game theory*

Rational choice theory, also known as choice theory or rational action theory, is a framework for understanding and often formally modelling social and economic behaviour (Axelrod, 1984; Harsanyi, 1977). It is the main theoretical paradigm in currently dominant schools of microeconomics. It is widely used as an assumption of the behaviour of individuals in microeconomic modelling and is also central to many textbooks in political science. It is the same as an instrumental rationality which involves seeking the most cost-effective means to achieve a specific goal without reflecting on the worthiness of that goal. In rational choice theory, these costs are only extrinsic or external to the individual rather being intrinsic or internal.

### *2.2 Cognitive and communication theory*

Communication theory applied to negotiations focuses on behavioural perspectives and the behaviour of negotiators and identifies important differences in communication styles between experienced and novice negotiators (Rackham and Carlisle, 1978; Jönsson, 1983). Successful negotiators for instance exhibit stronger use of listening and summarising skills and also use different approaches to planning of negotiations (e.g. more long-term, more oriented towards mutually acceptable solutions and less rigid structuring of issues).

### *2.3 Bounded rationality and bargaining theory*

Faced with the limitations of rational choice theory but still upholding some of the insights of game theory, a group of US social scientists broadened the theoretical frame to make space for inclusion of cognitive and psychological studies (Bartos, 1974; Raiffa, 1982). Their broadened theoretical frame allows for inclusion of social and cognitive contexts which bear clues to past and future human behaviour. Their theoretical frame is called "Negotiation Analysis", which draws on decision analysis and suggests several concepts which have become identified with bargaining theory.

#### 2.4 *Collective bargaining and industrial sociology theory*

Walton and McKersie (1965) first coined the term “mixed motive” pertaining to the employment relationship which is neither purely conflictual nor purely cooperative but a mixture of both (Crozier and Friedberg, 1977). Ideally, negotiators facing such mixed motive situation should engage in integrative bargaining (creating value) but face the uncertainty that the other party adopts a distributive last-minute power game leaving the other party vulnerable for last-minute losses.

#### 2.5 *Trust theory*

In the literature on integrative or win-win negotiations (e.g. as popularised by Fisher and Ury, 1983), the attempt to generate an integrative outcome relies on the willingness to share information and to work collaboratively to develop mutually beneficial opportunities for joint gain. For this to take place, the negotiating parties need to develop a degree of trust in their counterparts, or in the negotiation process or in the negotiation structure. Fischer and Ury (ibid) state ‘if there is mutual trust and confidence in one another’s reliability, negotiations are likely to be smoother and more successful for both parties’. Lewicki and Polin (2013) argue “trust is a critical element throughout a negotiation, as both the lubricant that enhances and facilitates the negotiation process, and the binding element that often holds deals together”.

Trust can be conceptualised on the interpersonal level (e.g. Mayer et al., 1995; Lewicki and Bunker, 1996; Hung et al., 2004), on the system level (e.g. Luhmann, 1979; Giddens, 1990), and the institutional level (e.g. Child and Möllering, 2003; Bachmann and Inkpen, 2011) amongst others. In an introductory article, a model for trust process and trust development is proposed based on Dietz (2011), Li (2007), Möllering (2006), Lewicki and Bunker (1996) and Lewicki et al. (1998). The approach allows an analysis of the ongoing development of the relationship and emergent culture within the negotiation and implementation process (see e.g. Jeive, 2016).

#### 2.6 *Cultural variance theory and anthropological science*

Culture represents an even larger frame than rules which encompass collective bargaining. Culture, understood as beliefs and norms passed on from one generation to the next, can pre-determine to some extent the freedom of action of negotiators (Gladwin and Walter, 1980).

De Dreu and Carnevale (2006) for example have done an extensive analysis of research methods used by conflict and negotiation scholars. Their results show that economists and political scientists prefer to use mathematical modelling to a very large extent compared to researchers from the organisational behaviour and social psychology fields, who prefer laboratory experiments and survey methods.

#### 2.7 *Process theory, network theory, multi-actor coalition building, multi-institutional negotiations*

Paying close attention to the process of international negotiations, Zartman (1977) has been instrumental in analysing conflicts and related negotiations from a time perspective looking at phases of negotiations and the unfolding of concession making leading to

agreement or withdrawal of parties. A key concept introduced by Zartman is the notion of “ripeness” indicating that parties resolve their conflict only when they are ready to do so and such a moment often occurs when parties are faced with a mutually hurting stalemate which neither party can win.

Moving beyond bilateral game theory and negotiation analysis requires analytical theories of broader conceptual scope. A first level of higher complexity is needed to describe and analyse multi-actor negotiations within a single institution of multiple membership like the UN, WTO and related multilateral institutions where plurilateral agreements (participation of limited number of members) or all members partake in the negotiations to reach consensus agreements (Saner and Michaelun, 2009).

### **3 Case examples of analyses of strategic alliance negotiations**

What follows are abstracts of case analyses of negotiated strategic alliances. The case examples first offer a narrative of the case and subsequently apply negotiation theory particularly complex multi-stakeholder theory, bargaining theory (integrative vs. distributive), and negotiation behaviour theory.

#### *3.1 The Lafarge-Holcim merger negotiations: successful merger*

The Holcim and Lafarge merger case is a significant case in which two leading cement producers obtained green light after the Phase I investigations through a comprehensive set of remedies of extraordinary size. From this merger case, one can learn that it is possible to get European Commission’s clearance in Phase I even for transactions of this enormous scale. Parties need to remove all competition concerns up-front through a credible, clear-cut and all-embracing package of remedies. The communications of Lafarge and Holcim demonstrate the importance of well-prepared pre-notification discussions and preparation of divestment/remedy packages so that the Commission’s concerns regarding competition in the common market are addressed and assuaged. The case focuses on the negotiation between Holcim and Lafarge as well as the parallel negotiations between the merging parties and the EU competition authorities plus the divestment agreements which enabled Phase I clearance.

#### *3.2 Astra Zeneca vs. Pfizer: failed merger*

Leading pharmaceutical companies have sought to differentiate themselves in the current challenging environment while keeping the cost base flat (or ideally lower by following two main trends: (1) outsourcing R& D and (2) increased M&A activity to gain scale, expand their geographical footprint and achieve market leadership in specialty segments. By 2010, more than half of late-stage pipeline compounds were externally sourced (David et al., 2010). This externalisation has occurred through product in-licensing, company partnerships or corporate venture funding, with the latter being mostly targeted at early-stage development. Company acquisition is another way to fill the development pipeline through external sources, leading to the second major trend: increased M&A activity. While the forecast that 2013 would see many acquisitions by big pharma

companies to fill their “growth gap” did not hold true, the first half of 2014 alone saw 10 deals with a total worth of almost \$90 billion. The most notable of these deals probably was the \$20bn asset swap between Novartis and GSK announced in April 2014 and closed in March 2015. The case in this issue focuses on the successful defence mounted by AstraZeneca against the attempted takeover by Pfizer and their ability to build support amongst influential stakeholders to influence the main institutional shareholders.

### 3.3 *Cameron’s pre-Brexit settlement for the UK within the European Union: failure or missed opportunity? Failed multi-actor negotiation*

The no vote on Brexit was a surprise to many including David Cameron himself who had negotiated intensely with the EU members before the Brexit vote for concessions to be extended by the other EU members with the hope that the Brexit referendum would be rejected and that the UK would remain a member of the EU. The case endeavours to assess these concessions, which Cameron obtained before the Brexit vote, and how they were obtained. Multi-stakeholder theory and multi-actor negotiation theory have been applied to shed light on the negotiation process and a final closing section assesses whether these concessions were not good enough or whether the concessions were not communicated adequately by Cameron and his government.

### 3.4 *The Alliance of Small Island States (AOSIS) during the COP 18 negotiations: successful multi-actor alliance building*

This article provides an analysis of a multi-actor negotiation in the context of the United Nations Framework on Climate Change Convention (UNFCCC) and describes the negotiation of the Alliance of Small Island States (AOSIS) during the UNFCCC negotiations in 2012 in Doha. Despite the fact that the AOSIS states have a significant power disadvantage compared to the main industrial countries, the group of small island states was able to influence the negotiation process considerably. The authors describe the alliance building of the AOSIS group thereby contributing to the understanding of alliance building in multi-actor negotiations such as the UNFCCC.

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## **Business diplomacy and international strategic alliances**

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**Abstract:** Many of the pressures that internationally active enterprises have to face are related to social issues in management rather than the traditional business of international strategic management. Some of these pressures are linked to non-state actors who can engender conflicts between states and between states and enterprises, often with significant economic impact and can play a powerful role in promoting either the resolution or renewal of conflict. Both companies and government agencies must take this into account in the event of a conflict. Business diplomacy can greatly help prevent a sliding into an impasse of a strategic alliance negotiation and if already in the process of negotiation, business diplomacy competence can help a company face multi-stakeholder issues and multi-actor negotiations which are often part of complex strategic alliance negotiations.

**Keywords:** business diplomacy; multi-actor and multi-stakeholder negotiations; non-state actors; strategic alliances.

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### **1 International strategic alliances**

Strategic alliances come about through negotiations. Understanding the negotiation process, how negotiation can vary from one industry to another, from one country to the next is crucial for the sustained success of strategic alliances.

A key role in such international partnership negotiations is business diplomacy, which is particularly needed in multi-party alliance negotiations involving state and non-state actors, be this other business enterprises or civil society organisations representing direct or indirect stakeholder groups.

## **2 Complexity of international relations and international business**

Strategic managers are consistently faced with the decision of how to allocate scarce corporate resources in an environment that is placing more and more pressures on them. Recent scholarship in strategic management suggests that many of these pressures come directly from sources associated with social issues in management, rather than traditional arenas of strategic management (Waddock and Graves, 1997).

Some of these pressures are linked to non-state actors who can engender conflicts between states and between states and enterprises, often with significant economic impact and can play a powerful role in promoting either the resolution or renewal of conflict. Such non-state actors can be supra national organisations such as the UN or non-governmental organisations (NGOs) such as Greenpeace, or even national media for instance in the case of the Global Moratorium on Bottom Trawling, in Ship-Breaking in India, and in the Government Use of Patents in Thailand<sup>1</sup>

Complex economic and political conflicts create situations where governments, multinational enterprises, UN organisations and specialised agencies (e.g., the World Trade Organization, WTO) are called in or invite themselves into the conflict. Such multi-actor proliferation within conflicts can occur in sectors such as energy, transportation or accession negotiations (e.g., to the WTO or the EU) where disputants often increase in number and in organisational type (government, NGO, international organisation and multinational enterprise).

In complex conflicts and negotiations, economics and politics are difficult to separate. For example, during Russia's accession to the WTO the conflict had to be addressed during the accession negotiations between Russia and Georgia over South Ossetia and Abkhazia. The same holds in regard to the politically charged negotiations of Turkey for EU membership where the Cyprus conflict, among other issues, presents a formidable additional political and social part of its economic negotiations.

The same characterisations apply in energy disputes regardless whether they revolve around natural gas or petroleum. At stake are not only long-standing political arrangements, but also means for economic development such as drilling rights, market rights – and beneath these commercial issues are often conflictual secondary conflicts with multiple official and unofficial stakeholders who are adept at voicing their positions and working to influence outcomes putting multinational companies (MNCs) often into defensive positions since purely commercial strategies are not sufficient to solve conflicts, other means are needed such as business diplomacy.

Companies basically pursue economic goals: generating profits, securing resources and minimising risk. Ignoring or negating social and environmental aspects can jeopardise their economic activity. This is all the more true since corporate social responsibility (CSR) has become more publicly discussed and demanded. Some companies are already responding by setting up a professional sustainability management system designed to ensure the sustainability of their business activities and, in addition, to contribute to the sustainable development of the economy and society. Sustainability is

becoming increasingly important within companies but economic activities often trigger external conflicts over ecological resources or social concerns. This is especially true in regions with weak civil society and weak or corrupt government agencies.

Non-governmental organisations often take on the defence of social and environmental interests. Civil society groups and NGOs can thus decisively influence a strategic alliance negotiation. Both companies and government agencies must take this into account in the event of a conflict. Business diplomacy can greatly help prevent a sliding into an impasse of a strategic alliance negotiation and if already in the process of negotiation, business diplomacy competence can help a company face multi-stakeholder issues which are often part of complex strategic alliance negotiations.<sup>2</sup>

### **3 Business diplomacy**

An important factor for successful survival in a complex global business environment is Business Diplomacy, a specialised field of international business and international relations (Saner et al., 2000; Saner and Yiu, 2005).

Business diplomacy management (BDM) refers to the ability of MNCs to effectively interact with non-business stakeholders wherever the MNCs have business interests be they in the form of local production, distribution channels or sales offices. Business diplomacy has been gaining a greater role in the field of stakeholder management of the MNCs (Sididbé and Saner, 2012; Saner, 2016b; Saner and Yiu, 2016).

Today's stakeholder management within global companies is highly complex due to the expansion of global supply chains, growing demand for social responsibilities and greater competition from other multinational companies based in the newly emerging economies competing for access to markets and resources worldwide.

Diplomacy was conventionally a domain of the government officials in the Ministries of Foreign Affairs. In the globalised economy, MNCs often independently conduct diplomacy for instance in regard to protecting corporate reputation, building credibility and defending the accountability claims against the companies. It is the process to minimise potential damage occurring from unfavourable incidents with their external constituencies or negative claims by stakeholder watchdog groups necessitating strategies for intervention and sustaining positive corporate image.

The way business diplomacy is handled in a company differs as countries have different work values and organise their institutional and personal relationships in unique fashions. Even within the same company, business diplomacy is conducted and handled in various ways particularly in the countries where they have less experience. When MNCs go into new markets, a period of 'adjustment' is required. Accumulated knowledge and skills of business diplomacy have to be adjusted and modified to fit the country context.

Besides negotiating a strategic alliance aiming at achieving gains and critical size, the same partner companies might also be increasingly engaged in CSR activities which might be affected by the outcome of a Strategic alliance since companies might use CSR projects as a defensive response to an acquisition request or for proactive promotion of a company's CSR activities aiming at increased market visibility, improved recognition and reputational capital and hence improved valuation of their assets.

Multinational companies need to maximise the degree of social contribution and external outreach to continuously integrate external responses by civil society stakeholder into their business strategies and thereby enhance their company's perceived valuation. Traditional CSR stakeholders are consumers, shareholders/investors, partner companies and employees. Detailed analyses of state versus non-state actors are given in Saner and Michalun (2009).

In addition, the non-business stakeholders such as local communities, local regulatory bodies and NPO/NGO are playing more and more important roles in terms of commenting and critiquing MNCs decisions and actions. Thus BDM has become an important element of a company's CSR strategy and a pragmatic tool to deal with the non-business stakeholder that might become critical of strategic alliance prospects especially in the context of mergers and acquisitions.

#### **4 What is business diplomacy?**

Business diplomacy is about making the environment suitable for business and to reduce risk and uncertainty. This in turn requires that companies for instance interested in a strategic alliance with an Iranian company should understand the historical factors which influenced Iran's economic, political–military, social and cultural forces which all impact business practice today in Iran (Saner, 2016a).

Diplomacy and business are neither incompatible nor are they totally different. Professional boundaries between business and diplomacy have gradually become blurred especially after the end of the Cold War period. States are championing economic development and trade relations in today's global economy which is increasingly interconnected and interdependent. Governments use economic and commercial diplomacy to represent their interests abroad and at home (Saner and Yiu, 2003). However, companies are less aware that they need to develop their own diplomatic competencies in order to be successful abroad and to be less dependent on information and guidelines provided by their embassies abroad.

The routine work at embassies abroad consists of well-known steps such as the ones of the *chargé d'affaires* or economic and trade advisor who reads the press, meets with economic decision-makers and writes summaries for the Ambassador on the state of business in the host country. Such summaries are later handed on to companies to help them assess investing in a host country, for instance in Iran. Today, the role of these summaries is no longer as important as it once was since similar information can be gathered by local corporate agencies. Companies without foreign branches can gather information on any country on earth by means of the internet.

With the globalisation of means of communication, many governments and corporations have regularly updated the internet sites containing pertinent information. The development of press agencies like Reuters and AFP has encouraged the circulation of a huge amount of information. Press agencies are increasingly fulfilling the task of Foreign Service officials. Multinationals employ local agents or firms not only to gather information, but also to act as facilitators in their dealings with local authorities

Multinational companies operating in other countries should anticipate that their managers will be asked to represent their company and communicate to government officials, business partners and non-business stakeholder groups what their company is

intending to do in their country, how their products and services will help the respective host country's economy to grow and how their investment will contribute to improving the host country's society at large.

The following definition of business diplomacy (Saner et al., 2000) highlights the role of the business diplomat in regard to a company's need to engage with its strategic alliance partner as well as with other stakeholders as seen needed.

Business diplomacy pertains to the management of interfaces between the global company and its multiple non-business counterparts and external constituencies. For instance, global companies are expected to abide by multiple sets of national laws and multilateral agreements set down by international organisations such as the World Trade Organization (WTO) and the International Labour Organization (ILO). On account of a global company, business diplomats negotiate with host country authorities, interface with local and international NGOs in influencing local and global agenda. At the firm level, they will help define business strategy and policies in relation to stakeholder expectations, conduct bilateral and multilateral negotiations, coordinate international public relations campaigns, collect and analyse pertinent information emanating from host countries and international communities.

The function of BDM should be placed close to other core functions of a company engaging in strategic alliance negotiations with foreign partners. In addition to this, the diplomatic know-how should be a company-wide responsibility and the business diplomacy function should be under direct supervision of the CEO (Saner, 2016b).

## **5 Business diplomacy management – the know-how strategic alliance partners need especially if partnership implies cross-continental cooperation**

Success of strategic alliances involving partners in foreign countries will depend on the commercial prowess of a firm and sufficient support from the host government of the strategic alliance partner but success also will depend on how the foreign partner interacts with its own local non-business counterparts. A foreign partner has to be able to look for commonality of interests while at the same time be able to agree to disagree without falling into the trap of carrying out disagreements only through third parties.

In other words, MNCs need to acquire diplomatic skills to manage the multiple differences between their own and the foreign partner's business and societal contexts (Sidibé and Saner, 2012).

To take an example, Iran's non-business stakeholders can be very problematic for a foreign alliance partner if the western partner does not know how to respond to Iranian non-business stakeholders in a competent and inappropriate way (Batmanghelidji, 2015). Business diplomacy management is for instance called for to constructively engage consumer groups, religious leaders or powerful forces like the Revolutionary Guards who run their own businesses and are used to receive a share of Iranian companies' profits making the life of a local producer or retailer difficult.

As a consequence of the normalisation of economic and political relations, Iranian firms will face a foreign alliance partner while at the same time still being asked to pay a kind of licence or protection fee to the Revolutionary Guards. Being faced by foreign competition and continuous extra-taxation costs, local partner companies might act very opportunistically and hence might not always be able to honour agreements with Western

business partners. Non-execution of commercial agreements might follow, generating a sense of insecurity on the side of the Western alliance partner who cannot read the factors that might have led to non-traditional business practice by his Iranian counterparts and who might decide to withdraw from Iran in case of broken promises or abrupt change of commitments.

To stay with the example of Iran and the possibility of engaging in strategic alliance with an Iranian company, the following skills and knowledge would be useful to acquire by a Western investor planning to find a strategic partner in Iran (Saner, 2016a).

- 1 History of Iran, from past Persian imperial glories to the trepidations of modern times.
- 2 Basic knowledge of Iran's legal systems (public law, constitutional law, administrative law, private law and criminal law) and principles of treaty making (soft and hard laws).
- 3 Evolution of Iran's economy from pre-WWII to current times, understanding current Iranian explanatory schemata of world development as seen through current ideological lenses.
- 4 Ability to be a gracious host to a wide variety of interlocutors from all parts of Iranian society including appreciation of all forms of art of Iranian society, past and present.
- 5 Cross-cultural awareness regarding norms and values governing decision-making and conflict resolution processes in today's Iran.
- 6 Understanding how Western and Iranian state diplomats disagree over the Iranian nuclear crisis.
- 7 Skills in presenting and representing one's own company and country of origin at Iranian gatherings and official meetings, getting respect while at the same time respecting Iranian counterpart's personality and dealing with Iranian media and informal pressure groups.
- 8 Strategy, tactics and procedures of negotiations with Iranian as well as recognising Iranian negotiation behaviour.

## **6 Conclusion**

Increasing pressure on MNCs in the social and ecological spheres has become an important factor in managing the sustainability of global business. Activities and calls for CSRs, global compact programmes and other socially or ecologically oriented outreach programmes are part of the effort of the MNCs in mitigating the potential negative impact of social demands put on them. They are also part of the public relations campaign and branding exercise in differentiating the more socially accountable MNCs from the one less socially inclined.

In order to meet these challenges and learn from success, some key competencies are required to be further developed for companies involved or prospecting for strategic alliances. Key competencies to be developed are as follows<sup>3</sup>:



- *Knowledge of key international business-related legal standards:* Compliance with international and local business legal standards is crucial. Knowledge of key international business-related standards is essential to further facilitate the dialogue with non-business stakeholders be they related to the strategic alliance partner or to one's own company.
- *Knowledge of 'corporate reporting to stakeholders':* In addition to global reporting framework and guidelines such as AA1000, GRI and ISO26000, there are other guidelines published by national government and sector-specific agencies calling for instance for compliance to a country's environmental standards. For MNCs, sound knowledge of such standards and knowing how to comply with them are crucial and require ability to communicate with a company's internal constituencies and with external stakeholders.
- *Knowledge of the interplay between politics, economics and culture by region or country:* This knowledge is particularly important when the company makes decision to launch an operation in a new market. To understand how the business will affect the local society and to correctly anticipate the reaction from local stakeholders can guide the MNCs to conduct a strategic alliance with confidence.
- *Managing and leading international negotiations and communications with stakeholders:* A proactive way of communication and dialogue is highly beneficial for pursuing a strategic alliance especially if this involves cross-border cooperation. It is not only beneficial to defend one's company's corporate values but also proactive to promote mutual understanding through competent negotiation and effective business diplomacy communication.

A strategic alliance must contribute towards the strategic objectives of organisations involved in a strategic partnership and the likely outcomes of the strategic alliance must be in line with the required strategic outcomes of those organisations.

Finally the strategic alliance has to be made to work. Strategic alliances come about through negotiations. Understanding the negotiation process, how negotiation can vary from one industry to another, from one country to the next is crucial for the sustained success of a strategic alliance.

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## **Notes**

- 1 For detailed analyses of such state versus non-state actor conflicts and negotiations, see Saner and Michalun (2009).
- 2 For case examples and analysis of complex multiparty negotiations, see Saner and Grimm (2011).
- 3 These items of competencies are based on 'Business diplomacy management: a core competency for global companies'(Saner et al., 2000).

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## Applying a trust lens to the study of international strategic alliance negotiations

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**Abstract:** This paper considers the value of applying a trust lens to the study of international strategic alliance negotiations. This paper considers that, in the context of international strategic alliances, negotiation is not limited to the process of reaching an initial agreement, but also includes the implementation and joint value creation phases. In a context where neither party has the power to enforce values on the other, the process of negotiating values and managing expectations brings the structures of the working relationship into sharp focus illuminating the ongoing process whereby agreed or accepted behavioural values emerge and begin to underpin the collaborative endeavour. Following a brief cultural diversion to show how the trust lens can illuminate the development of alliance culture, the paper provides an overview of key recent literature on the conception of trust and trust development before returning to a discussion of trust and negotiation and especially of the strategic alliances.

**Keywords:** strategic alliances; negotiation; trust; interpersonal trust; system trust; process trust; trust development; values.

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### 1 Introduction

The trust literature and especially the literature relating to the development of trust and distrust offers a methodology to investigate the collaboration processes at the interpersonal, system and process levels. At the interpersonal level it illuminates person to person interactions, highlighting the development of the collaborative attempt. The trust lens can also be applied at the system or institutional level to focus on the broader context of stakeholder management and influence the process or the longer-term development of the joint enterprise over time. Thirdly, the trust lens can also help us understand the attitudes of the practitioners to the process itself and their engagement with it. A focus on the development of process trust and its breach and repair within collaborative activities (Clases et al., 2008) focuses on the behaviours and encounters bringing a process orientation and highlighting the implicit and explicit value systems which support or hinder the development of trust in the particular collaboration.

The importance of trust in negotiations is often stated, but rarely examined. In the literature on integrative or win-win negotiations (see e.g. Saner 2007), the attempt to generate an integrative outcome relies on the willingness to share information and to work collaboratively to develop mutually beneficial opportunities for joint gain. For this to take place, the negotiating parties need to develop a degree of trust in the either their counterparts, in the negotiation process or in the negotiation structure.

Fischer and Ury (1991, p.179) state “if there is mutual trust and confidence in one another’s reliability, negotiations are likely to be smoother and more successful for both parties”. Lewicki and Polin (2013, p.29) argue “trust is a critical element throughout a negotiation, as both the lubricant that enhances and facilitates the negotiation process, and the binding element that often holds deals together”. These are just two of the very many references to start throughout negotiation literature.

However, as Kong et al. (2014) argue “research on trust in negotiations has focused on rather elementary issues and relationships and has not sufficiently considered some more complex – and also fundamental – roles that trust may play in negotiations... Not only do negotiations provide a promising arena for future trust research, but research in this arena may also yield new insights for existing areas”.

Deutsch (1949, 1958) recognised that trust plays a critical role in negotiations, Kelly (1966) introduced the “Dilemma of Trust and Honesty” into the negotiation literature, and Fisher and Ury (1983/1991) demonstrate necessity of trust in creating the willingness to share information which is a prerequisite to win-win outcomes. However, more recent literature has tended to focus on highly focused micro-level analysis (for example Campagna et al., 2016; rely on simulations and experiments to examine national level variations in trust; Gunia et al., 2011; or carry out meta-analyses e.g. Kong et al., 2014).

While literature designed for negotiation practitioners tends to emphasise trust without analysing it, academic literature has often either avoided the question, relegated trust to a micro-level interpersonal factor, or elided trust and culture. Trust is assumed, attributed, used as evidence, but rarely investigated. At the same time, trust authors focus on a wide range of topics but only rarely negotiation, although one specific exception to this tendency is the issue 1 of *Journal of Trust Research* (see <http://www.tandfonline.com/toc/rjtr20/7/1?nav=toCList>).

This paper proposes an approach to negotiation analysis which applies a multi-lens trust perspective to better understand the dynamics of the changing negotiation situation. By understanding the mechanisms of trust and distrust development, trust breach and trust repair, I argue that we gain a deeper insight into the specific negotiation at the interpersonal, system, and process levels.

## **2 A cultural diversion**

The recent analysis of international negotiations appears dominated by a conception of culture which focuses on the national level (Søderberg and Holden, 2002; Shenkar et al., 2008), and applies cultural distance models widely and often inappropriately. “Culture” is often broadly cited as a success factor or as contributing to failure, but often it is the application of national culture dimensions (e.g. Hofstede, 1980). The development of such national level models may be traced via the ground-breaking work of Boas (1940), Kluckhohn (1951), Kluckhohn and Strodtbeck (1961) as well as Edward Hall’s *The Silent Language* (1959) and *The Hidden Dimension* (1966) etc.

Although the use of intercultural dimensions may add value and help to sensitise some practitioners to general tendencies within societies, there is a parallel tendency for users to abuse the models by failing to recognise the impact of relative power and agency, by ignoring culture as construct, by eliding small and large cultures (Holliday, 1999, p.2011) and by assuming national culture primacy in analysis; and by falling into the so-called ecological fallacy (Robinson, 1950; Hofstede et al., 1993).

While the models may have some relevance and application when analysing encounters at a national level, very few business encounters are actually national in nature, being rather encounters between individuals or small groups each of whom have developed complex specific cultural practices and behaviours. Even in situations such as diplomatic and trade negotiations, where the negotiation is apparently carried out between nations, it is actually the individual and small groups who, metaphorically or literally, sit at the table. Nations do not negotiate, people do.

The “Hofstedian grip” (Søderberg and Holden, 2002; Sachmann and Phillips, 2004) when combined with the essentialist and orientalist impact of work by authors such as Thomas Friedman (1999) and Samuel Huntington (1996) might lead to a dangerously simplistic approach towards complex international and intercultural phenomena. This combination can nurture analyses which appear as archetypes of “orientalising” (Said, 1978) “modern west and the backward rest” (Fougère and Moulettes, 2007) “othering” (Devlin, 2011b, 2015) essentialism. When allied to negative priming affects, stereotyping and halo effects (Kahneman, 2011) the misuse of national cultural distance models can and sadly does lead to fallacious results and misdirected real world practitioner performance. Although the use of intercultural dimensions may add value and help to sensitise some practitioners to general tendencies within societies, there is a parallel tendency for users to abuse the models by failing to recognise the impact of relative power and agency; by ignoring culture as construct, by eliding small and large cultures (Holliday, 1999, 2011) and assuming national culture primacy in analysis; and by falling into the so-called ecological fallacy (Robinson, 1950; Hofstede et al., 1993).

A more useful and less divisive analysis of culture would need to consider the degree to which culture is negotiated in context (see for example Bjerregaard et al., 2009). A negotiated culture perspective would recognise that culture is created through social interaction and that this interaction can lead to greater convergence and understanding or to conflict. It would focus on the interactions themselves and not only on reported values. It would recognise that social interactions are negotiated within contexts where power relations and the ability to reciprocate and respond are determined by the degree of agency of the participants. It would also recognise the existence of coexisting contradicting meanings at different levels within the individual, the organisation and the society which may be more or less explicit once again depending on the power relations and degree of agency of the participants in the culture creation process. The production of culture is in itself a socially situated sense-making process which cannot be understood without a fundamental analysis of the context within which it is taking place.

Bjerregaard et al. (2009) identify three central dimensions of culture in communication in anthropological literature:

- The interrelation between culture and the local context of social, professional or organisational relationships in which communication is conducted.
- The specific motivations and interests of actors informing the act of invoking cultural identities or categories in communication.
- Actors’ strategies of communication.

They argue for a focus on agency, process, interests and motives and analysing intercultural communication through the nexus of culture, actors and the context of communication

As the communication process continues, a concurrent process of small culture (Holliday, 2009) formation is taking place whereby the potential complexity of the situation (Holliday, 2011, p.43) is represented by moveable alliances, shifting realities and specifically, by the forming and re-forming of boundaries between and around the protagonists.

**Table 1** Two paradigms (Holliday, 2009, p.241)

	<i>Small cultures</i>	<i>Large cultures</i>
Character	<i>Non-essentialist, non-culturist</i> relating to cohesive behaviour in activities within any social grouping	<i>Essentialist, culturist</i> ‘culture’ as essential features of ethnic national or international group
Relations	no necessary subordination to or containment within large cultures, therefore no onion-skin	small sub(cultures) are contained within and subordinate to large cultures through onion-skin relationship
Research orientation	<i>Interpretive, process</i> interpreting emergent behaviour within any social grouping heuristic model to aid the process of researching the cohesive process of any social grouping	<i>Prescriptive, normative</i> beginning with the idea that specific ethnic, national and international groups have different ‘cultures’ and then searching for the details (e.g. what is polite in Japanese culture)

The analogy, when applied to integrative or interest-based (Ury and Fisher, 1981), collaborative interactions (Thomas and Killman, 1974) implies a movement from an oppositional “I” vs. “the other” to a recognition of the commonalities between “I” and “the other” or even of the benefits of “we”. This process should mitigate against the more virulent examples of the sociological form of “othering” (Dervin, 2015) and, as the process takes place at the micro-level, can also reduce the potential for the macro-level othering of orientalisation (Said, 1978).

By focusing on real behaviours, actual interactions and bottom-up culture development rather than an essentialised and deterministic culture model, the analyst can reduce the negative impacts of the national culture paradigm (see e.g. Jeive, 2016, 2011). Analysing negotiation through the trust lens invites us to focus our analysis in a given setting, to consider the nature and definition of boundaries, the relative permeability of those borders, on the bases of power and agency within a defined context. Furthermore, by investigating emergent behaviours and attitudes between the players in a given interaction, we not only uncover the trust trajectory, but also obtain insight into the development of the small culture.

### 3 Understanding trust

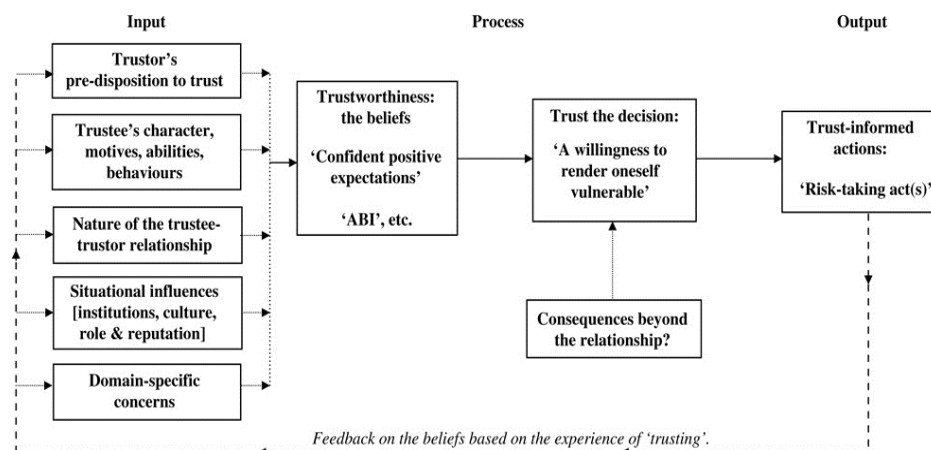
While trust is often attributed, often cited as causal and often discussed, it is all too rarely analysed. This section will provide a brief overview of the relevant theory and before applying to negotiations and specifically strategic alliance negotiations.

Trust can be conceptualised on the interpersonal level (e.g. Mayer et al., 1995; Lewicki and Bunker, 1996; Hung, 2004), on the system level (e.g. Luhmann, 1979; Giddens, 1990), and the institutional level (e.g. Child and Möllering, 2003; Bachmann and Inkpen, 2011) amongst others.

In general, authors writing about trust begin with interpersonal trust and the starting point is often with Mayer et al.'s (1995) model of trustworthiness. The authors begin the discussion by stating that "working together often involves interdependence" early on introduce the idea that trust may be a mechanism "for minimising the risk inherent in working relationships". The authors propose a definition of trust as "the willingness of the party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party." At the heart of Mayer et al.'s paper is a conceptualisation of trustworthiness as ability, benevolence, and integrity (ABI). Rousseau et al. (1998) in 'Not So Different After All: A Cross-Discipline View of Trust' develop the definition "Trust is a psychological state comprising the intention to accept vulnerability based upon positive expectations of the intentions or behaviour of another".

In both cases, psychological states based on the willingness to be vulnerable or the intention to accept vulnerability are central to the definition of trust. However, is this trust itself or a precursor to trust? For example, Dietz (2011), drawing on Li (2007) argues that this initial psychological state is in itself not enough to make trust happen. Li calls this initial psychological state "trust-as-attitude" and argues that for trust to be realised there must also be a further stage which he calls "trust-as-choice" i.e. the move from the simple willingness to trust to the conscious decision to trust.

**Figure 1** A depiction of the trust process (Dietz, 2011)



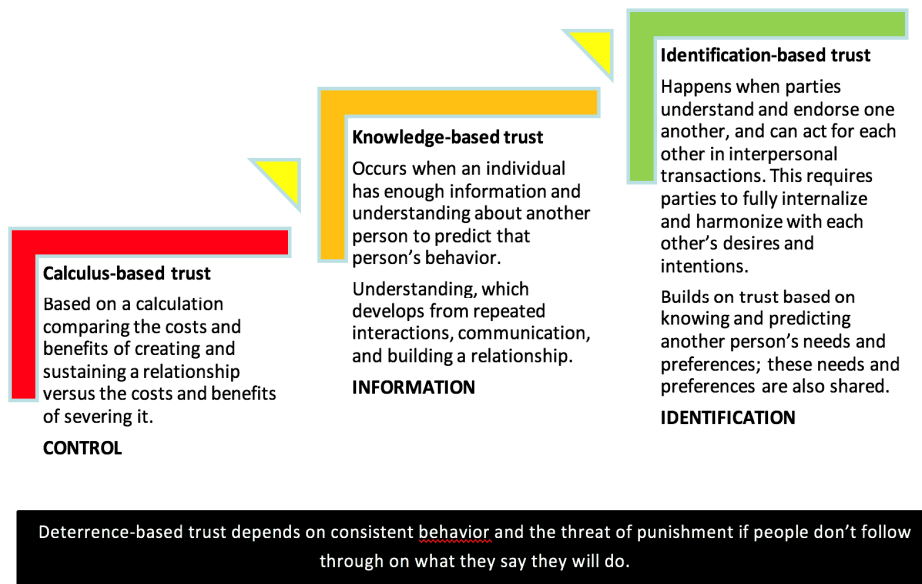
Dietz (2001) demonstrates this argument in Figure 1. We can see that an individual's decision to trust will be influenced by certain inputs such as their own willingness or predisposition, the perception of the trustee's character, the nature of the relationship and

factors specific to the given situation. Assuming that this assessment is generally positive, we can see a willingness to accept the other as trustworthy. From here, the trustor needs to make a further step to make a conscious decision to trust and in the process to make oneself vulnerable to potentially disappointed expectations before the final output step “trust-informed actions”.

#### 4 Trust development

Lewicki and Bunker (1995) developed a model of trust development (and decline) where the initial level of trust is calculus-based, basically a cost benefit approach in which the trustee analyses the cost of sustaining a relationship without severing it. This level of trust requires little or no previous knowledge or experience of the trustor and may even be considered as being akin to a rational economic judgement of the costs and benefits of behaving trustingly (or accepting risk) in a given situation (c.f. for example Williamson, 1993; Möllering, 2014 for a discussion). As a relationship between the trustee and the trustor develops, the learning effect of knowledge and experience allows the trustee to better predict the likely behaviour of the other based on the history of the repeated interactions. At this stage, we enter into a knowledge-based trust relationship. We should not discount the fact trust and distrust can occur simultaneously and repeated engagement between the parties could result in the rise or fall both trust and distrust (Lewicki et al., 2006).

**Figure 2** Trust in relationships: a model of trust development and decline (adapted from Lewicki and Bunker, 1995)

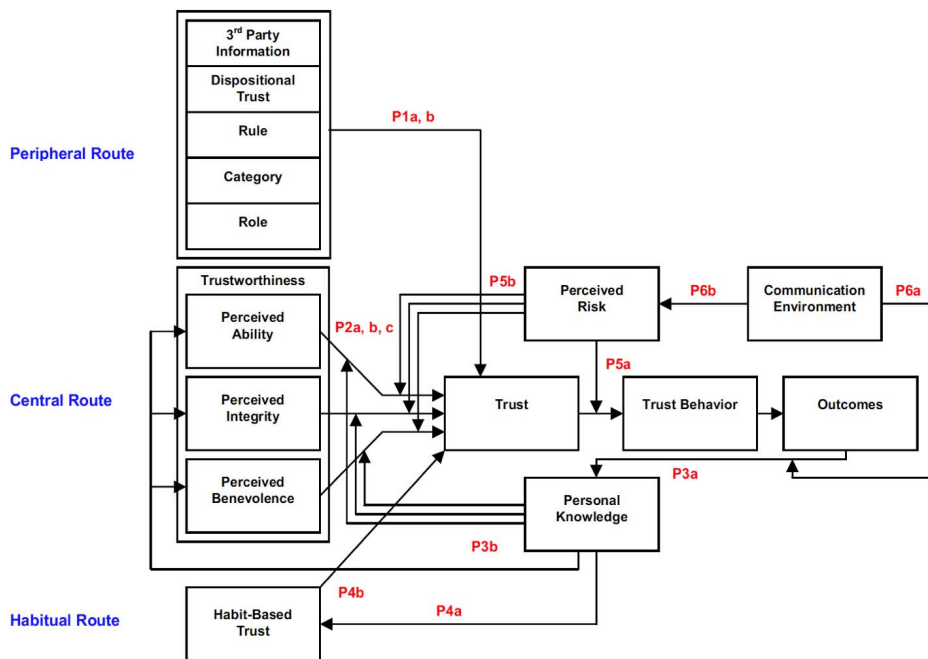


Hung et al. (2004), drawing on Meyerson et al. (1996), further develop this model in their research concept to include additional potential antecedents to trust including third party information, dispositional trust etc. "... there are two distinct routes to attitude formation



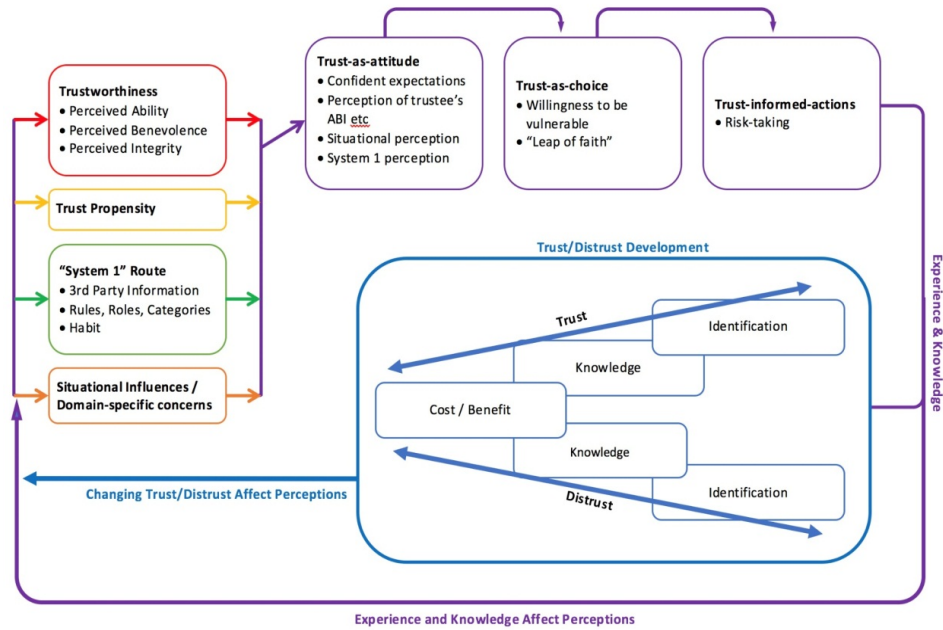
(central and peripheral); under the central route, attitude formation results from an individual’s deliberate, cognitively active, consideration of available information evaluating the true merits of a particular attitudinal position, while under the peripheral route, attitude forms as a result of a less cognitively involved assessment of simple positive or negative cues in the context (e.g., the attractiveness or reputation of the person providing information).” The peripheral and habitual routes enrich the conceptualisation by including “System 1” (see Kahneman, 2011 for a reflection on multiple previous papers discussing this concept) routes to trust which appear especially relevant when considering system trust.

**Figure 3** An integrative model of trust formation (Hung et al., 2004)



The concept of ‘system trust’ (Giddens, 1990; Luhmann, 1979) considers trust as an “...‘organising principle’ (McEvily et al., 2003) or a ‘social mechanism to coordinate expectations and interaction’ (Bachmann, 2001) in relationships between individual and/or collective (i.e., organisational) actors” (Bachmann, 2011). In contrast to interpersonal trust, system trust (or in Bachmann’s terminology institutional trust) is considered as the “decision that embedded social actors make in the light of specific institutional arrangements”. Rather than “trust-as-attitude” > “trust-as-choice” > trusting actions (Li, 2007; Dietz, 2011) being driven by the individual attitudes, propensities and perception of trustworthiness of one individual towards another, it is the individual’s attitude to a given system or institutional structure.

**Figure 4** Trust process and trust development based on Dietz (2011), Li (2007), Möllering (2006), Lewicki and Bunker (1995), Lewicki et al. (1998)



Take for example the common experience of taking a plane. How many passengers consider the interpersonal trust they have in the particular pilot? Rather, passengers place their trust in the airline’s systems, safety procedures, recruitment practices, reputation etc. We can see that that certain contexts, systems or processes are more likely to engender trust, or more specifically, more likely to persuade the trustor to make an active decision to rely on the other (person or system) under conditions of risk. The trustor makes a ‘leap of faith’ (Möllering, 2006) making a more or less conscious decision to rely on the trustee to ensure she or he will not suffer negative outcomes (Sitkin and Pablo, 1992; Currall and Inkpen, 2006; Li, 2007).

Following Luhmann (1979), we can see that the possible need to analyse the potential risk in detail is replaced by trust, a mechanism to reduce uncertainty. Trust is therefore risky inasmuch as trust may be misplaced or disappointed, but also “a simplifying social mechanism, i.e., a ‘leap of faith’, which allows him or her to align his or her expectations and interactions with those of the trustee” (Bachmann, 2011).

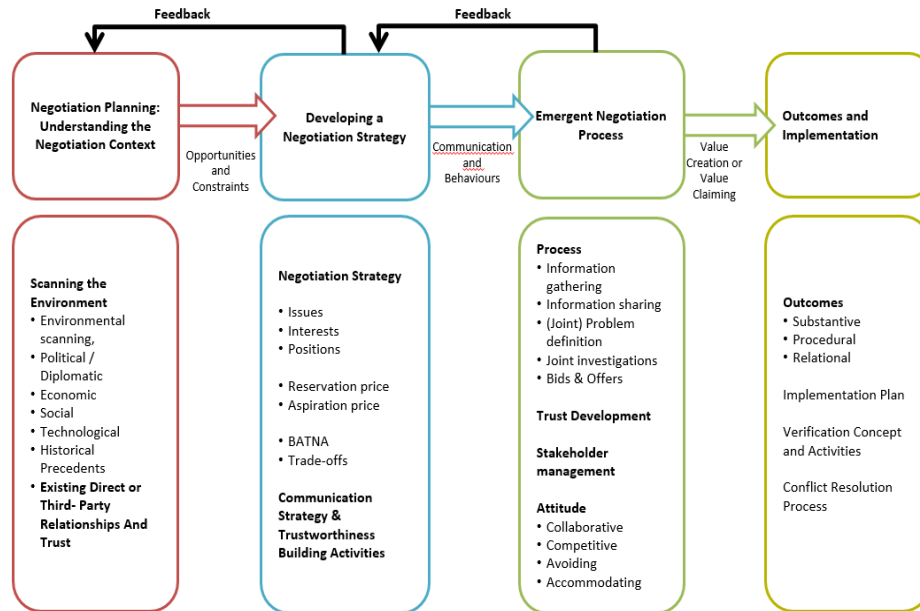
## 5 Trust and negotiation

In the literature on integrative or win-win negotiations (see e.g. Saner, 2007) the attempt to generate an integrative outcome relies on the willingness to share information and to work collaboratively to develop mutually beneficial opportunities for joint gain. For this to take place, the negotiating parties need to develop trust in the either their counterparts, in the negotiation process or in the negotiation structure.

As we have seen, trust can also be conceptualised on the interpersonal level (e.g. Mayer et al., 1995; Lewicki and Bunker, 1996; Hung, 2004), on the system level (e.g. Luhmann, 1979; Giddens, 1990), the institutional level (e.g. Child and Möllering, 2003; Bachmann and Inkpen, 2011) amongst others. A focus on the development of trust and its breach and repair within collaborative activities (Clases et al., 2008) focuses on the micro-level behaviours and encounters bringing a process orientation and highlighting the implicit and explicit value systems which support or hinder the development of trust in the particular collaboration.

The negotiation stage begins with an investigation into the attitudes, beliefs and histories of the protagonists prior to any given negotiation encounter, their underlying interests and needs in the upcoming negotiation and their expectations of the other protagonists as defined by their history and experience (Watkins, 2003; Lewicki, 2015). The analysis uncovers opportunities for action and behaviour (as well as value creation) and also constraints felt by the protagonists.

**Figure 5** Trust in the negotiation process



Based on the initial analysis, negotiators can develop an initial strategy which considers the issues to be negotiated, the underlying needs and interests of the parties concerned, the reservation and aspiration prices as well as the alternatives and BATNA (Best Alternative to a Negotiated Agreement) and potential trade-offs. These items include both substantive, tangible needs and intangible or emotional needs of the various protagonists in the negotiation situation. The strategy should also include a communication strategy which takes into account the negotiator's present level of knowledge and the information she/he requires, the information they are ready to share initially and that which will only be shared in response to information sharing by their

negotiation counterparts. Vitaly, the negotiation frame should be considered – how the negotiator can best present their arguments to speak to the interests and needs of their counterpart, thus promoting collaborative behaviours while remaining firmly aware of their own needs and interests. In complex negotiations, especially where additional external parties may have a strong influence on the outcome of the negotiation, this stage might also include a stakeholder engagement strategy or 3D strategy (Sebenius and Lax, 2004).

Once the formal negotiations begin, negotiation strategies are applied through interaction with the other parties in an emergent process and the responses, reactions and counter-offers are fed back into the strategy analysis and therefore the structure analysis to create an iterative re-editing and refining process whereby existing beliefs about the situation and the relationships between the protagonists are continually modified and re-formed. During the negotiation process, patterns of behaviour and communication emerge, drawing the protagonists together, or pushing them further apart, based on the protagonists' ongoing analyses of the value of the encounter, its potential to create benefits for the parties involved and the evaluation of the opportunity costs of continuing this process as opposed to ending it and applying the resources being used elsewhere. While in the early stages of the encounter a cost-benefit approach may be predominant (especially in cases where there is little or no previous shared history), the longer the negotiation encounter continues, the more likely it is that issues of trust, confidence in a positive outcome, perceived shared values (and potentially worries about sunken costs) will become increasingly important. As the communication process continues, a concurrent process of small culture (Holliday, 2009) formation is taking place involving the potential complexity of the situation (Holliday, 2011, p.43) represented by moveable alliances, shifting realities and specifically, by the forming and re-forming of boundaries between and around the protagonists.

In focusing on micro-level interactions and the development of greater understanding within and between the protagonists, trust would appear an excellent candidate. If we approach from the perspective of interpersonal culture and consider the classic ABI (Mayer et al., 1995) or the three-stage Lewicki and Bunker (1996) model, we would need to consider how the parties view one another and their mutual attitudes and how ongoing cost-benefit analyses and the general accumulation of knowledge change this initial assessment. If we approach from an institutional level (e.g. Lane and Bachmann, 1998; Bachmann 2001), we would need to consider the tension between power and trust or if we consider Child and Möllering (2003) and include organisational trust, active trust development and the institutional framework. Such frameworks may be further concretised in e.g. Bachmann and Inkpen (2011) to include legal frameworks, reputation, certification and norms structures and procedures.

The negotiation analogy invites us to focus our analysis of culture and trust formation or impact in a given setting, to consider the nature and definition of boundaries, the relative permeability of those borders, on the bases of power and agency within a defined context. The analogy, when applied to integrative or interest-based negotiation (Ury and Fisher, 1981) or collaborative negotiation (Thomas and Killman, 1974) implies a movement from an oppositional "I" vs. "the other" to a recognition of the commonalities between "I" and "the other" or even of the benefits of "we".

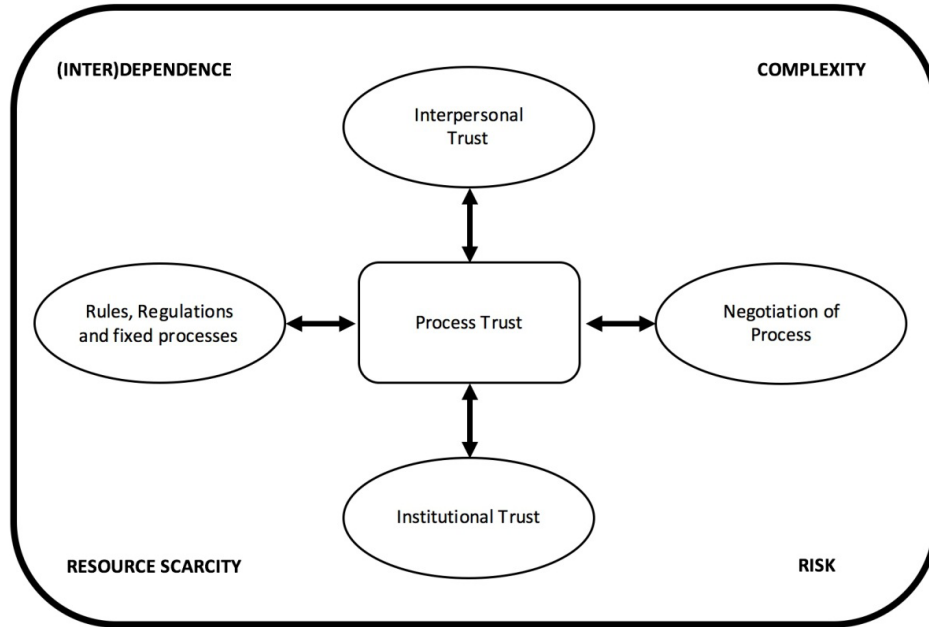
In considering the development of trust, we might consider a “process trust” concept. Clases et al. (2008) speculating on the concept of process trust argue that while system trust (Luhmann, 1989, 2001) is independent of the individual’s ability to directly impact the development of the system itself, central to the conception of process trust is the ability of the individual to influence the process variables through for example the initiation, definition, implementation or evaluation of a given project. The individual is both bound within the structural constraints of the system structure (whether behavioural expectations, norms or rules) and, simultaneously, able to influence those same variables. Process trust develops through the cognitive and affective evaluation of concrete interactions or cooperation processes and can bridge the space between the interpersonal and the system.

In common with interpersonal trust which is commonly conceptualised as moving from a cost benefit to an identification stage via the accretion of knowledge and of being conceived as being two dimensional with trust and distrust being two independent but simultaneous variables (Lewicki and Bunker, 1996; Lewicki et al., 2006), process trust also builds on experience. The concept assumes that implicit scripts (“A script is a structured whole, a generalised representation of a sequence of activity that has occurred more than once” (Engeström, 1987) exist at both the system and individual level, but that the various scripts of the protagonists may not initially be aligned or compatible. As a result a degree of uncertainty pervades the initial encounter and requires negotiation of behaviours or the application of rules or norms to manage the uncertainty in the situation and clarify the system structure. At this stage in the encounter there is real uncertainty with regard to the ability to achieve an agreed way of proceeding. Scripts are deeply internalised routines of behaviour and expectations, they influence our cognition, they shape our expectations of others and of systems and their breach can result in irritation, uncertainty, conflict and the reduction of trust in a given system.

Process trust develops at the intersections of the interpersonal and institutional trust dynamic and that of the application of rules/norms vs. negotiation of process. The development of process trust requires a context within which cooperation or interaction is required (interdependence) and some expectation of benefit from the cooperation. It develops in situations where neither interpersonal nor system trust are sufficiently developed and between actors who have sufficient agency to allow them to influence the process and contribute to the writing of new agreed scripts.

In a context where neither party has the power to enforce values on the other, the process of negotiating values and managing expectations brings the structures of the working relationship into sharp focus illuminating the ongoing process whereby agreed or accepted behavioural values emerge and begin to underpin the collaborative endeavour. The initial case research has shown that there is a strong interrelationship between the various trust conceptions and that while trust is required for success in collaboration, it can be based on interpersonal, system, institutional or process forms, or more generally on a combination of various forms. In practice, we face a situation where degrees of trust and distrust at the interpersonal, system/institutional and process level combine to produce an overall level of trust which affects the perceptions of the protagonists and their willingness to proceed collaboratively with the joint endeavour.

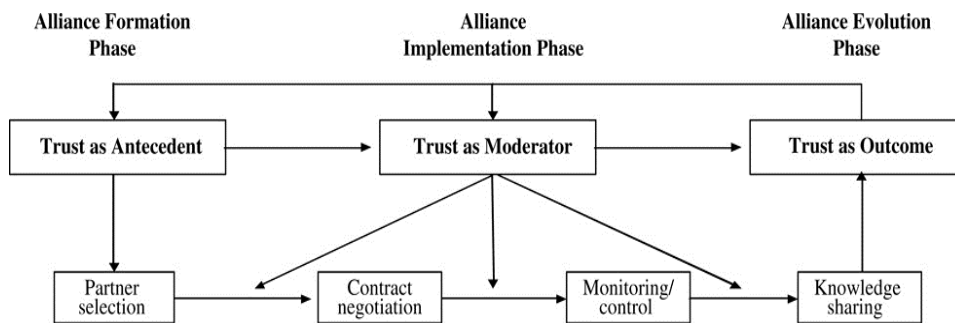
Figure 6 Process trust



## 6 Negotiating strategic alliances

Globerman and Nielsen (2007) reach similar conclusions “... alliance relationships that are founded primarily on the basis of calculative trust, for instance, may result in widely different governance contracts compared to alliances based on affective (interpersonal) trust. Similarly, in environments characterised by relatively low quality of institutional governance where institution-based trust is low or absent, alliance parties may opt for elaborate contractual stipulations and/or choose equity modes in order to safeguard against opportunism.”

Figure 7 Trust in strategic alliances (Nielsen, 2011)



Their paper discusses a range of examples from practitioner and academic literature including Hamel et al. (1989) who argue that the actual coordination is not achieved through contractual mechanisms but, rather, is realised by the day-to-day interaction of the employees involved in the alliance activities; ‘Top management puts together strategic alliances and sets the legal parameters for exchange. But what actually gets traded is determined by day-to-day interactions of engineers, marketers, and product developers’ (1989, p.136). This points to a possible substitution effect (e.g., Poppo and Zenger, 2002) between the two types of governance, that is when firms invest (time and resources) in high degrees of contractual specificity they tend to rely less on trust, or vice versa. For instance, Carter and Miller (1989) show how in the absence of highly specified contracts, benevolence-based trust and competence-based trust between vendors and buyers limits the occurrence of quality problems in the materials delivered. Similarly, Ring and Rands (1989) document how NASA and 3M articulate their goals for a common project on microgravity experiments and subsequently work through the implementation of their collaboration via adaptive coordinating mechanisms based on competence-based trust. Hence, trust may affect the extent to which firms adopt formal mechanisms for coordination, monitoring, and control during alliance evolution.”

In collaborations and alliances which depend on long-term relationships and information sharing to generate joint gains, increased levels of trust serve to facilitate knowledge exchange and increase the likelihood of positive results. Such collaborations, especially where the final outcomes of the joint activities can only be vaguely specified in terms of hopes or expectations at the outset demonstrate high levels of task uncertainty and require joint definition and joint problem-solving or mutual learning. Therefore contracts, while they exist, are insufficient and incomplete while “... trust, in its various forms serves as the glue that binds the firms together and allows smooth transfer of knowledge without unnecessary adherence to formal monitoring and control mechanisms” (Globerman and Nielsen, 2007).

## 7 Conclusion

The research indicates a new approach to studying the development of behavioural and system values within collaboration activities, reduces the tendency to seek essentialist national-level explanations for success and failure in strategic alliances and opens the way for further methodological development to allow for the analysis of larger and more complex phenomena through the development of a mixed-methods approach.

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## The Lafarge–Holcim merger negotiations

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**Abstract:** The Holcim and Lafarge merger case is significant as two globally-leading cement producers obtained early-stage regulatory approval from the European Commission due to a comprehensive large-scale set of pre-emptive remedies. This case shows that it is possible to achieve early-stage regulatory approval even for transactions of enormous scale if the merger parties address all competition concerns up-front through a credible, clear-cut and all-embracing package of remedies. Lafarge and Holcim faced a rapidly changing global cement market characterised by overcapacity in industry and overcame the problem of unprofitable investments by creating a powerful position for the merged company within the industry. The two private sector protagonists were able to build process trust and a common approach to the task enabling the merger to proceed.

**Keywords:** Holcim; Lafarge; European Commission; regulatory approval; divestment; merger; negotiation; trust.

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Marya Imbach gathered her experience at the edge of Financial and IT industries. She is currently working as an Internal Consultant in New Technologies (Artificial Intelligence, Machine Learning, Blockchain) at UBS. She has been actively involved into the startup industry and is a member of Swiss Private Equity & Corporate Finance Association (SECA). Previously she has worked at VZ VermögensZentrum and EPAM Systems. She holds two Master degrees in International Management and Business Information Systems from University of Applied Sciences of Northwestern Switzerland and a Bachelor's degree in Business Communications from Minsk State Linguistic University (Belarus).

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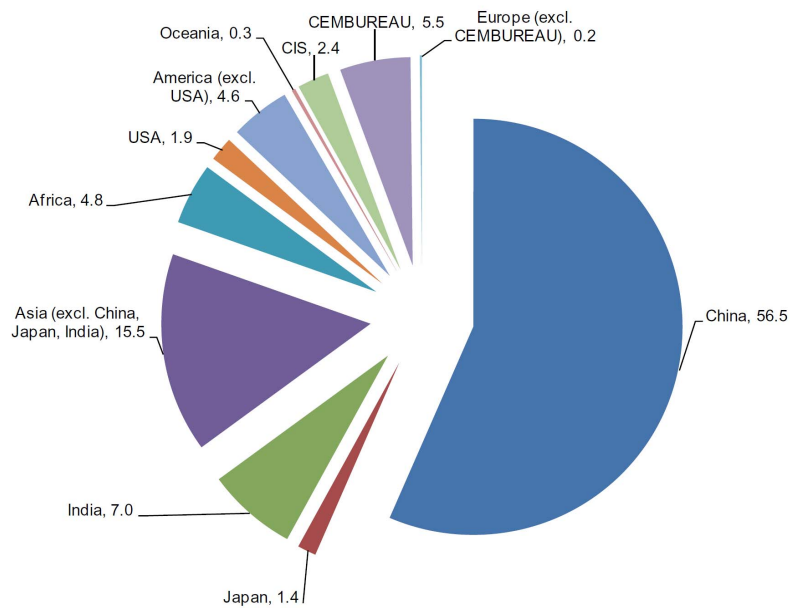
## 1 The cement industry at the time of the merger

The cement industry is one of the most capital-intensive industries and due to the initial capital outlay, entry barriers are high. A construction of a new production line represents more than two years of its full capacity sales. As a result, the cement industry saw a trend toward concentration beginning in the 1970s (Herve and Aland, 2000). Around 4.3bn tons of cement were produced worldwide in 2014, with China accounting for 56.5% of the global production (Peter, 2014). Outside China, the global demand and production is mainly served by six vast international firms, Holcim, Italcementi, Lafarge, Buzzi, Cemex and Heidelberg. It is a huge business with the world's cement-makers generating revenues over \$250 billion a year (The Economist, 2013).

On the demand side, over the past 20 years, worldwide cement consumption has significantly increased with an average rate of growth above 5% per year despite the economic and financial crisis, driven by the dynamism of many emerging markets (Asia, Middle East & Africa, Latin America) which currently represented 90% of the world market, while North America and Western Europe make up the remaining 10% (Lafarge, 2013).

Cement demand will increase for an individual country up to a certain level of urbanisation. Passing this level, frequently quoted as 600 kg per capita per year, most countries would enter a “repair and maintain” stage (Peter, 2014). In developed countries (EU28, the USA, and Japan). This trend is reinforced by low population growth rates. The cement industry of each of these developed regions produced 12–34% less cement in 2012 than it did in 2000.

**Figure 1** World cement production 2014, by region and main countries (CEMBUREAU, 2014)



**Table 1** World cement consumption (Bloomberg, 2016)

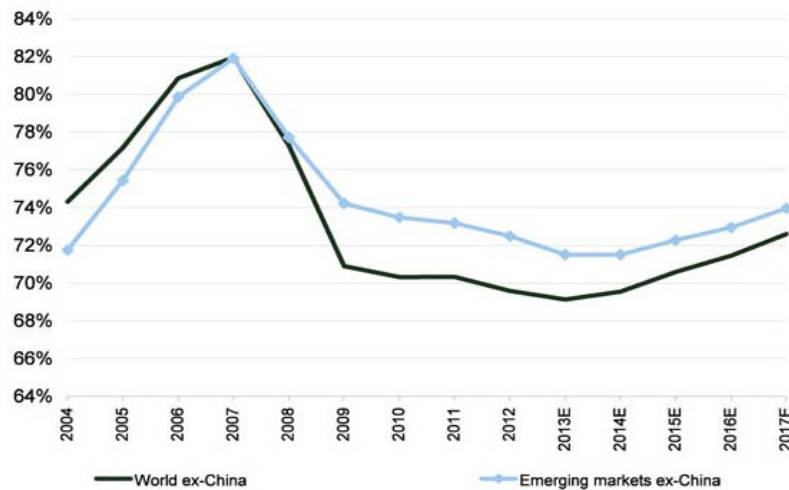
Cement consumption by region (Mn t)	2015	2014	2013	2012	2011	2010
World	4276	4140	4034	3746	3585	3312
Asia	3210	3107	3023	2763	2621	2390
Middle East	218	205	198	187	172	171
Europe	191	183	185	181	177	167
America	348	347	342	337	351	331
Australasia	298	286	275	266	251	239
	11	11	10	12	13	13

Looking through the data above, demand and supply in 2015 was well in balance at 4.3 billion tons. However, global capacity utilisation continued to fall until 2013 from a peak in 2007, below 70% if China is excluded.

In an attempt to seek growth, European construction material producers, like Lafarge, Holcim, and Heidelberg Cement, have built up a truly global footprint over the last two decades and have diversified their revenue and profit streams, focusing on strongly growing markets. Asia-Pacific represents the largest and the fastest growing market worldwide. Growth in the region is driven by strengthening construction activity, rapid

industrialisation and urbanisation, rising housing needs of a growing population, growth in business activity and the resulting increased in commercial construction projects (Global Industry Analysts, 2015).

**Figure 2** Global cement production and utilisation rate (Peter, 2014)



Demand is still growing in Asia. American house building is perking up, even if European economy remained sluggish. After six years of crisis, 2014 appeared as the first year of recovery in construction output while slowly expanding private consumption has been the only constant growth driver since the start of the recovery almost two years ago (The Economist, 2014).

Some emerging economies may be near the end of their cement-hungry phase of rapid construction growth. Nonetheless, growth of the urban population will continue during the coming decades, setting challenges that will call for imagination and innovation. Urbanisation, which rose with the demographic explosion of the twentieth century, will become even more spectacular. In 2014, 54% of the world population has lived in towns and cities, compared to 30% in 1950. This rise will require sustained infrastructure investment in railroads, highways, bridges, ports, airports, water, power, energy and telecommunications, creating massive opportunities for multinational contractors and their international and local suppliers (World Health Organization, 2015).

The building materials' industry paradigm is changing, with the potential for improved profit. Less is being spent on new production sites, with the onus on capacity rationalisation and asset swaps. The focus is moving to raising operating leverage and cash-flow generation and cutting capacity spending and onerous historic maintenance investments (Bloomberg, 2016).

Building remains a polluting and energy consuming business, for all its attempts to clean up. The cement industry's strategy is to cut capital spending and exploit its assets better. Efforts to reduce its CO<sub>2</sub> emission footprint are also underway, given the United Nations-sponsored climate change adoption starts in 2020 and companies need to comply with targets. Putting the brakes on new capacity and focusing on replacing existing facilities is a sound industry initiative, given the current overcapacity. Leaders of the Cement Sustainability Initiative are targeting a 20–25% reduction in emissions by 2030 (Economist, 2014).

Given highly capital-intensive nature of business, huge volume, low value and local market competition, it is better for a corporation to expand through M&A as green field expansion with new capacity added could bring the industry to oversupply situation (Herve and Aland, 2000).

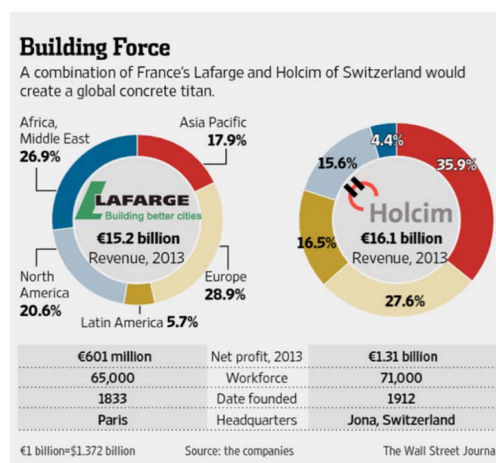
**Table 2** Historical building materials operators M&A transactions (Gregor and Elliott, 2014)

Year	Deal value (mn)	Bidder	Target	Cost synergy targeted	Cost synergy actual (mn)	% cost synergy to proforma sales
2001	£3155	Lafarge	BCI	€63.4m	€136	0.8%
2004	US\$2319	Cemex	RMC	US\$110.9m	US\$199.7	0.9%
2007	£7964	Heidelberg Cement	Hanson	€137m	€318	2.1%
2007	US\$14164	Cemex	Rinker	US\$150m	US\$400	1.7%
2007	US\$12,930	Lafarge	Orascom	€150m	€150	0.7%
2007	US\$4656	Vulcan Materials	Florida Rock	US\$50m	US\$50	1.1%
2011	US\$4740	Vulcan	Martin Marietta	US\$200-250m	n/a	5.5%
2013	£2000	Lafarge	Tarmac	£60m	£60	3.3%
2014	US\$2000	Martin Marietta	Texas Industries	US\$70m	n/a	2.5%

## 2 Holcim and Lafarge

Before the merger, according to 2013 figures, Holcim was the world's largest cement maker in terms of revenue and profits, with total sales of €16.1 billion and net profit of €1.31 billion, followed by Lafarge with total sales of €15.2 billion, and net profit of €0.6 billion. Holcim's largest market by sales was in the Asia Pacific region while Lafarge's largest exposure was in Europe. Both derived more than half their revenue from outside Europe and North America as these two companies are diversified globally.

**Figure 3** Comparison of Holcim and Lafarge (Robinson, 2014)



From their historical M&A, Lafarge prefer acquiring the stakes or taking over to have major control over the targeted businesses. Holcim, on the other hand, prefer to expand gradually into the prospective countries by having strategic alliance or having some stakes enough to have knowledge transferring (Holcim, 2014). Both Lafarge and Holcim had been increasing their stakes (in total) over 90 countries, mainly in emerging market, to mitigate the risk of economy slow down and matured construction industry. With historical aggressive expansion, Lafarge’s balance sheet was stretched and had limited capacity to expand through debt financing. It was further hit by the upheaval of the Arab Spring in 2011 and 2012 as it had bet heavily on the Middle East market by buying up Egyptian company Orascom Cement (Tom, 2014). Although Holcim had healthier finances, its operation in emerging countries, especially in India, was a key drag due to slower-than-expected infrastructure projects. Amid global economy slowdown, where their cash flow was at risk, the future expansion would require further merger or acquisition activity.

### 2.1 Strengths and weaknesses of Lafarge and Holcim

**Table 3** Strengths and weaknesses of Lafarge and Holcim

<i>Lafarge’s strengths</i>	<i>Holcim’s strengths</i>
<p><i>Strong and diversified presence in emerging countries</i></p> <p>71% of revenue outside Europe; 58% of revenue in emerging countries; No single emerging country represents more than 5% of sales.</p> <p>Lafarge (2013)</p>	<p><i>Global presence</i></p> <p>Holcim has operations at roughly 1500 sites in around 70 countries on every continent. 72% of revenue outside Europe.</p> <p>Holcim (2014)</p>
<p><i>Staying ahead through innovation</i></p> <p>The world’s largest R&amp;D centre in the building materials sectors, established in 1887.</p> <p>116 new patent applications in 2013.</p> <p>Development laboratories in Lyon, Mumbai, Chongqing and Algiers. Project2014: Brazil.</p> <p>More than 140 launches of cement and concrete products by countries in 2013.</p> <p>Special concrete products accounted for 36% of concrete sales volume in 2013.</p> <p>Lafarge (2013)</p>	<p><i>Operational efficiency with transparency</i></p> <p>Focus on existing operational projects and initiatives with only a limited number of new projects. Transparency was increased through the implementation of coordinated financial tracking and qualitative initiative tracking.</p> <p>Holcim (2014)</p>
<p><i>A growing number of services to support projects and distribution</i></p> <p>The “placing and finishing” service for concrete launched in 21 countries.</p> <p>Creation of innovative distribution circuits.</p> <p>Lafarge (2013)</p>	<p><i>Strong financial health</i></p> <p>Holcim has a conservative financing policy, in contrast to its competitors, Holcim did not undertake any highly leveraged acquisitions in the presence of a booming housing market before 2008. Thus, it has higher free cash flow, lower debt ratio as well as stronger credit rating compared with peers.</p> <p>Holcim (2014)</p>



**Table 3** Strengths and weaknesses of Lafarge and Holcim (continued)

<i>Lafarge's strengths</i>	<i>Holcim's strengths</i>
<p><i>Continuous improvement in performance to boost competitiveness</i></p> <p>€450 million of cost reduction in 2013, through various levers continuous improvement of the cement/clinker ratio during the past ten years.</p> <p>Lafarge (2013)</p>	<p><i>Cost leadership</i></p> <p>Achieving €659 million of cost reduction in 2013 through optimisation and reduction of its cost, especially energy, logistic, procurement and its fixed costs with local initiatives, process excellence and shared service centre.</p> <p>Holcim (2014)</p>
<i>Lafarge's weakness</i>	<i>Holcim's weakness</i>
<p><i>Exposure in politically risky countries</i></p> <p>As Lafarge has some stakes in countries suffering political turmoil, i.e. Iraq, any deterioration in the political situation in the Middle East and North Africa region would act as a headwind for the operation and share price. Note that Lafarge has 28% exposure in the Middle East and North Africa.</p> <p>(Patrick and Dwight, 2014)</p>	<p><i>High exposure in a single emerging country</i></p> <p>Holcim has a significant exposure to the Indian market (via its 50% stake in ACC and Ambuja Cement), which represents the largest single contributor to its sales. An increased competition, pressure on prices and cost inflation in the future. Its pricing power seems to be low in this market (on average, cement prices declined by 4% in 2013) and the likelihood of an overcapacity might pose an additional threat. (Patrick and Dwight, 2014)</p>
<p><i>High debt burden</i></p> <p>Its historical M&amp;A showed the rush to buy the best firms in the most attractive locations but overpaid. Hence, its debt level has been higher compared with its peers.</p> <p>The Economist (2013)</p>	<p><i>High foreign exchange risk</i></p> <p>There is a significant currency risk which may increase the volatility of its revenues and profits.</p> <p>Patrick and Dwight (2014)</p>

### 3 Value creation

The M&A of Lafarge and Holcim would create the following synergies:

#### 1 *Operational synergy*

- Synergies assessed at regional HQs and overlapping countries. In addition, if Lafarge could adapt Holcim's operation style (lean and effective), the administrative expenses, especially staff costs, will also decrease. Normally, Holcim's management compensation is about half of Lafarge's (Elodie et al., 2014a).
- Operational optimisation in overlapping countries should be able to reduce freight, transport, and distributions costs while the best practices in productivity, use of alternative fuels, energy consumption optimisation from Holcim's expertise in grinding efficiency or Lafarge's know-how in operational productivity also help boost its operating margin (LafargeHolcim Ltd., 2014a).
- Improve procurement expenses with the alignment on "best prices" in overlapping countries, beneficial scale effect from high volumes, enhanced category management and low-cost country sourcing (LafargeHolcim Ltd., 2014b).

- R&D and innovation deployed on a large-scale help reduce redundant R&D cost and increase high value added construction material products (LafargeHolcim Ltd., 2014c).
- With combined portfolio, there will be presence in over 90 countries (LafargeHolcim Ltd., 2014d) reducing revenue and earnings volatility through higher diversification.

2 *Financial synergy*

- Reducing financial cost of the group through a stronger financial profile than Lafarge’s on a stand-alone basis. Holcim has an investment grade rating with the cost of debt of 4.8% compared with Lafarge’s cost of debt at 6% (Elodie et al., 2014b).
- Reducing capital expenditure as the integrated portfolio would cover more than 90 countries. In addition, there are some overlapping in some countries and needed to dispose (HolcimLafarge, 2015). This would help increase utilisation while increase free cash flow from assets divestment.

The combined Lafarge/Holcim business would be the biggest building material company globally. Combined with higher diversification of revenues and earnings, would reduce volatility risk of the group. With a lower risk premium, the group would expect a higher valuation.

4 **Underlying interests**

After the analysis of the negotiation structure, the interests identified are listed in Table 4.

**Table 4** Underlying interests

<i>Holcim’s underlying interests</i>	<i>Lafarge’s underlying interests</i>	<i>Mutual underlying interests</i>
To improve R&D units, knowledge transfer from Lafarge after the merger and achieve higher HVA (High Value Added) products sales.	To reduce financial cost with improved credit rating after two businesses combined (lower risks with greater diversification).	To expand the construction materials businesses without much cash as their cash flow situations are not well.
	To improve operating efficiency by learning from Holcim’s operational efficiency.	To divest some of their units in the overlapping areas, non-core assets and free up some cash flow to improve liquidity and future investments.
		To reduce redundant operating expenses in both headquarters and overlapping areas to improve margins.
		To be the biggest construction materials operators in the world.
		To increase shareholders’ value with a better valuation after the merger.

The synergies of a combined LafargeHolcim would be around 1.4 billion euro (before tax) over three years after the merge (LafargeHolcim Ltd., 2014a). Despite some conflict in corporate strategies and cultural difference, there is a convergence of interests between these companies. The cost savings, the improved image as the biggest construction material company globally brought them to the closer solution for this M&A.

### 5 General timeline of the negotiation process

The negotiation leading to the consolidation of the largest construction materials manufacturer in the world spanned a period of more than 14 months. The first public step of this negotiation was the announcement of an agreement on the 7th of April 2014 as shown on the left side of the following timeline.

Figure 4 General timeline of the negotiation

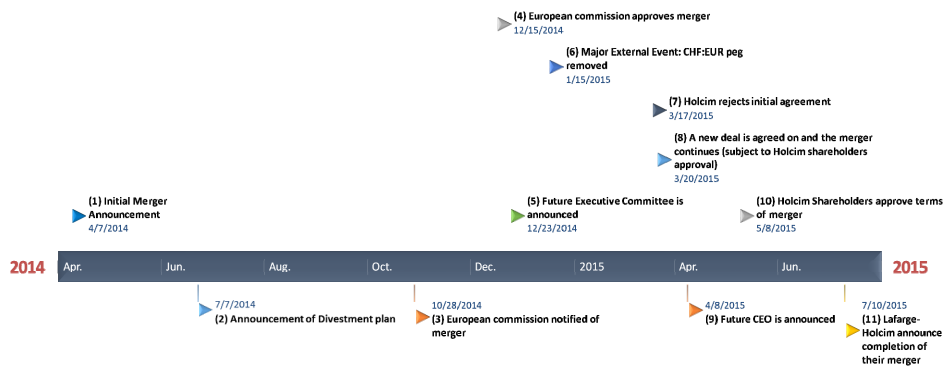
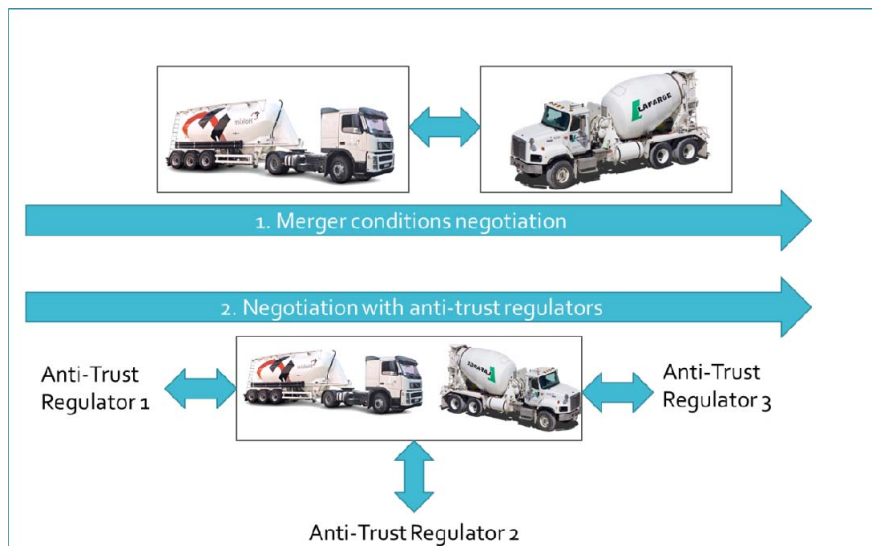


Figure 5 Parallel negotiations leading to the merger



In effect, two parallel negotiation tracks were running simultaneously as shown in Figure 5. On one hand, Lafarge and Holcim were negotiating with each other the terms for their merger including price, governance and further aspects later described in this section. On the other hand, the companies worked together, jointly negotiating with multiple anti-trust regulators in several jurisdictions in order to secure the necessary authorisations for the merger.

The initial merger announcement of 7 April 2014 covered key aspects including:

- A merger of equals with a clear and public price for their shares.
- A governance agreement splitting the Chairman and CEO positions as well as a 50–50 split of the board of directors.
- Stock listing both in SIX and Euronext.
- Broad divestment plan to meet anti-trust regulations.
- The expected completion time for the merger was announced to be the first half of 2015.

Two months after the merger announcement (on 22 June 2014), the companies formally announced a divestment plan that was meant to meet the expectations of anti-trust regulators in multiple jurisdictions (LafargeHolcim Ltd., 2014c). This divestment plan led to the formal filing of the merger request to the European Commission on 10 October 2014. Only 45 days later, the European Commission granted its approval of the merger on 15 December 2014, paving the way for the continuity of the negotiation.

With the initial merger announcement, the companies had provided a concept of the governance scheme that they would put in place for the merger and for the management of the merged company. On 23 December 2014 this scheme became concrete as the companies announced the composition of the executive committee that would lead through the merger process (Anonymous, 2015) and in the future the merged company finishing the year with concrete leadership plans, an clear agreement signed back in April and the approval of the most relevant regulator for this two companies: the European Commission.

However, January 2015 brought an unexpected event that would shake the once solid foundations of this process. On 15 January the Swiss National Bank decided to end an intervention to maintain a parity between the European and the Swiss currencies at 1.2 Francs per Euro (Dorgan, 2014).

“So on January 15th, when the Swiss National Bank (SNB) suddenly announced that it would no longer hold the Swiss franc at a fixed exchange rate with the euro, there was panic. The franc soared. On Wednesday one euro was worth 1.2 Swiss francs; at one point on Thursday its value had fallen to just 0.85 francs.... The Swiss stockmarket collapsed” (The Economist, 2015).

Three months later, on 17 March 2015, Holcim decided to pull the plug and publicly announce their rejection of the previously agreed conditions. Under the context of the economic changes caused by the Swiss National Bank’s decision, Holcim offered to pay not 1 but 0.875 shares per share of Lafarge and challenged the leadership of Bruno Lafont, questioning his ability to secure the synergies expected from LafargeHolcim (Eyck and Shayndi, 2015).

Three days later, on 20 March the companies jointly announced that the negotiation was back on track (Massoudi et al., 2015). The newly agreed conditions included Holcim’s willingness to pay 0.9 shares per share of Lafarge and the election of a different

CEO to lead the future merged company. Nevertheless, this agreement was subject to the approval of Holcim's shareholders who ultimately voted for the terms with an approval rate of 72%. The final merger completion announcement was released on 10 October 2015, 4 months later than expected.

## **6 Antitrust regulations**

Due to the scale of the Lafarge and Holcim merger competition concerns were raised. Four antitrust regulators worldwide were asked to give clearance on the merger: the European Commission (European Union), Federal Trade Commission (USA), Competition Bureau (Canada) and Competition Commission of India (India). In this paper the focus will be on the European Commission.

### *6.1 European competition law*

The legal basis for EU Merger Control is Council Regulation (EC) No 139/2004, the EC Merger Regulation. The regulation prohibits mergers and acquisitions which would significantly reduce competition in the common market, for example if they would create dominant companies that are likely to raise prices for consumers (European Commission, 2013).

The European Commission only examines larger mergers with community dimension. This means that the merging companies have to fulfil one out of two alternatives to reach affected turnover thresholds.

The first alternative, Council Regulation (EC) No 139/2004, art 1, requires:

2. A concentration has a Community dimension where:

(a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5000 million; and

(b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million;

unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

3. A concentration that does not meet the thresholds laid down in paragraph 2 has a Community dimension where:

(a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 2500 million;

(b) in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than EUR 100 million;

(c) in each of at least three Member States included for the purpose of point (b), the aggregate turnover of each of at least two of the undertakings concerned is more than EUR 25 million; and

(d) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 100 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State.

To clear the way for the Commission's acceptance of remedies in phase I investigations, the Commission needs to be fully convinced that remedies inhibit negative effects on

competition in the common market. In areas where no remedies are planned, the Commission has to be ensured that the combination of merging parties' activities do not give rise to concerns.

## **7 Modus operandi**

The parties' course of action is codified in the EC Merger Regulation (European Commission, 2013).

### 1. Notification, art 4

The European Commission has to be notified of any merger that could reach an EU dimension prior to its implementation.

### 2. Phase I investigation, art 10 para 1, art 11

After notification, the European Commission has 25 working days to analyse the deal.

Usually, a 'state-of-play meeting' is held towards the end of phase I. The Commission informs the merging companies about the results of phase I investigation. If competition concerns occur, companies can offer remedies, which extends the phase I deadline by 10 working days.

### 3. Remedies, art 6 para 2

If the Commission has concerns that the merger might significantly affect competition, the merging companies could offer 'commitments' to guarantee that competition on the market would be continued. Companies are allowed offer remedies in phase I or in phase II. The European Commission analyses if the proposed remedies are practicable and sufficient to abolish competition concerns. If commitments get accepted, they become binding upon the companies.

### 4. Phase II investigation, art 10 para 3

From the opening of a Phase II investigation, the Commission has 90 working days to make a final decision on the accordance of the planned merger with the EU Merger Regulation. This can be extended by up to additional 35 working days. A Phase II investigation is opened when the case cannot be resolved in Phase I, because concerns about restriction of competition on the common market still exist. If the Commission still believes that the planned merger will impede competition, it sends a statement of objections to the notifying parties, informing them of the Commission's preliminary conclusions. Parties then have the right to respond within a certain period, consult the Commission's case file and can request an oral hearing.

### 5. The final decision, art 8

As soon as phase II investigation is completed, the Commission may either

- unconditionally clear the merger; or
- approve the merger subject to remedies; or
- prohibit the merger.

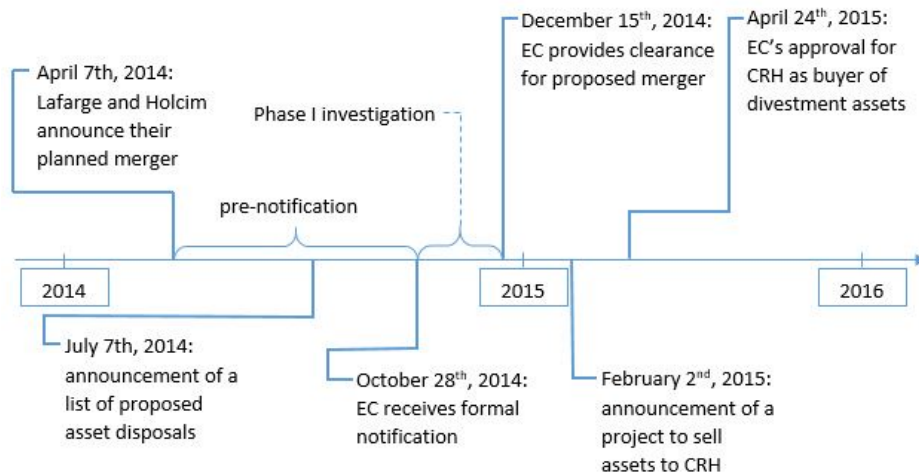
### 6. Judicial review, art 16

All decisions and procedural conduct of the European Commission are subject to review by the General Court and ultimately by the Court of Justice. The companies or other parties demonstrating an interest can appeal within two months of the decision.

## 8 Timeline of EU antitrust process

Under a merger of equals scheme, the companies were accepting that their market value was similar, neglecting differences between their share prices at the time (CHF 65.1 for Lafarge vs. 67.15 for Holcim on the 31st December of 2014) and their corresponding performance (marginally better for Holcim). At this stage, the negotiators were probably aware of those differences but the intention to reach an agreement minimised the relevance of those differences.

**Figure 6** Timeline of EU antitrust process



*Sources:* LafargeHolcim, Merger Announcement, 2014; Asset Disposals, 2014; Notification, 2014; EC Clearance, 2014; Assets to CRH, 2015; EC Approval CRH, 2015

In April 2014, Holcim and Lafarge communicated that they would make “selected divestments in developed countries” in order “to anticipate any regulatory requirements” and secure an early approval for the planned merger by the European Commission. In July 2014, both companies announced a list of assets that will be included in the divestment package. With few exceptions, one would divest entire positions, if overlapping, in countries of the European Economic Area (EEA). At the end of October 2014, Lafarge and Holcim presented remedies together with the formal notification towards the European Commission. This new package contained several changes compared to earlier statements. According to the parties, these changes have been made following preliminary constructive pre-notification discussions with the Commission.

Announcing a bigger divestment plan than required (\$8 billion compared to \$5.5bn) can indicate that the companies calculated the assets they were willing to let go independently and the sum of the independent calculations, meaning they would not enter conflict regarding the assets to be sold or at least not let the markets know of possible clashes in this matter.

As early as 7 July 2014, the two countries had published a divestment plan which included for example in Europe (LafargeHolcim Ltd., 2014c):

- Austria: Lafarge’s Mannersdorf cement plant
- France: Holcim’s assets in metropolitan France, except for its Altkirch cement plant and aggregates and readymix sites in the Haut-Rhin market; Lafarge’s assets on Reunion island, except for its shareholding in Ciments de Bourbon
- Germany: Lafarge’s assets
- Hungary: Holcim’s operating assets
- Romania: Lafarge’s assets
- Serbia: Holcim’s assets
- the UK: Lafarge Tarmac assets with the possible exception of one cement plant

By 28 October 2014, on the date of the official notification to the EU, the companies announced that they were in negotiations with potential buyers. As early as 2 February 2015, the companies announced in a joint press release (LafargeHolcim Ltd., 2015a):

As part of their proposed merger, Lafarge and Holcim announce they entered exclusive negotiations further to a binding commitment made by CRH regarding the sale of several assets.

- The assets include operations mainly in Europe, Canada, Brazil and the Philippines (*see complete list below*).
- Taken together, the assets being disposed under the terms of today’s announcement generated estimated 2014 sales of EUR 5.2 billion, with an estimated 2014 operating EBITDA of EUR 744 million.
- The enterprise value of EUR 6.5 billion [CHF 6.8 billion] reflects the value of these high quality assets.

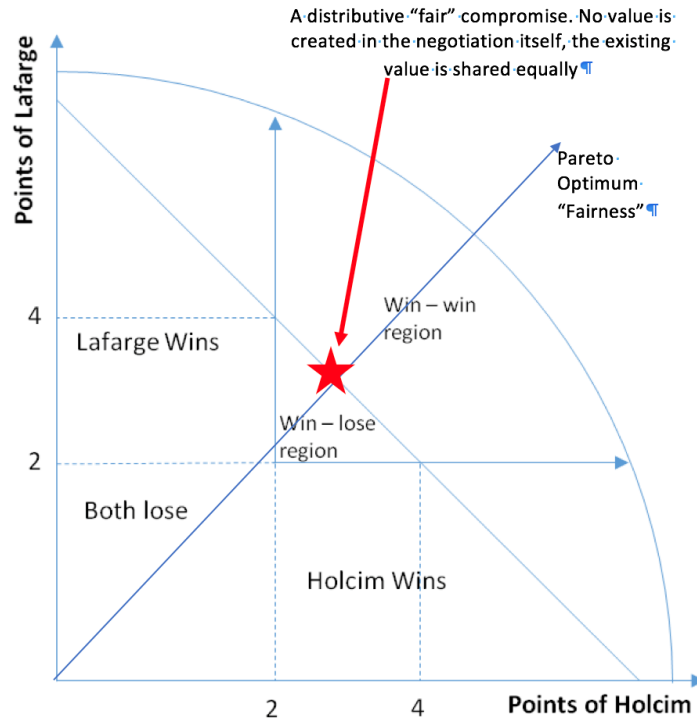
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The divestment process will be carried out in the framework of the relevant social processes and the ongoing dialogue with the employee representatives’ bodies. It will be submitted to the relevant Competition authorities and to the shareholders of CRH. The divestments are subject to the completion of the merger, including a successful public exchange offering and approval by Holcim’s shareholders in the second quarter of 2015.

The decision to locate their headquarters in France and Switzerland, together with a divestment plan that exceeded requirements and the merger of equals scheme leads to the conclusion that this first negotiation was performed under a collaborative paradigm in which the companies managed to avoid conflict and work together. Figure 7 shows that the companies didn’t really directly create value in the negotiation but compromised by exchanging concessions. The companies may have recognised that increasingly challenging trading conditions would drive further consolidation within the industry as significant new emerging market competitors arose. In these conditions, the primary motivation of the deal was to build a strong European-based global player by merging with a company which offered sufficient synergies and limited integration challenges. In this case, the negotiators may have been willing to compromise on the merger terms providing they saw sufficient opportunities for the newly merged company. In this case, a fast and relatively simple compromise solution, although in itself not creating value, enables the newly merged company to move forward most quickly.

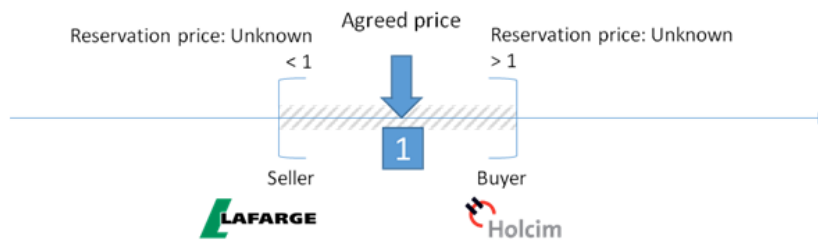


**Figure 7** Comparative outcome of negotiations (based on Saner, 2012)



Considering the price that the companies agreed on for their merger, a first raw version of the ZOPA can be drawn as shown in Figure 8. The *Public Exchange Offer* (Fontana and Aebischer, 2015) was initiated by Holcim for the shares of Lafarge. The document states Holcim as the “Offeror” and states the condition that Holcim would get “...at least two thirds of the share capital or voting rights”. In the light of this information Holcim will be treated as the Buyer and Lafarge as the Seller in the figures containing the ZOPA in pages to follow.

**Figure 8** ZOPA on 7 April 2014



The agreed price at this point was 1 share of Holcim for each share of the merged company. This means that the reservation price for Holcim should logically be equal or higher than 1. From the seller’s side (Lafarge), the reservation price was somewhere

below 1, meaning that they would possibly be willing to accept exactly 1 or less stocks for the deal. Reservation prices and the size of the ZOPA are unknown at this point in time (7 April 2014) but more information will surface later and provide a clearer picture.

After the merger approval under the conditions agreed with the European Commission, Holcim and Lafarge quickly announced their integration committee (Anonymous, 2015). A joint announcement by the CEOs of both companies provided a detailed list of the 10 executives that would be in charge of the integration of the companies, lead the transition until the completion of the merger and become the Executive Committee of the future merged company. At the time of the announcement, 9 of those 10 names were disclosed and the integration committee would be led by Lafarge's CEO, Bruno Lafont. The composition of the committee included 5 executives from Holcim, 4 executives from Lafarge and one position was open to selection (India).

### **9 Major external event – EUR:CHF peg removed (15 January 2015)**

In December 2011, the Swiss National Bank introduced a floor for the trading of Euros vs. Swiss Francs in a move intended to protect the local market and in response to investors buying massive amounts of francs at a time when markets sought an alternative to the dollar and the euro (Dorgan, 2014). At the moment, Swiss companies enjoyed increased competitiveness in international markets but SNB's strategy was not sustainable as the Bank amassed around 480 billion francs in foreign currency during the time the exchange floor was in place. The day on which the SNB announced the end of the peg, markets were shocked and volatility took over the trading scene. An analyst from UBS was quoted saying "... *many businesses and investment decisions might not be seen as viable anymore...*" (Bishop 2015). This statement was almost premonitory of the influence that this major event would have on the negotiation between Holcim and Lafarge. In a single day, the shares of Holcim were effectively 20% more valuable and as the markets stabilised in the following days, the revaluation of the franc averaged 11.25%, having an impact on the ZOPA which will be discussed in the following section.

### **10 Holcim rejects initial agreement terms (17 March 2015)**

After the market assumed the decision by the Swiss Central Bank to remove the EUR:CHF peg they had held for the previous 4 years, the new market conditions seemed to come to a less volatile point. The Euro floated freely at a rate around 1,065 EUR per CHF after three months (An average revaluation of 11.2% for the Swiss Franc). At this point Holcim decided to reject the original agreement challenging the following (Eyck and Shayndi, 2015):

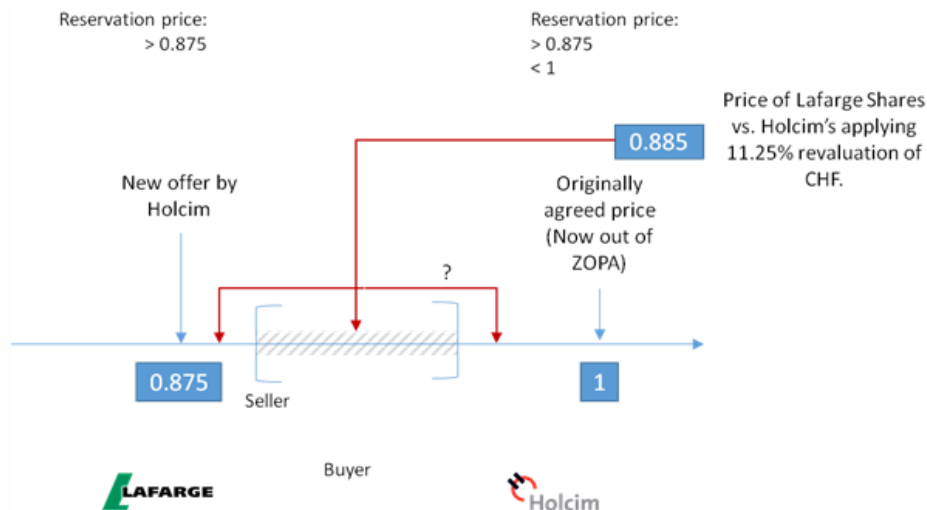
- (a) Financial Terms: Holcim sought to pay 0.875 Holcim shares per each Lafarge share, down from the 1:1 ratio previously agreed.
- (b) Governance Structure: Holcim questioned whether Lafarge CEO Bruno Lafont should lead the combined company.

This negotiation *impasse* can be analysed from two perspectives, the first being the impact that the new market conditions had on the Zone of Possible Agreement. The second perspective is the *impasse* as a tactic for the negotiation.

### 10.1 Impact on the zone of possible agreement

Regarding the ZOPA, the new market conditions and the new price aspirations of Holcim support its construction with more information than available before. The previously agreed share exchange of 1:1 is at this point clearly out of the zone of possible agreement as shown in Figure 9. The new offer by Holcim of 0.875 is at this point not rejected or denied by Lafarge, raising the question whether this offer is within or outside the ZOPA. An opening bid should normally be set beyond the perceived ZOPA to ensure that potential gains are not lost. This is presented in Figure 9 under the label “New offer by Holcim”.

**Figure 9** ZOPA on 17 March 2015



The 11.25% revaluation of the Swiss Franc with a stable market can be applied to the share exchange ratio and resulting in an equivalent of 0.885 Holcim shares per each Lafarge share. The small difference between Holcim’s new offer (0.875) and the revaluated share price can have two possible reasons which were undisclosed.

- Holcim’s calculation of the CHF revaluation considered different data, forecasting a revaluation of 14.4% instead of 11.25%, resulting in a new equivalent price of 0.885 shares per Lafarge’s share.
- Holcim decided to offer less than the result of the CHF revaluation applied to the share exchange ratio in order to have a margin for the upcoming negotiations.

In Figure 9, the revaluated share exchange ratio (0.885) doesn’t have a fixed position and could be within or outside the ZOPA with the information available on 17 March 2015.

### *10.2 Apparent use of an impasse tactic*

Holcim also challenged Bruno Lafont, CEO of Lafarge at the time. Holcim was not publicly making a demand for a specific name or to have a Holcim executive appointed as CEO. This request may be explained with two hypotheses:

- 1 Holcim was effectively against Lafont as future CEO, doubting his capability to lead the merged company towards the objectives.
- 2 Holcim challenged Lafont's leadership in order to have a concession in the negotiation days to come and use this issue to secure better terms in other areas.

Following on the second hypothesis and considering that the rejection was public, an impasse tactic could be assumed. The following points support this rationale:

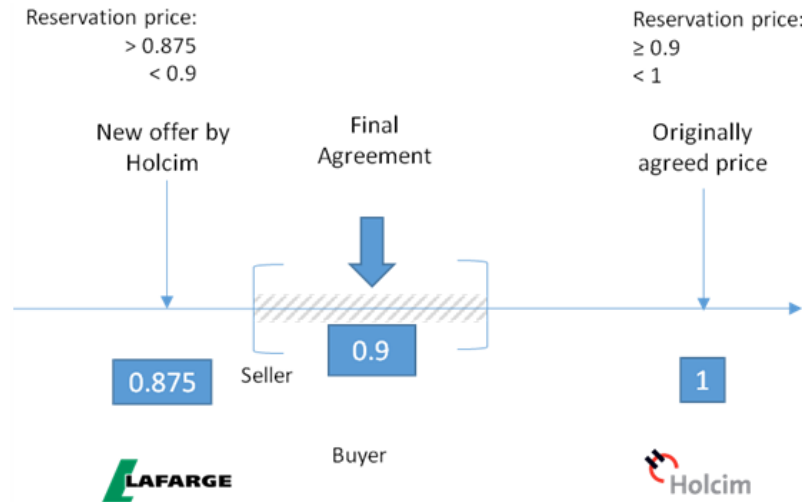
- 1 Between the removal of the EUR:CHF cap by the Swiss National Bank and the rejection of the initial agreement, 3 months passed.
- 2 The fact that the rejection of the initial terms was done publicly by Holcim could mean that they wanted to go around Lafarge's leadership to achieve the terms they wanted.
- 3 The rejection was accompanied by clear demands demonstrating that Holcim was not backing out of the merger but seeking more favourable terms.
- 4 Holcim and Lafarge agreed on a break-up fee of 350 Million Euros. Holcim was conscious of the possibility of this penalty but it is likely that the benefits of obtaining a better deal outweighed the risk.

## **11 A new deal is agreed on and the merger continues (20 March 2015)**

After three days of negotiations a new deal is jointly announced by Holcim and Lafarge. The highlights of this new deal are (Massoudi et al., 2015):

- a Bruno Lafont is appointed co-chairman of the board and a different CEO is to be chosen for the merged company.
- b An exchange ratio of 0.9 to 1 meaning that Holcim Investors would pay 0.9 shares for each share they would receive of the merged company.
- c All investors (Holcim's and Lafarge's) will receive a dividend after the merger of 0.05 shares for each share they have.
- d The deal was subject to the approval of Holcim's investors so it is not confirmed at this point if it would be approved.

As shown in Figure 10, the ranges for the reservation price are much narrower at this point in time when the deal was reached. It is also clear that the originally agreed price was far away from the ZOPA once the Swiss National Bank removed the market cap on the EUR:CHF. A factor that is not drawn in the ZOPA is the extra dividend for the shareholders of both companies. This dividend represented at the time around 3 francs per share which is an important sum, especially for large investors. This can be seen as a tactical element used by the negotiators to secure the approval of the deal by their corresponding shareholders.

**Figure 10** ZOPA on the date of the final deal, 20 March 2015

## 12 Lafarge–Holcim and competition law

On 15 December 2014, the European Commission gave clearance for the merger between Holcim and Lafarge, subject to conditions (European Commission, 2014b).

The scale of the merger between Holcim and Lafarge is extraordinary, as it combines worldwide players that operate industrial assets in most of Europe. Because most of their products are traded locally, the Commission's case team was confronted with hundreds of potential relevant markets. Numerous markets showed substantial overlaps, hence all involved parties knew in advance that competition concerns had to be expected.

When executing a deal of this size, the Commission's case team has to analyse hundreds of potentially affected markets. For this reason, Lafarge and Holcim already initiated pre-notification talks with the Commission at an early stage. Holcim and Lafarge admitted from the start that significant overlaps in a mature industry such as cement would require an all-embracing remedies package. In each of the EU Member States, where overlaps occur, either Holcim or Lafarge would have to divest its activities covering the complete array of products they produced. Any exception to that rule would have to pass the Commission's investigation.

Holcim and Lafarge achieved clearance in phase I investigation thanks to a structural remedy, which would remove the entire overlap between Holcim and Lafarge and ensure the practicability of the divested business.

## 13 Conclusion

The Holcim and Lafarge merger case is a significant case in which two leading cement producers obtained green light after phase I investigations through a comprehensive set of remedies of extraordinary size.

From this merger case can be learned that it is possible to get European Commission’s clearance in phase I even for transactions of this enormous scale. Parties need to remove all competition concerns up-front through a credible, clear-cut and all-embracing package of remedies. Lafarge’s and Holcim’s press releases witness the importance of well-prepared pre-notification discussions and preparation of divestment/ remedy packages, so that the Commission’s concerns regarding competition on the common market get abolished.

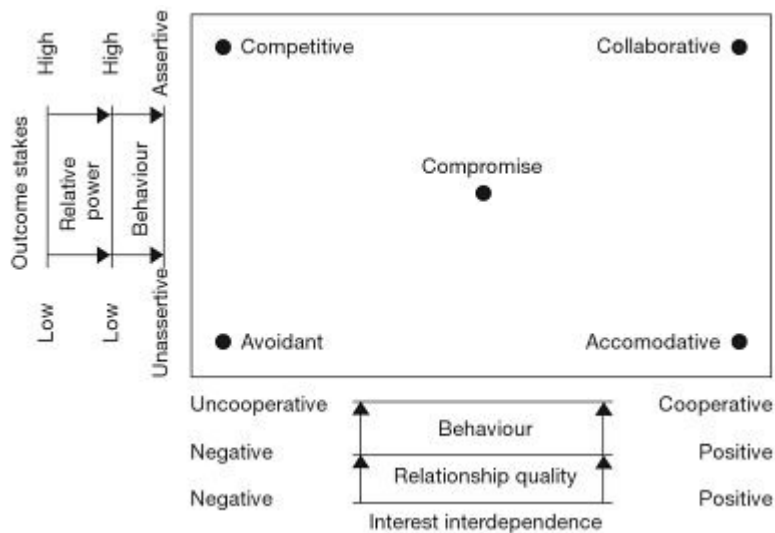
In phase I investigation, the Commission sought for views of other market players on the proposed merger and the adequacy of the contemplated remedies. Subsequently the European Commission’s decision grounds on this investigation. This merger case demonstrates that the clearance in phase I was only possible because both parties, Lafarge and Holcim, were prepared to offer all that was needed to clear the Commission’s concerns, i.e. a structural upfront remedy removing the entire overlap between the parties.

Finally, this case also illustrates the readiness of the Commission to show flexibility because of the exceptional size and scope of both the merger itself and the remedies package (Calisti and Mauger, 2015).

### 13.1 The determinants of conflict behaviour

In 1980, Thomas Gladwin and Ingo Walter broadened the Thomas Kilman Conflict Mode Instrument (1976). Not only the negotiator’s cooperation and assertiveness are in focus, Gladwin and Walter amended the quality of relationship and the relative power of negotiators.

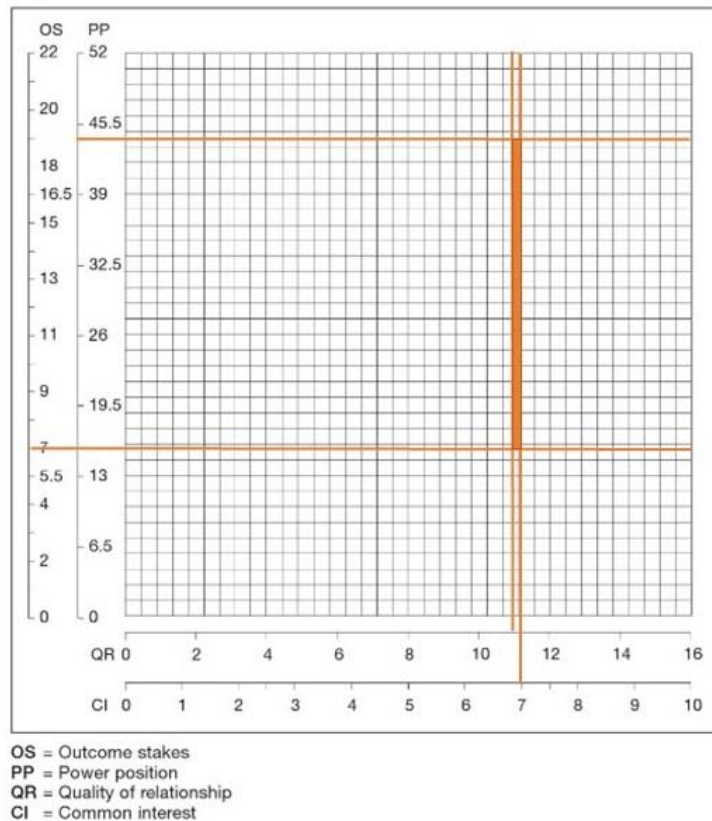
**Figure 11** Determinants of conflict behaviour



Another way of finding a suitable behaviour in negotiations was founded by Lichia Liu in 1987. She provides a Strategic Analysis Checklist, which provides scores that get plugged in into a Strategic Positioning Grid (Saner, 2012).

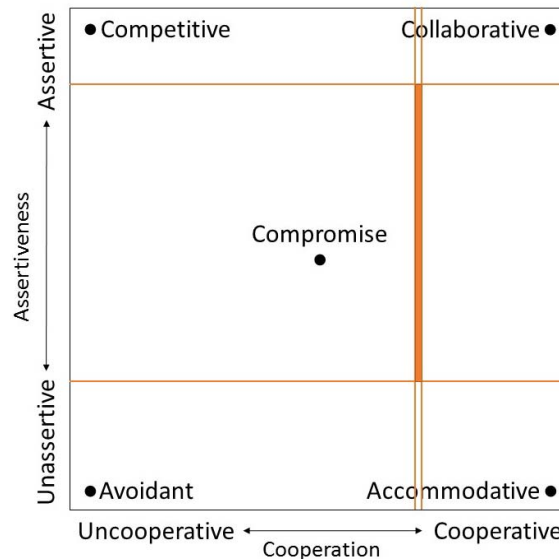
After plugging in the scores into the Strategic Positioning Grid (Figure 12) and applying this to the Thomas Kilman Conflict Mode Instrument (Figure 13), it can be seen, that in the circumstances it was wisest for Lafarge and Holcim to act collaboratively and accommodate where necessary. According to Gladwin and Walter, the companies should focus on the quality of their relationship towards the European Commission.

**Figure 12** Strategic positioning grid for Holcim–Larfarge merger



To satisfy these needs, Lafarge and Holcim pursued certain objectives. First, they were addressing the overcapacity in the cement industry and overcoming the problem of unprofitable investments in the industry. Second, they were strengthening a dominant position of the companies in the industry, increasing market power (European Commission, 2014a) and improving the image. By becoming the biggest player in the market, they changed the nature of competition. One essential objective behind this merger was improving the profitability of both companies as combined ROI of both companies predicted to exceed the individual. Another ambitious goal was to raise the share prices of the merged company compared to individual development. Last but not least, both companies were reducing their presence in Europe through divestments.

**Figure 13** Application of the strategic positioning grid on the Thomas Kilman conflict mode instrument



Despite the fact that their objectives in certain issues were different, the set of common objectives outweighed the discrepancies, and both companies could complete the merger. The two private sector protagonists were able to build process trust and a common cultural approach to the task (Clases et al., 2006; Jeive, 2016). Notwithstanding the signing of an agreement when Holcim and Lafarge first announced their merger, the firmness of this agreement was strongly challenged by changing economic conditions that were brought by the Swiss National Bank’s decision to remove an intervention that was in place for years. The fact that that agreement was initially subject to the approval of their shareholders gave Holcim a margin for manoeuvre that allowed them to step back and demand new terms as the market conditions played in their favour and valued their business above that of Lafarge.

The Holcim and Lafarge merger case is a significant case in which two leading cement producers obtained green light after the phase I investigations through a comprehensive set of remedies of extraordinary size. From this merger case can be learned that it is possible to get European Commission’s clearance in Phase I even for transactions of this enormous scale. Parties need to remove all competition concerns upfront through a credible, clear-cut and all-embracing package of remedies. Lafarge’s and Holcim’s press releases witness the importance of well-prepared pre-notification discussions and preparation of divestment/remedy packages so that the Commission’s concerns regarding competition on the common market get abolished.

In phase I investigation, the Commission sought for views of other market players on the proposed merger and the adequacy of the contemplated remedies. Subsequently the European Commission’s decision grounds on this investigation. This merger case demonstrates that the clearance in phase I was only possible because both parties, Lafarge, and Holcim, were prepared to offer all that was needed to clear the Commission’s concerns, i.e. a structural upfront remedy removing the complete overlap between the parties.



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## **AstraZeneca versus Pfizer**

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**Abstract:** The Pfizer–AstraZeneca case shows how an acquisition target can successfully repel an attempted takeover by engaging with positively disposed stakeholders and managing communications and the news agenda. The company communicated clearly, consistently and powerfully throughout the process and could benefit from a natural, if temporary, coalition of interests between the UK scientific establishment, unions, and a significant portion of the media. In the end, they were able to persuade enough major shareholders to support their vision and reject Pfizer’s offer. AstraZeneca presented themselves as a local champion, a cornerstone of Britain’s high-tech industry, a key investor, valuable employer and in general, a standard bearer for the high-tech, value-added industry that was at that time being actively championed by the UK Government. At the same time, they characterised Pfizer’s approach as an example of greed-driven capitalism most clearly demonstrated by their interests in the tax conversion possibilities.

**Keywords:** AstraZeneca; Pfizer; acquisition; takeover; stakeholder management; negotiation; strategy; defence; communication.

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## 1 The business environment

### 1.1 *Pharmaceutical industry – major challenges and trends*

In 2014, total global spending on medicines for the first time exceeded one trillion US dollars, a number that was projected to grow with a compound annual growth rate of 4–7% to \$1.6tn by 2020 (IMS, 2014, p.5; PwC, 2012, p.4). This growth resulted from an increasing global demand for medicines that is significantly driven by demographic trends. In developed markets, ageing populations and advancements in the diagnosis and treatment of chronic diseases drive demand. In emerging markets, overall population growth and improved access to healthcare act as growth drivers. Here, both the implementation of Universal Healthcare schemes that aim to secure the overall populations’ access to medicines and the increasing spending power of an emerging

middle class for innovative pharmaceuticals are playing their part (IFPMA, 2014, p.31). Overall, analysts expected that 50% of absolute growth in 2018 can be attributed to 21 “pharmerging” countries<sup>1</sup> (IMS, 2014, p.8).

However, this increasing demand for medicines does not automatically translate into a more favourable business environment for pharmaceutical companies. In particular, the industry is confronted with the following challenges. First, government’s healthcare budgets do not suffice to meet the increasing demand for medicines. Accordingly, they implement measures to contain costs to their healthcare systems – either by regulating prices directly and/or strict assessment of drug’s cost-effectiveness before reimbursement. Measures to regulate prices can include price ceilings, government-mandated price cuts, price-volume agreements or external price referencing by using other countries’ prices as a benchmark (Bouvy and Vogler, 2013, pp.23–32). Formal cost-effectiveness assessments such as the Health Technology Assessment (HTA) compare the number and quality of life years added by the drug with its incremental costs. Based on this, it assesses whether funding the drug adds value to the society (Bouvy and Vogler, 2013, p.11).

Most countries, increasingly also emerging markets, have already implemented a combination of the above measures. With the expected demand-driven strain on countries healthcare budgets, this trend is likely to continue. As a result, pharmaceutical companies will find it increasingly challenging to secure their envisaged prices and gain full reimbursement for their products. Secondly, whereas most of the expected market growth will come from the emerging markets, 80% of this growth is expected in the non-branded, generics market segment. Countries like India and China continue to build a strong local generics industry and originator companies’ Intellectual Property Rights are increasingly challenged (PhRMA, 2013). Given that it takes an average of 10–15 years and an average \$1.5bn (\$4bn if adjusted for opportunity costs) to bring a drug to market, pharmaceutical companies perceive patent infringement as significant threat to recuperate their investment and securing their profitability (Herper, 2012; IFPMA, 2014). This concern is further exacerbated by a flattening return on R&D investments and many major pharmaceutical companies experiencing a “patent cliff”. On average, pharmaceutical companies re-invest 15.6% of their sales into R&D (Mizuho Bank, 2014, p.10). However, the return on this investment has decreased from an average 14% in the 1990s to 4–9% from 2006–2010 (Dhankhar et al., 2012, p.3). The generic erosion following the “patent cliff”, namely several former blockbuster drugs going off patent, is expected to reduce pharmaceutical revenue by \$148bn between 2012 and 2018 (PwC, 2012, p.6).

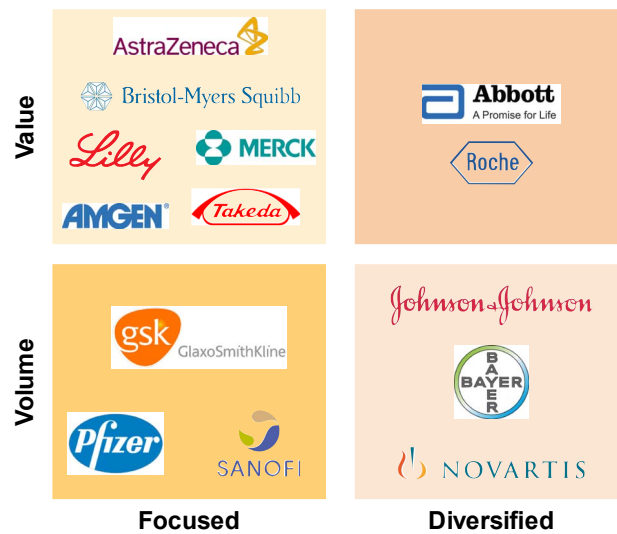
Seeking to differentiate themselves in this environment while keeping the cost base flat (or ideally lower), major pharmaceutical companies have followed two main trends: (1) Outsourcing Research & Development and (2) Increased M&A activity to gain scale, expand their geographical footprint and achieve market leadership in specialty segments. By 2010, more than half of late-stage pipeline compounds were externally sourced (David et al., 2010). This externalisation has occurred through product in-licensing, company partnerships or corporate venture funding, with the latter being mostly targeted at early-stage development (David et al., 2010; Carrol, 2014). Company acquisition is another way to fill the development pipeline through external sources, leading to the second major trend: Increased M&A activity. While the forecast that 2013 would see many acquisitions by big pharma companies to fill their “growth gap”<sup>2</sup> did not hold true, the first half of 2014 alone saw 10 deals with a total value of almost \$90 billion

(EY, 2014; Palmer, 2014). The most notable of these deals probably was the \$20bn asset swap between Novartis and GSK that was announced in April 2014 and closed in March 2015 (Novartis, 2015).

### 1.2 The competitive landscape

Large pharmaceutical companies' product portfolio typically is a mix of product segments. The scale (volume vs. value) and scope (focused vs. diversified) of this product mix allows for a segmentation of the pharmaceutical industry.

**Figure 1** Divergent strategies among leading pharma companies (Rosenberg, 2013, p.15)



First, there are *high volume diversified* “healthcare conglomerates” that sell products across all categories such as Johnson & Johnson (Consumer Healthcare, Medical Devices and Pharmaceuticals), Bayer (HealthCare, Crop Science, Material Science) and Novartis, who divested its Animal Health, Vaccines and OTC divisions but maintains a diversified portfolio across its innovative pharmaceuticals (incl. biologics), generics (Sandoz) and eyecare (incl. medical devices) divisions. Secondly, one can identify a group of *high value diversified* companies. These focus on high-margin originator drugs including both chemically-synthesised drugs and biopharmaceuticals as well as complementing business segments such as diagnostics. Swiss drug-maker Roche, with its strong Oncology portfolio would be an example. Thirdly, there are *high value focused* companies. These companies typically invest a significant proportion of their sales into R&D and focus these R&D efforts on a limited number of high margin products. Besides companies like Eli Lilly, Bristol Meyers-Squibb and Merck, this segment also includes AZ. All of these companies' R&D investments exceed the global industry average. Finally, one can identify a segment of *high volume focused* companies including Pfizer. These companies typically focus their business on core pharmaceutical products in high volume therapeutic areas (Diabetes, Hypertension etc.) with global scale.

### 1.3 Company strategy and history of M&As

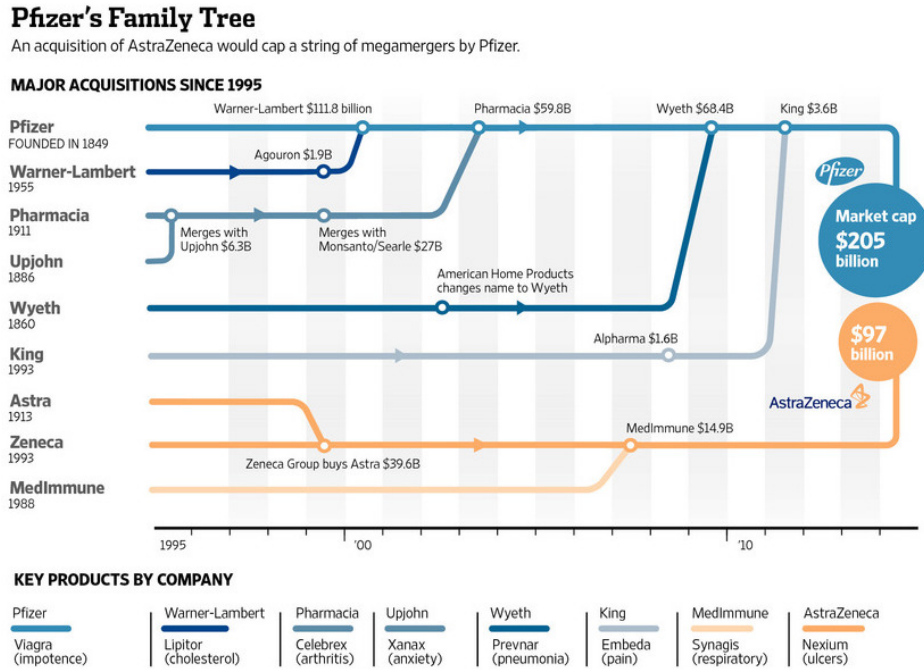
Pfizer's mission is to "*be the premier innovative biopharmaceutical company*". To fulfil this mission, it had defined *four strategic imperatives*: 1. Innovate in biomedical R&D and lead in developing high-value medicines and vaccines, 2. Maximise shareholder value through targeted investments and resource allocation, 3. Earn greater respect in society and 4. Own the company culture (Pfizer, 2013b, pp.2–3). Since 2000, M&A activity had played a central part in achieving the first and, in particular, the second strategic imperative. Until 1999, Pfizer had not engaged in any major acquisitions. This changed in 2000, when Pfizer paid \$90bn to acquire Mid-Western drug maker Warner Lambert, primarily for their cholesterol-lowering drug Lipitor (Langreth, 2000). In 2003, Pfizer continued its series of mega-mergers by acquiring Pharmacia for \$60bn, this time primarily for its painkiller Celebrex (Frank and Hensley, 2002). Finally, faced with Lipitor going off patent in 2011 and a slow pipeline, Pfizer acquired Wyeth for \$68bn to "address these issues" (Abkowitz, 2009; Karnitschnig, 2009). In sum, Pfizer's strategy has been to secure its market position through buying up competitors, rather than investing into their R&D pipeline.

Astra Zeneca's mission, on the other hand, was to *achieve scientific leadership* in their core TA's (Cardio Metabolic, Oncology, Respiratory, Inflammation & Autoimmunity), supplemented by an opportunity-driven approach to Infection, Neuroscience and Gastrointestinal diseases (AstraZeneca, 2013a, p.17). To achieve this, AZ continuously rebuilt its existing R&D pipeline by pursuing business development and investment in R&D. Although being the product of a "mega-merger" themselves, AZ focused on product in-licensing and partnerships as well as small acquisitions of specialist companies rather than large takeovers. In 2007, AZ had its only major acquisition with MedImmune (\$15.6bn). The aim of this acquisition was to add the flu vaccine FluMist and the popular children's respiratory drug Synagis to their portfolio (Olson, 2007). Another significant deal was the diabetes joint venture between AZ and Bristol-Myers Squibb which entailed buying the biotech company Amylin Pharmaceuticals for \$3.4bn in 2012 (AstraZeneca, 2012).

The fundamentally different strategies and long-term aspirations of both companies imply a potential culture clash beyond the American/British management (see e.g. Jeive, 2016). Pfizer's previous acquisitions had not help its reputation as the aggressive post-merger integration of these acquisitions established its reputation as a "Shark that can't stop feeding" (LaMattina, 2014). Both the Warner-Lambert and Pharmacia integration had seen massive cost cuts, both through layoffs and closure of R&D sites. During the announcement of the Wyeth acquisition in 2009, then Pfizer CEO Jeffrey Kindler insisted that this deal would be different and not only "about a single product or cost-cutting". Cost-savings or "synergies" were planned for around \$4bn including cutting of 20,000 jobs (Arnst, 2009). However, by the end of 2013, Pfizer had cut 51,500 jobs, more than twice the initial announcement (Staton, 2015). The Pfizer-Wyeth post-merger integration is also used as an example for the negative impact of mergers on pharmaceutical R&D (LaMattina, 2014). In 2009, Pfizer and Wyeth had R&D spending of \$8bn and \$5bn respectively. In 2012, three years after the merger, Pfizer had cut back its overall R&D spend to \$7.8bn, practically erasing the additional \$5bn that came in through Wyeth. This was achieved through closing various R&D sites including Sandwich (UK) and across the USA (Carrol, 2013; LaMattina, 2014).



**Figure 2** Pfizer’s M&A history (*The Wall Street Journal*)



*1.4 AZ and Pfizer in comparison*

Being a “high value focused” company, **AZ** dedicated almost 17.5% of its 51,500 workforce to R&D (AstraZeneca, 2013b, p.3). This covered 11 locations with the three main scientific centres in Cambridge (UK), Gaithersburg (US) and Mölndal (Sweden) (AstraZeneca, 2015). Compared to these 11 R&D sites, AZ had only 22 manufacturing plants reflecting the focus on value rather than volume (AstraZeneca, 2015).

Serving more than 100 countries, AZ exclusively concentrated on four main therapy areas (TA) with a total revenue of \$25.7bn (AstraZeneca, 2013c, pp.2–3).

**Pfizer** as a “high volume focused” company concentrated mainly on blockbuster products with high volume and increasing internal productivity. From 2011 to 2013 Pfizer was able to save approximately \$5bn in adjusted R&D and Selling, Informational and Administrative expenses (Pfizer, 2013d, p.4; Pfizer, 2014b, p.5). With a yearly spending of \$6.7bn (12.9%) on R&D, Pfizer invested less compared to the rest of the industry (15.6%) (Pfizer, 2013a, p.30). Pfizer’s 78,600 employees exclusively concentrate on three business divisions with focus on different TAs, generating a total revenue of \$51.6bn (Pfizer, 2014a, p.12).

**Table 1** AstraZeneca's key TAs and products

Infection, Neuroscience and Gastrointestinal (\$9bn)	<ul style="list-style-type: none"> <li>• Nexium (\$3.9bn): Acid-reflux</li> <li>• Seroquel (\$1.4bn): Schizophrenia, major depressive disorder</li> <li>• Synagis (\$1.1bn): Respiratory infection in infants</li> </ul>
Cardiovascular and Metabolic diseases (\$8.8bn)	<ul style="list-style-type: none"> <li>• Crestor (\$5.6bn): Managing cholesterol levels</li> <li>• Seloken (\$0.7bn): Hypertension, heart failure and angina</li> <li>• Atacand (\$0.6bn): Hypertension and symptomatic heart failure</li> </ul>
Respiratory, Inflammation and Autoimmunity (\$4.7bn)	<ul style="list-style-type: none"> <li>• Symbicort (\$3.5bn): Asthma, Chronic obstructive pulmonary disease</li> <li>• Pulmicort (\$0.9bn): Maintenance treatment of asthma</li> </ul>
Oncology (\$3.2bn)	<ul style="list-style-type: none"> <li>• Zoladex (\$1bn): Prostate and breast cancer</li> <li>• Faslodex (\$0.7bn): Breast Cancer</li> <li>• Iressa (\$0.6bn): Lung Cancer</li> </ul>

**Table 2** Pfizer's key TAs and products

Global Established Pharma (\$27.6bn)	<ul style="list-style-type: none"> <li>• Lyrica (\$4.6bn): Medication for neuropathic pain</li> <li>• Celebrex (\$2.9bn): Arthritis pain and inflammation, acute pain</li> <li>• Lipitor (\$2.3bn): Reduction of cholesterol</li> <li>• Viagra (\$1.9bn): Erectile dysfunction</li> </ul>
Global Innovative Pharma (\$14.3bn)	<ul style="list-style-type: none"> <li>• Enbrel (\$3.8bn): Rheumatoid, juvenile rheumatoid, psoriatic arthritis</li> </ul>
Vaccines (\$4bn), Oncology (\$2bn) and Consumer Healthcare (\$3.3bn)	<ul style="list-style-type: none"> <li>• Prevnar family (\$4bn): Prevention of pneumococcal disease</li> <li>• Advil (\$0.8bn): Painkiller (Ibuprofen)</li> <li>• Sutent (\$1.2bn): Gastrointestinal, pancreatic tumours</li> </ul>

Pfizer's main focus is clearly on their Global Established Products division including 33 of 46 major biopharmaceutical products representing 72% of sales (Pfizer, 2013a, p.24; Pfizer, 2014c, p.30). However, the focus on blockbuster drugs represented a risk for Pfizer. The pharmaceutical giant had to cope with a revenue drop in 2013 due to patent expiration for Enbrel in North America and the continued effects from Lipitor's patent expiration in Europe and other developed markets (McGrath, 2014). Pfizer, facing a potential patent cliff need to strengthen their pipeline through R&D or acquisition. As a potential acquisition target, AZ offered three major attractions:

- 1 *Established Product Portfolio*: By acquiring AZ's existing product portfolio, the combined companies' revenue of \$77.3bn would enable Pfizer to become the undisputed number one pharmaceutical company surpassing Johnson & Johnson. The diversified product portfolio would help Pfizer become leader in therapeutic areas such as Gastrointestinal (Nexium), Diabetes (Brilinta), Metabolic diseases (Crestor), Respiratory (Symbicort), Oncology (Zoladex). The increased scale and portfolio breadth of combined established business would help to increase critical mass for market access and cost efficiencies. Pfizer's existing manufacturing infrastructure can boost a rapid response in distribution and reliable supply of high quality at competitive costs. Based on that, the newly gained cash flow can be used for reinvestments as well as return of capital to shareholders.
- 2 *Global Footprint – Developing countries*: According to AstraZeneca, developing markets such as China, represented approximately 85% of the world population and over 20% of the world's pharmaceutical revenues (AstraZeneca, 2013a, p.13). With AZ's strong revenue of \$5.4bn in developing countries, Pfizer could boost its current emerging market revenue of \$3.1bn significantly (AstraZeneca, 2013b, p.214; Pfizer, 2014c, p.31). With AZ's China net sales of \$1.8bn, Pfizer could further strengthen its position as No. 1 pharma company in China – with a significant head start compared to the current number three Sanofi (AstraZeneca, 2013c, p.13). An enhanced presence in emerging markets would unlock opportunities for prolonging the established product lifecycle to maintain a strong cash flow profile.
- 3 *R&D Pipeline*: Established products will boost the revenue in the short-term until patents expire. AZ's R&D pipeline would make a complementary strategic fit across multiple key therapeutic areas with enhanced global offering. At the end of 2013, AZ had a total of 60 projects in Phase I & II and 11 projects in the final Phase III (AstraZeneca, 2013d). The two main areas representing 72% of all projects were linked to Oncology (27) and Respiratory, Inflammation & Immunology (24). In the same period of time, Pfizer's R&D pipeline contained 55 projects in Phase I&II and 20 projects in the final Phase III (Pfizer, 2013c). The main advantage of AZ's Oncology pipeline was that the products did not replicate Pfizer's approach, but rather complemented the existing portfolio and pipeline. This means a combined AZ Pfizer Oncology pipeline would have added up to 44 potential products creating a stronger research platform (AstraZeneca, 2013d, p.4).

Beside these TAs, AZ's most promising research is linked to ageing societies with Phase I & II projects in Cardiovascular/Metabolic and Neuroscience to fight Chronic Kidney Disease, Alzheimer's and Parkinson's Disease. AZ's pipeline could have been used to create a stronger research platform and thereby increase the possibility for new product launch opportunities. In particular, Forxiga the diabetes drug newly launched in the EU would have helped Pfizer in case their anticipated pipeline candidates did not pass Phase III (Astrazeneca, 2013d, p.8; Pfizer, 2013c, p.5). Finally, potential synergies in key areas such as Oncology could have helped to decrease the cost of development and speed up the process.

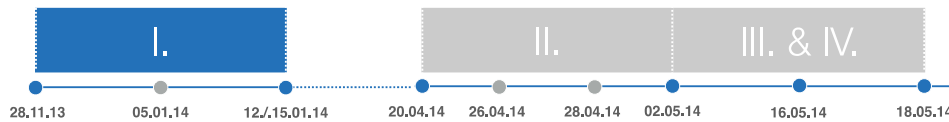
## 2 The attempted takeover

**Table 3** A takeover timeline

26.11.13	Pfizer approaches AZ
05.01.14	Pfizer bosses meet AZ's leadership in NY
05.01.14	Pfizer proposes £46.61/share (a total of £58bn)
12.01.14	UK Company declines and end contacts
15.01.14	Pfizer steps away
20.04.14	UK Sunday Times rumours on a potential Pfizer-bid for AstraZeneca
26.04.14	Pfizer requests AZ to restart talks without concrete bid; AstraZeneca refuses to discuss in the absence of a firm and attractive offer
28.04.14	Pfizer goes public about the interest in AZ/Pfizer says they will move domicile to the UK (for non-US business)
02.05.14	New offer of £50/share (a total of £63bn) and pledging to have European operations and 20% of research in UK, Cambridge
04.05.14	Labour leader increases political pressure calling for an independent assessment of whether the proposed takeover is in the national interest
06.05.14	AstraZeneca publishes a strategy update highlighting its drugs in development and setting a revenue target of more than \$45bn by 2023
07.05.14	With political pressure unrest over potential job losses to UK science research, stronger commitments from Pfizer are requested
08.05.14	Former Science Minister calls against the US firm's intentions
10.05.14	Pfizer talks about win-win in a video statement and praises AstraZeneca's Research
13.05.14	Pfizer CEO Ian Read and AstraZeneca CEO Pascal Soriot appear separately at the business, innovation and skills committee
14.05.14	Read and Soriot appear in parliament again, this time before the science and technology committee
15.05.14	The chairman of the science select committee writes to the science minister to express his growing concerns about Pfizer's £63bn takeover
16.05.14	Secret proposal of £53.50/share (a total of £67.5bn) rejected by AZ board of directors
18.05.14	New £55/share proposal, worth £69.4bn, piles pressure on AstraZeneca's board to enter negotiations with Pfizer
19.05.14	AZ board rejects Pfizer's final £69bn takeover bid, irking some large shareholders
26.05.14	Pfizer steps away
26.11.14	As cooling-off period ends – Pfizer does not take any further actions towards AZ

## 2.1 Round I – initial approaches (28 November 2013 to 19 April 2014)

**Figure 3** Timeline Round I



### 25 November 2013

Pfizer CEO Ian Read contacted AZ’s Chairman Leif Johansson the newly EU launched drug on Friday, 25 November 2013 to express a non-binding interest regarding a possible transaction.

### 5 January 2014

After nearly two months, Pfizer initiated the first meeting between both parties. Ian Read and Frank D’Amelio (CFO) invited Leif Johansson and Pascal Soriot to a New York hotel on Sunday, 5 January 2014 (King, 2014). At this first face-to-face meeting, Pfizer expressed their interest in AZ by offering £58bn for a takeover. Pfizer was willing to pay £46.61 per share representing a premium of approximately 30% at that time. 70% of the amount would be paid in Pfizer shares, the rest in cash.

### 12 January 2014

As former CEO of Genentech, which Roche acquired in 2009 for \$46.8bn, Soriot was experienced in M&As. After one week of consideration, AZ formally declined the offer as it “very significantly undervalues [AZ] and its prospects” (Pfizer, 2014) Pfizer decided to step away from the deal at least for the time being.

### 2.1.1 Negotiation behaviour

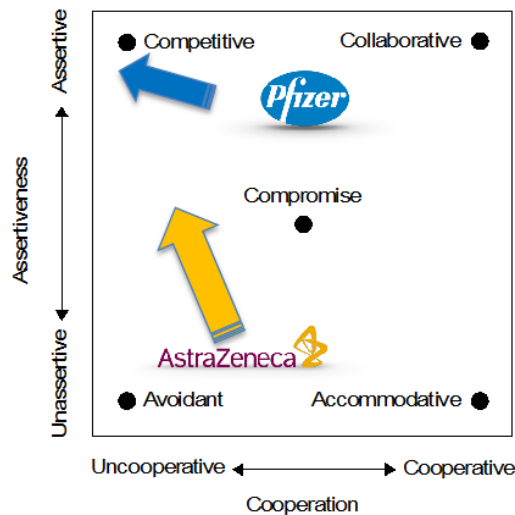
Pfizer’s initial approach can be considered direct and assertive. The offer appears to be for a full takeover and we may assume would result in AstraZeneca being fully integrated into Pfizer. There is little evidence of any concerted attempt to consider other options or a more equal combination of the two companies. Whether this initial approach by Pfizer was driven by the company’s strategic needs, by a perceived need on the part of Ian Reid, the Pfizer CEO, to ensure that he emulated his predecessors in achieving a significant takeover during his tenure, or combination of both is unclear. There is little evidence at this stage for any sustained investigation of the underlying interests of AstraZeneca. Although the authors were not privy to the actual conversations, one might assume that some arguments put forward to attempt to persuade AstraZeneca’s senior managers of the benefits that would accrue to them either in terms of personal financial gain or future roles within the merged organisation. We can also speculate there was some discussion of the impact of an offer on AstraZeneca’s share price and the benefits to their existing shareholders.

In their rapid and outright rejection of the deal, AstraZeneca clearly communicated their position on the initial offer. Following this first offer AstraZeneca avoided immediate further discussion of any potential takeover by Pfizer.

Despite this clear rejection of the initial offer, speculation in the press and markets continued and was not surprising that a second offer was made three months later.

If we plot these initial behaviours onto Thomas and Kilmann's (1974, pp.309–325) conflict mode instrument, we can argue that Pfizer's assertiveness places them clearly in the upper half of the grid and the direct offer of the takeover, plus no evidence of any exploratory talks into the creation of a new merged entity implies a competitive approach. There is also little or no evidence that AstraZeneca intended to behave in a cooperative manner placing them to the left of the grid and their behaviour can be considered somewhere between avoiding and competing. On the one hand, they appear to be avoiding any further substantive talks, on the other assertively rejecting the initial offer, and we can assume preparing their defence, which would later be assertively stated.

**Figure 4** Pfizer & AZ attitude in Round I



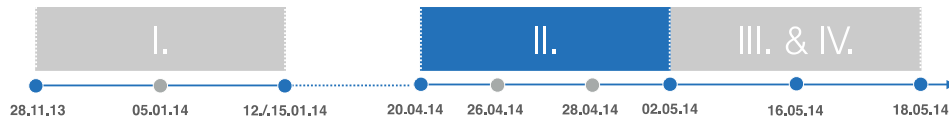
### 2.1.2 Strengthening positions

AstraZeneca's defence had begun in earnest. On 6 February, the company presented its 2013 full year results and indicated a faster than anticipated pipeline progression noting they had outreached 2016 target for phase 3 pipeline NMEs<sup>3</sup> by 1, with a rise from 10 to 11 (AstraZeneca, 2014c). While this in itself may seem minor, it is indicative of the defence strategy which would focus on AstraZeneca's future R&D potential as an independent company and the risk to its R&D if acquired by Pfizer.

AstraZeneca's bullish R&D forecasts were clearly intended to persuade shareholders that an active pipeline would generate stronger future financial results. As Pfizer's offer was not officially public at this stage, we can consider this action as both a means to persuade shareholders to support the existing management and also, perhaps by default, to ensure that any future Pfizer bid would be significantly higher than that of January 2014. In either case, AstraZeneca is seeking to strengthen its negotiating power.

## 2.2 Round II – from private to public (20 April 2014 to 2 May 2014)

**Figure 5** Timeline Round II



### 20 April 2014

After three months without any interaction from both companies the potential deal became public in the UK *Sunday Times* at 1.01 AM UK time with the Headline “Pfizer weighs £60bn bid for Astra Zeneca: American drug giant makes secret approach for struggling rival, paving way for biggest ever British takeover” (Marlow et al., 2014) According to industry and investment bank sources, the article stated that both companies had had informal talks in previous weeks. Neither company responded to the story immediately.

While the authors cannot be certain of the source of the original *Sunday Times* article. Pfizer had a track record of using the press to influence negotiations. During the Warner-Lambert takeover, announcing to the press that it was not willing to accept the proposed merger between Warner-Lambert and American Home Products and would seek to legally block any such merger. Prior to its acquisition of Wyeth, the Wall Street Journal had received information about supposedly private talks and some speculate that Pfizer may have been involved in the leak. In this case, once Pfizer’s concrete interest became public it will be far easier for them to actively lobby both government and key AstraZeneca shareholders. On the other hand, for AstraZeneca, public knowledge of Pfizer’s bid would, in all probability, lead to an increase in its share price thus forcing the bid price upwards. An increased share price could also be presented as signal of belief in the company’s new strategy and future prospects. Furthermore, if AstraZeneca’s defence strategy was to question Pfizer’s longer-term intentions especially related to R&D investment and the protection of jobs in the UK, it would need to build a coalition of stakeholders including shareholders, unions and employee representatives, supportive politicians and other key influencers - this could far better be done once the bid had become public.

### 26 April 2014

Six days after the story was published, Ian Read approached AZ again in an attempt to persuade them to agree to a joint press statement on current merger talks (Pfizer, 2014c). As stated earlier, AZ refused, arguing that they would not engage in the absence of a firm offer (AstraZeneca, 2014a). Legally forced to go public, Pfizer now released a press statement, published a presentation showing the potential synergies between the two companies and held an extensive investor’s call (Pfizer, 2014d).

#### 2.2.1 Synergy potential

Pfizer’s main goal in these actions was to publicly demonstrate the advantages of a combined company. Ian Read argued in the investor call that Pfizer had “great respect for AZ and its proud heritage” He also explained the timing of the offer – four months after

the firm discussion had taken place – was that he felt, due to an increase in Pfizer’s pipeline, “*that [Pfizer was] coming from a position of greater strength and confidence*” (Pfizer, 2014b). Furthermore, he emphasised the fact that shareholders would get a considerable premium with regard to the current share price.

AZ replied approximately three hours later (Rockoff et al., 2014) with a rather brief statement outlining the deal and reasoning that a firm and attractive bid is necessary before engaging with Pfizer. In addition, AZ attempts to demonstrate progress on their plan for growth (AstraZeneca, 2014c; King, 2014). AZ were not willing to accept the request in the absence of an official “Statement of Interest” together with a firm offer as required by the UK Takeover Code paragraph 2.4.

*28 April 2014*

Pfizer issued their official “Statement of Interest” along with a press release, an investor/analyst and media call (Pfizer, 2014c). The Statement highlights potential synergies, such as:

- *Highly innovative and established pharmaceutical businesses, combined ability to meet patient needs*
- *Enhanced pipeline development (Product development)*
- *Operational synergies*
- *Financial opportunities, such as tax structure*

AstraZeneca’s response (AstraZeneca, 2014a) clearly identified its lines of defence. Firstly, Pfizer’s offer lacked specifics; secondly, the merger was less to do with securing R&D resources and more to do with potential tax inversion if Pfizer’s headquarters were transferred to the UK;

*“[...] it considered this request and concluded that, absent a specific and attractive proposal, it was not appropriate to engage in discussions with Pfizer.”*

*“[...] it raised certain concerns regarding the execution risks associated with the proposed inversion structure, as Pfizer would re-domicile to the UK for tax purposes.”*

*“[...] it remains committed to executing the strategy announced by AstraZeneca in March 2013. This strategy centres on re-establishing scientific leadership and returning to growth.”*

*29 April 2014*

Only one day after the press release, Pfizer representatives flew to London to have a personal meeting with members of the UK government and the major shareholders of AZ (Ward, 2014). Pfizer were making a concerted effort to engage with the key shareholders and stakeholders in an attempt to push through the deal. Their tactics from this point on appear to be to be focused on building pressure on the AstraZeneca board to force the latter into accepting a deal.

*2 May 2014*

After meeting key stakeholders Pfizer submitted its first official offer on 2 May 2014 for the takeover of AZ. At this stage of the negotiation, Pfizer was offering £50 per share,



including £15.98 in cash, valuing the British group at £63bn (Kollewe et al., 2014; The Guardian, 2014). The cash element was only slightly higher than in the first bid in January (32% instead of 30%).

In addition, Pfizer sent an open letter to UK Prime Minister David Cameron, to address the concerns of the UK government. The open letter must be seen in the context of the government's policy at the time of promoting the UK as a centre for research and innovation and as a result to attract investment and create jobs. The government's policies had also included the tax breaks on R&D which would have made relocating Pfizer's corporate HQ so attractive. AstraZeneca's focus on Pfizer's history of reducing R&D spending and R&D jobs was clearly having an effect on public sentiment and Pfizer was seeking to react.

Pfizer referred to the bid and added the following commitments which would be met for a period of at least five years from the date of the deal (Pfizer, 2014d):

- Establishing the combined company's corporate and tax residence in England
- Substantial R&D innovation hub in Cambridge to be completed
- Key scientific leadership in the UK
- 20% of the combined company's total R&D workforce in the UK going forward
- Substantial commercial manufacturing facilities retained at Macclesfield
- European Business Headquarters and European Regulatory Headquarters to be located in the UK
- At least two AstraZeneca Board Members to join combined company's Board
- Board Meetings to be held in the UK as appropriate and meaningful participation in the UK commercial, economic and social community

Following a meeting of the AZ Board on the same day, the offer was rejected as it still "substantially undervalues AstraZeneca". Moreover, AZ referred to the unchanged tax inversion structure as well as the amount payable in Pfizer shares (AstraZeneca, 2014a). For the first and the second deal, Pfizer approached AZ with approximately 30% cash and 70% stock bid.

Leif Johansson, AZ chairman highlighted the strengths of staying independent and referred to the current rapidly progressing pipeline (BBC, 2014). After the second offer, Pfizer faced two options. First, they could issue a new offer, second, they could change their strategy and consider a hostile takeover by sending the offer directly to AZ's shareholders (Wood, 2014).

As discussions moved from private to public, a variety of further interest groups became involved. Some flavour of the public discussion can be gauged by the following:

**UK biggest trade Union Unite**

*"AstraZeneca is strategically significant for the UK economy. We expect the UK government to pay special attention to this bid and do everything possible to protect jobs and to support the UK's knowledge base"* said Unite's national officer, Linda McCulloch (Rowena et al., 2014).

**UK Business Secretary Vince Cable**

*"Pfizer's interest might endanger jobs in the UK"*.

**David Rosenbloom, US attorney**

*“What it’s all about is stripping the U.S. tax base”* (Waldman, 2014).

**John LaMattina, former Pfizer chief global R&D**

*“If combined, Pfizer-AstraZeneca would likely reduce overall spending on research and development”* (Waldman, 2014).

**Adrian Bailey, chairman of the UK Parliamentary Business Select Committee**, calls for an investigation as it could threaten the UK’s strategic interests. Bailey is requesting an investigation and questioning of Pfizer’s interests and intentions as soon as possible (Rubert, 2014).

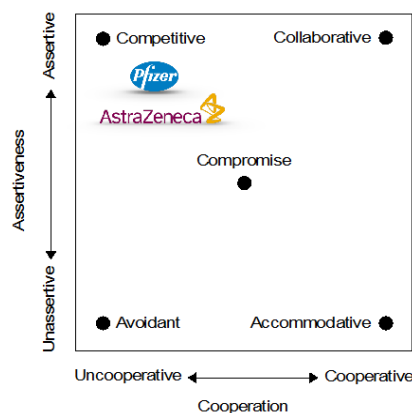
**Vince Cable, UK Business Secretary**, states that he is also minded to intervene and he has certain power to do so under Enterprise Act. The “UK Enterprise Act 2002” which gives the right to act in public interest if national security is threatened.

After the second bid was rejected, AZ provided a strategy update on 6 May emphasising that an “independent strategy will create significant value for patients and shareholders” (AstraZeneca, 2014b). Upon the presentation of strong results in the strategy update and the initiation of a phase III study for a lung cancer drug, Soriot takes the negotiation atmosphere to the emotional level by stating: *“What will we tell the person whose father died from lung cancer because one of our medicines was delayed – and essentially was delayed because in the meantime our two companies were involved in saving tax and saving costs?”* (The Guardian, 2014).

AZ is behaving more competitively in its statements in the public realm assertively arguing that a combined company would not be beneficial for its most important stakeholders, i.e. customers and shareholders. Furthermore, AZ’s press statements also become more pointed, *“The Board of AstraZeneca believes Pfizer is making an opportunistic attempt to acquire a transformed AstraZeneca, without reflecting the value of its exciting pipeline. This value should accrue fully to AstraZeneca shareholders”* (AstraZeneca, 2014a).

Pfizer, simultaneously, openly shows disappointment about the lack of engagement of AZ board in a press release on 13 May 2014 (Pfizer, 2014c). Both companies are at this stage making use of stakeholder emotions by communicating negatively about the counterpart supporting the fact that the negotiation strategy had become more competitive.

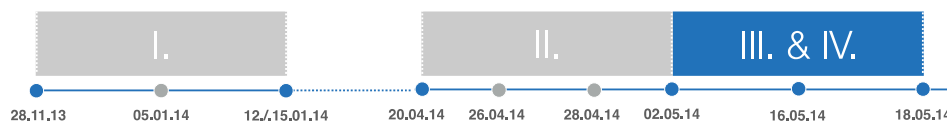
**Figure 6** Pfizer & AZ attitude in Round II



### 2.3 Rounds III & IV – the last dance

Despite having been rejected twice, Read persevered with the deal, arguing “we ... believe it is in the best interests of both companies and AstraZeneca and Pfizer shareholders that we pursue a friendly negotiated transaction that can be recommended by both our boards” (Wood, 2014).

**Figure 7** Timeline Round III & IV



#### 6 May 2014

At the start of Q2 2014, both parties announced their Q1 results. Pfizer’s revenues had declined by 9% down to \$11.35bn leaving the analysts disappointed. In their results and outlook, AZ published updated sales targets with a boost of up to 75% by 2023 as an independent company. Nearly one third of the sales are contributed to recently developed drugs. In addition to that, AZ announced the transition of their most anticipated lung cancer drug to the last stage of clinical trials. The new outlook, based on optimistic forecasts, can be seen as a clear statement of intent. AZ’s management would fight for their independence and would offer major shareholders an alternative vision which offered them potentially even greater returns, or at least required a significantly higher bid price from Pfizer.

#### 7 May 2014

Apart from the company negotiation, other parties such as the UK scientists are involved themselves publishing an open letter in the *Daily Telegraph* urging the government to protect AZ. This external voice also led the Prime Minister to respond “*Let me be absolutely clear, I’m not satisfied. I want more. But the way to get more is to engage. We want the investment, the jobs and the research that comes with the competitive tax system*” (Telegraph, 2014).

#### 8 May 2014

In the same week, AZ visited its main shareholders in Sweden and the UK. The shareholders were divided into two camps. One group supported AZ’s independence and believed in their growth projection, the other side saw a highly lucrative deal in Pfizer’s offer.

#### 13 May 2014

The raising concerns of public stakeholders and the ongoing discussions in the UK Parliament led to a meeting at the House of Commons Business Innovation and Skills committee with the two companies being called. Both company representatives had to appear separately in the governmental meeting. In his hearing, Read mainly addressed the future R&D spending together with an increase in efficiency and synergies. UK Labour Party leader Ed Miliband did not take Read’s vague answers for granted and stated: “*Pfizer failed to provide enough assurance for job security and future R&D Development in the UK*” (Hjelmgaard, 2014).

Read, on the other hand, felt confident and promised AZ shareholders that Pfizer would not give up and would fight hard with the UK government (Pratley, 2014). In the second hearing, Soriot criticised Pfizer's cost saving strategy and pointed out that an R&D pipeline delay due to the integration process might even cost lives (Rubert, 2014).

*14 May 2014*

The US and Swedish governments shared their concerns regarding Pfizer's tax inversion strategy and specifically pointed out the potential job losses. This is especially linked to Pfizer's former acquisition and their cuts in R&D to make cost synergies. The Royal Society of Chemistry in the UK reported in its newsletter that "*UK, US and Sweden are concerned what will happen if Pfizer forces through a deal. US senators like Carl Levin want to close the 'tax loophole' Pfizer plans to exploit, while Maryland and Delaware's state governors have written to Ian Read over possible job losses. Meanwhile, Read has written to UK Prime Minister David Cameron with assurances, including keeping at least 20% of any combined company's R&D workforce in the UK and retaining 'substantial' manufacturing in Macclesfield. In response the Wellcome Trust, the country's largest independent research funder, also wrote to Cameron, demanding he find ways to hold Pfizer to these promises*" (Extance, 2014).

*15 May 2014*

Two days after the hearings, Soriot repeated his concerns regarding Pfizer's strategy and that their sole interest in the deal was for tax reasons. He confirmed again that he had no interest in selling AZ and therefore to engage with Pfizer. Additionally, Soriot questioned the degree of support of the UK government. Especially, as the French government had increased regulations for foreign takeovers at the same time, as a reaction to the GM-Alstom approach. In the same week the complexity of the negotiation grew further as British civil servants started exploratory discussions with the EU government to evaluate possible options to block the takeover putting Pfizer under pressure to increase its commitments from 5 to 10 years. Apart from this development the true influencers, AZ shareholders, are still divided and they started to share their interests in public. Pfizer took this chance and contacted AZ's largest shareholder to win them over for a potential acquisition. Some of them were not adverse to start discussions, which created additional pressure on AZ. In return, shareholders who favoured AZ's independence started to speak publicly, backing Soriot's strategy (Kollewe, 2014a).

*16 May 2014*

Two weeks after the initial offer, Read approached AZ again for "private talks" to make a new non-official offer bidding £53.50 per share (6% increase). Additionally, Pfizer raised the cash rate from 30% to 40%. AZ refused the offer and stated that they would start discussions if the share price reaches £58.50 and the cash ratio significantly rises. AZ shares ended trading that week at £48.23.

*18 May 2014*

Only two days later Pfizer made their final offer and placed a bid of £55 per share valuing the British company at £69bn. The cash element to AZ shareholders was further increased to 45% with the rest paid in Pfizer shares. AZ recognised the bid and took some time to reflect.

21 May 2014

AZ’s board of directors rejected the deal resulting in a drastic AZ share price drop of 13%.

26 May 2014

With the end of the 28 days offer period, Pfizer officially announced that they would not renew their offer for AZ. The fact that no agreement was reached imposes the start of the so-called “cooling-off” period allowing no offers and bids for the next six months.

After the AZ board rejected the deal for a fourth time, Pfizer delivers its promise and steps away not trying to pursue a hostile takeover. After this last bid is denied and the 28 days offer period expires, the cooling-off period helps the companies to reassess their positions and interests.

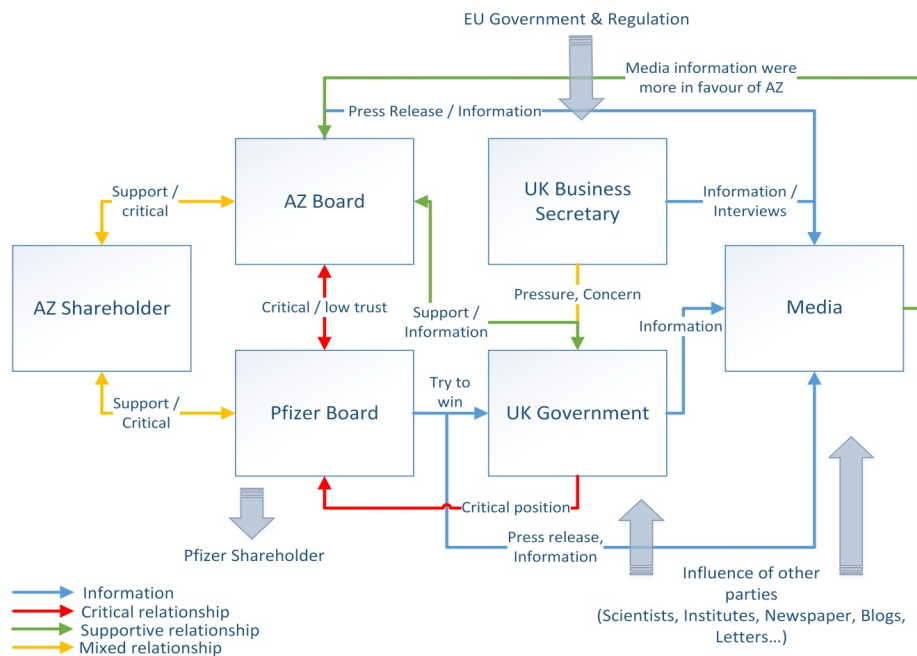
### 3 The post-mortem

#### 3.1 Analysis of stakeholders from the negotiation perspective

##### 3.1.1 Relationship and influence among stakeholders

To further improve our understanding of the influence of the various stakeholders, we need to consider the relationships between them, the information flows, and attitudes towards one another. The main stakeholders are shown in boxes, whereas the others with lower power are mentioned separately. The coloured arrows show the type and quality of relationship (supportive or critical).

**Figure 8** Relationship among stakeholders



AstraZeneca were better able to mobilise their supporters in government and the media by presenting themselves as a champion of British high-tech industry, a valuable employer and a contributor to innovation and scientific excellence, while presenting Pfizer as a rapacious interloper driven by short-term financial goals.

### *3.2 3-D negotiation & negotiating backwards*

Sebenius and Lax (2003) argue that sophisticated negotiators apply a 3-D approach, which includes the following dimensions:

- 1 Tactics: Act “at the table” to improve interpersonal exchange
- 2 Deal design: Go “back to the drawing board” and try to unlock value
- 3 Setup: Move “away from the table” and include relevant parties

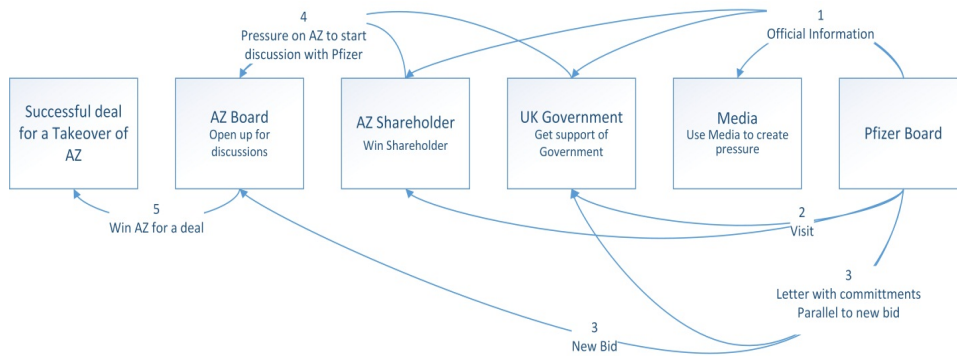
During Phase II of the negotiation, it must have become clear to Pfizer and their CEO Ian Read the chances of persuading AstraZeneca’s Board to accept the deal on the table were vanishingly small. Other than raising the offer price significantly as well as increasing the cash percentage, it appears that Read had a few other incentives to offer at the negotiating table. Read also faced considerable time constraints. In the circumstances, it appears that he and the Pfizer senior management decided against restructuring the deal to try to unlock additional value, but rather to approach key shareholders and stakeholders directly. To understand the way the stakeholders reacted, why and how they were influenced, Sebenius and Lax (2003) suggest 3D negotiation analysis and backwards integration.

### *3.3 Pfizer’s stakeholder management*

At the time of its second bid, Pfizer increased its stakeholder engagement by its investor calls and by sending an open pledge letter to UK Prime Minister David Cameron (Economist, 2014; Pfizer, 2014d).

Initially key shareholders were split and the deal might have gone either way. One major hurdle was the attitude of at least parts of the UK Government, especially the Business Secretary, the unions and the media, and the influence that these attitudes were having on those shareholders still undecided or supportive of the AstraZeneca board. Pfizer had been communicating with the media, but a significant proportion of the press was still hostile questioning Pfizer’s long-term commitment to the UK. On 13 May 2014, Pfizer CEO Ian Read testified to the House of Commons Business Innovation and Skills Committee, potentially offering him the opportunity to publicly respond to his critics. However, it is generally considered (e.g. Bloomberg, 2014) that his appearance was mostly defensive and his arguments failed to sufficiently address the needs of key stakeholders. The failure to persuade the committee of the benefits of Pfizer’s bid for AstraZeneca together with Pfizer’s failure to win over key influencers in industry and the media meant that they were unable to put pressure on the AstraZeneca board to accept formal discussions which could have resulted in a deal. Ultimately, Pfizer were unable to generate sufficient process trust (Clases et al., 2006) to create momentum for the deal. At the same time AstraZeneca were able to consolidate their support amongst undecided stakeholders thus effectively blocking the deal.

**Figure 9** Potential visualisation of Pfizer's stakeholder engagement activities and goals (adaptation of backwards integration by Sebenius, 2004)



### Legend

- 1 Official statement on 28.4.2014.
- 2 Visit on 29.4.2014 and third bid on 2.5.2014.
- 3 Pfizer publishes letter to UK Govt including commitments. Initially the UK Govt appeared to accept these commitments.
- 4 Following pressure by the Business Secretary, letters from leading scientists and media reports the government modified their position. Pfizer has no majority of AZ shareholders sufficiently supportive of bid.
- 5 The result was a split of the shareholders in a group supporting the takeover of Pfizer and a group supporting AZ independence.

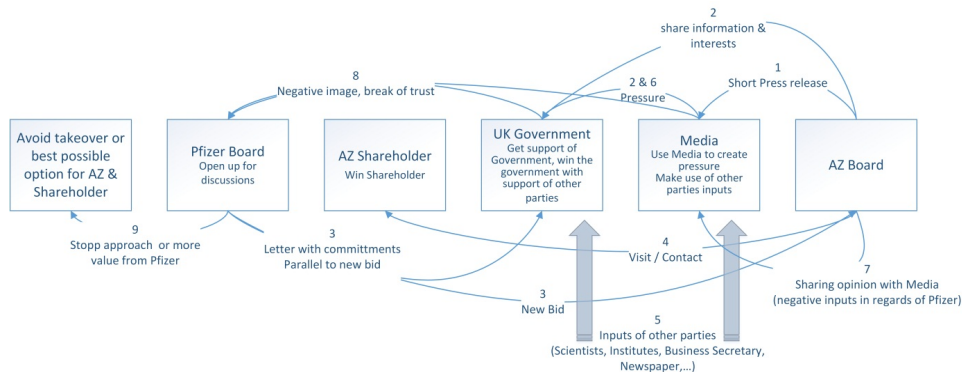
### 3.4 AZ stakeholder management

AZ interacted regularly with their shareholders throughout the process, independent of Pfizer's approach (AstraZeneca, 2014c). After the first approach in January, AZ started to push their strategy and communicated higher sales goals. Besides a rather short press release on 28.4.2014 to answer the official statement of interest (AZ Press release, 2014), AZ visited and contacted its shareholders in the week of 8.5.2014. The goal was to highlight the promising long-term strategy and the recent positive pipeline results with clinical tests.

AZ's interest was to focus on research with a good pipeline of new products selling the company was not the intention of AZ board unless the offer was extremely valuable for AZ and its shareholders.

AZ made use of the influence of further parties in the media and towards UK Government. For AZ, the reaction of these parties was most often positive and helped to gain the government as a supporter. AZ rejected the bids within short time, which gives a clear push back signal to Pfizer. Furthermore, with on-going negotiation, AZ started to share more in the media and used the media to win more parties for their interest. By mid-May, AZ started to highlight statements in the media with negative impact for Pfizer (Kollewe, 2014b).

**Figure 10** AstraZeneca's perspective of Stakeholder engagement (adaptation of backwards integration by Sebenius, 2004)



AstraZeneca's strategy was actually relatively simple, they presented themselves as a local champion, a cornerstone of Britain's high-tech industry, a key investor, valuable employer and in general, a standard bearer for the high-tech, value-added industry that was at that time being actively championed by the UK Government. Pfizer's approach was characterised as an example of greed-driven capitalism most clearly demonstrated by their interests in the tax conversion possibilities and the history of stringent cost-cutting and reductions in research and development spending. AZ could benefit from a natural, if temporary, coalition of interests between the UK scientific establishment, unions, and a significant portion of the media. Throughout the process the AZ Board were consistent in their rapid rebuttal of any offer tabled by Pfizer (although an offer above £58 per share might have changed that), insisting in the message the company had a clear strategy which will deliver returns to shareholders and success for stakeholders. The company communicated clearly, consistently and powerfully throughout the process. In the end, they could persuade enough the major shareholders to support their vision and reject Pfizer's offer.

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## Notes

- 1 China, Brazil, Russia, India, Algeria, Argentina, Colombia, Egypt, Indonesia, Mexico, Nigeria, Pakistan, Poland, Romania, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine, Venezuela, Vietnam.
- 2 Big pharma sales growth assessed to be \$100bn below overall drug market growth (EY 2014).
- 3 NME: New molecular entity or NCE: New chemical entity.

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## **Cameron's pre-Brexit settlement for the UK within the European Union: failure or missed opportunity?**

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**Abstract:** While the vote on Brexit showed a narrow yes to leave the EU, the most stunning effect was the end of former Prime Minister (PM) Cameron's political career. The vote was a surprise to many including Cameron himself who negotiated intensely with the EU members before the Brexit vote and got a surprisingly high number of concessions with the hope that the Brexit vote would be negative and that the UK would remain a member of the EU. This article endeavours to assess these concessions PM Cameron obtained before the vote, and how they were obtained. Multi-stakeholder theory and multi-actor negotiation theory have been applied to shed light on the negotiation process and a final closing section assesses whether these concessions were insufficient or whether the concessions were not communicated adequately by PM Cameron and his government.

**Keywords:** UK–EU negotiations; pre-Brexit negotiations; European Union negotiations; political negotiations.

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## 1 Introduction: a new settlement for the UK in the EU

For decades, the question of Europe has divided UK politics like no other issue and the relationship between the UK and the EU has always been seen as a troubled marriage. In other words, despite their membership since 1973, the EU and UK somehow never seemed to be able to remain in harmony for long.

This issue was openly (re)addressed by UK's Prime Minister David Cameron in his Bloomberg speech in January 2013, where the Conservative Party had committed to holding a referendum on the UK's membership in the EU by latest 2017. However, this referendum was not supposed to be a simple "in-out referendum" on the situation, but on a new settlement. In Cameron's words:

*"[...]A vote today between the status quo and leaving would be an entirely false choice. [...] It is wrong to ask people whether to stay or go before we have had a chance to put the relationship right".*

*"The decision to hold a plebiscite on quitting the EU is the biggest risk taken in recent British political history".*

The Bloomberg speech was the start of what turned into long multilateral (re)negotiations about status of the UK in the EU, which *de facto* aimed to clear the relationships according to the vision of *Europe à l'anglaise*.

After three years of hard bargaining, on 20 February 2016, the negotiation parties came to a final agreement where the UK achieved its *new special status in the EU*. However, UK vote on 23 June 2016, ended up with a majority of British voters opting to exit from the EU.

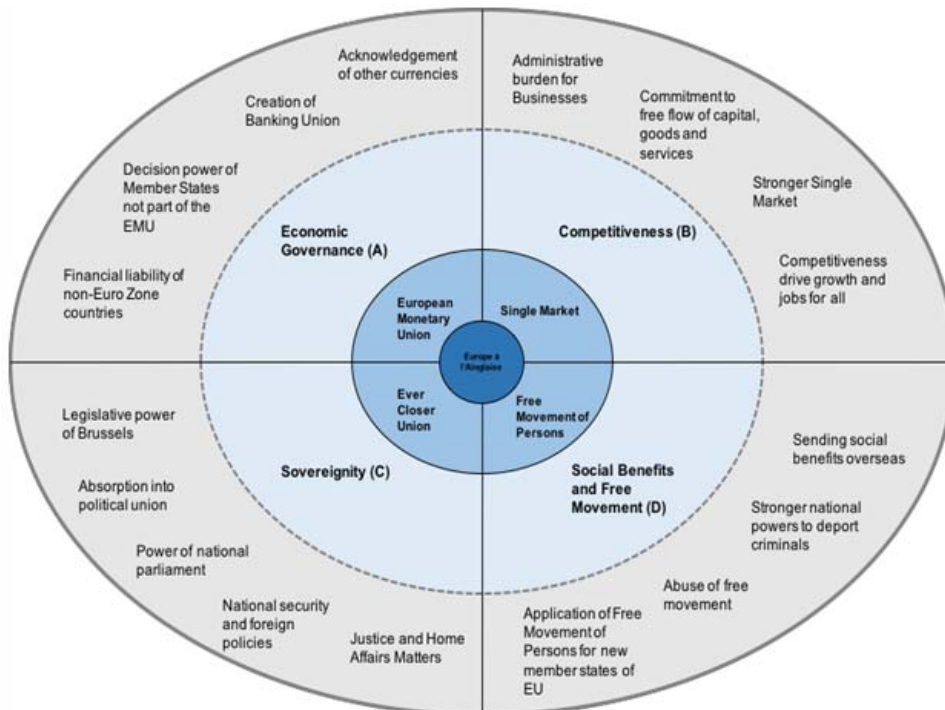
Understanding the pre-*Brexit* negotiations to gain a new settlement and the subsequent vote in favour of *Brexit* need to be discussed within its historical context, as the new settlement pre-*Brexit* negotiations marked the beginning of a new Europe and are key to understand the post-*Brexit* negotiations.

## 2 Negotiation background: historical issues embedded in the pre-Brexit crisis

The roots of the UK’s complex relationship with Europe can be dated back to Winston Churchill’s famous Zurich speech, and include contentious issues such as the migration, foreign policy and Eurozone crises.

In order to create a more comprehensive overview about the interconnectivity between the issues, Figure 1 presents the so-called *spheres of issues in the UK-EU negotiations*. The core sphere presents the core issue of the *Europe à l’anglaise*, which forms the fundamental mind-set of the second sphere that includes the four sub-spheres divided into underlying issues of the *European Monetary Union (EMU)*, the *European Single Market*, the so called *Ever Closer Union* and *Free Movement of Persons (FMP)*.

Figure 1 Spheres of issues in the UK-EU negotiations



These four underlying issues form the basis for the third sphere with the four main negotiated issue packages presented in the case, and finally but essentially the integrative issues within those four buckets, which create in the integrative part of the negotiation.

In advance, one can already analyse from the figure that the course (and curse) of history never ends and fundamentally influences a negotiation and is in particular important when it comes to the new settlement between the EU and the UK. Therefore, creating the awareness of conflict and potentially find a common interest between the negotiation parties starts by analysing from the core towards the fourth sphere. However, one needs to essentially point out that the source of these issues was situated in the UK domestic political situation as a promise of a referendum had been used to influence the UK's domestic elections.

### **3 The core sphere – Europe à L'Anglaise**

Churchill pointed out in his *United States of Europe* speech: “*We have our own dream and our own task. We are with Europe but not of it. We are linked but not compromised. We are linked and not absorbed.*” These lines of Churchill's speech sum up the idea of *Europe à l'anglaise* and Cameron's direction of changing the relationship with the EU.

Looking back in history, one can identify that the UK's prior strategic purpose to join the European alliance was predominately the economic trading opportunities, which the ECC offered. Hence, from a British perspective, the strategic alliance, formed by joining the ECC in 1973, was purely based on a trade. This purpose represented also the mutual balance of interest according to the UK. However, the European integration project soon neglected this core British strategic purpose with the implementation of the Common Agricultural Policy (CAP) and the resulting high contributions, putting pressure on the Sterling and leading to the EU referendum in 1975.

Despite the British decision to stay in the EU in 1975, the underlying issues were not resolved. With the years to come, the British expressed their dissatisfaction numerous times, particularly during the Thatcher era, and negotiated several deals within the EU such as the Fontainebleau deal, the opt-out option from the EMU or the Schengen deal while at the same time accepting the Maastricht Agreement. However, the numerous deals achieved and the consequently special status of the UK in the EU did not re-establish the initial strategic purpose of joining the ECC.

Nevertheless, besides the UK's special status in Europe, the UK is aware that it holds not only a special but a strong and key position on several key issues in Europe. Financially, the British are the third biggest net contributors to the European budget behind France and Germany and London is the strongest financial marketplace in Europe and also a major global centre. From a foreign policy and defence perspective, the UK holds a key strategic position in Europe as part of the UN Security Council, its strong ties with the USA, particularly in NATO, and the perhaps the best intelligence agencies in Europe. Consequently, with the British knowing that they hold such a dominant position and the slow erosion of the British idea of Europe including their core strategic purpose of being part of the EU, a deep British frustration resulted, which is the fundamental conflict in these negotiations.



#### **4 The second sphere – the underlying issues**

From the previously described core issue and the fundamental source of conflict, namely the British vision of Europe but more importantly the strategic position of the UK within the European alliance, the next sphere extends the core into four distinctive but interconnected underlying issues: (1) the European Monetary Union (EMU), (2) the Single market, (3) the ‘*ever closer union*’, and (4) the Free Movement of Persons (FMP). One can state in advance that each of the four spheres addresses a particular issue earlier addressed in the core issues during the pre-*Brexit* negotiations.

##### *4.1 European Monetary Union*

From a historical perspective, the underlying issue is embedded within Thatcher’s hostility towards EMU’s launch in 1990 and the final decision 1999 by Blair that the UK would stay out of the Eurozone after it had failed to pass Gordon Brown’s five economic tests. Today, the major difficulty is that the UK is bound to EU internal market law, but not by EU Monetary policy as non-Eurozone member. In other words, the complicated conflict here addresses the question of who is competent to regulate the EMU and on what legal basis. The complex issue is that monetary policy development falls into the EU’s competence field, however, the EU shares competences with the other member states to regulate the internal financial market, which also means the financial services and instruments. Hence, fiscal and monetary policy do not fall into the same competence field, which is particularly problematic for the non-Eurozone members. This issue of missing economic governance competences was especially highlighted during the financial crisis in 2008, where it was not clearly defined in which sphere of governance competence and responsibility the financial crisis issue falls, which caused additional tension between the EU and the UK but also other EU member states. In the aftermath of the crisis, the UK became even more concerned that the European Central Bank (ECB) became the ultimate regulator through the *Banking Union*, meaning that the stability of the Euro fell within the European banking regulations and therefore negatively affecting non-Eurozone members (Staiger, 2014). In particular, the financial market in London, and therefore the City of London itself, became particularly worried with the EMU underlying issue.

##### *4.2 Single market*

The single market issue is strongly linked to the EMU issue and has significant implications for constitutional issues for the UK but also other EU member states. The establishment of the four freedoms in the Lisbon Treaty leading to the Single Market including its free trade and free movement area did not include how the market operates. Hence, despite the fact that the UK is content with the single market itself as this fits best into the UK’s core strategic purpose for being part of the EU, the regulation of the single market can be seen as the heart of the problem (Webb and Keep, 2016). Hence, the UK wants a better regulated single market but on the other hand no further political integration of that market, which leads towards the underlying issue of the ‘*ever closer union*’.

### 4.3 *Ever closer union*

Political integration has always been a fundamental issue for the UK, as the British always wanted to stay at 'arm's length' from any absorbing involvement. Particularly the wording of an *ever closer union* in the Treaty of Functioning of the European Union (TFEU), implying also politically, is a key and highly emotional issue, feeding the Euro-sceptics in the UK but also populist movements across Europe. Looking back in history, the British voted to stay in the ECC in 1975, but never intended to stay in a political union that is now the EU. Hence, the conflict is based on the sentimental wording '*ever closer*' within the treaties, which the British perceive as nothing else than *The United States of Europe*, an idea Churchill ironically invented but never intended the UK to be part of.

### 4.4 *Free movement of people*

The free movement of people (FMP), besides the free movement of goods, services and capital, all deeply anchored in the Treaty of Maastricht, can be seen as the most critical and essential underlying issue of all four issue packages presented, due to its political and public sensitivity. Having looked at the key strategic purpose of the UK in joining the ECC, namely the enlargement of trade options, only three of the four freedoms apply to this core strategic purpose, whereas the FMP does not directly serve this purpose at a first glance.

Nevertheless, the free movement of labour is key to a functioning single market that is strategically important to the UK. Despite the strategic functionality of the free movement of labour, the underlying issue lies in the fear of mass migration, especially during the refugee crisis. Embedded in the FMP is also the Schengen issue for the Schengen countries, which the UK is not part of. With this mass migration fear comes the critical issue of the so called 'benefit tourism', which implies that jobless migrants shop around in the EU social welfare. Hence, the source of conflict lies in the restriction of the FMP, currently for the entire EU, and for the UK especially in combination of the social benefits and the FMP of Eastern countries (Webb and Keep, 2016).

## 5 **The third sphere – the embedded distributive issues**

This section briefly elaborates how the issue buckets are connected to the underlying issues and the overall core issue and UK's strategic purpose of being EU member.

After the Conservative Party's electoral victory in May 2015 Cameron set out on a charm offensive across EU capitals to obtain support for his reform plans. However, European leaders demanded more clarity from Cameron's plans, which he did not want to expose in order to keep his party's Eurosceptic wing calm.

Nevertheless, on 10 November 2015, Cameron put forward an open letter to CoE president Donald Tusk including the following four main summarised reform sections containing a number of several concrete and more detailed negotiation issues. These issues can be summarised under the four main areas: Economic Governance (A), Competitiveness (B), Sovereignty (C) Social Benefits and Free Movement (D) (Emerson, 2015). It is essential to point out in advance that these four main issue buckets would have to be accepted by 27 other EU member states, the European Commission and the

European Parliament in order to reach a potential deal. In other words, before any hope of entering into integrative negotiations, Cameron had to make sure to *simplify the agenda* in order to avoid a major distributive bargain, where in the end all parties would have been losers.

### 5.1 *Economic governance (A)*

In general, the issue bucket *Economic Governance* addresses the underlying issues of the EMU. Next to the existing special status of the UK prior to the negotiations, this issue bucket demands more protection for non-Eurozone countries and the introduction of better functioning economic governance mechanisms.

Looking into more detail, the first multi-layered issue is the economic and financial issue with regard to keeping Sterling. Given that the UK holds a special status as an EU member without Eurozone membership, its demand that the Euro should not be the only currency in the union and that countries outside the currency zone should not be materially disadvantaged is plausible. Consequently, it wishes no involvement in Eurozone bailouts and an implementation of safeguards protecting non-Eurozone members from further steps to financial union. Further, the introduction of mechanisms to ensure that crises in the Eurozone do not damage interests of third countries, which includes safeguards for financial centres such as the City of London. UK voters were demanding that the EU membership should benefit the economy and criticise that the contributions of the UK to the EU budget exceeds its returns (Morillas and Barbet, 2015).

Therefore, the draft deal of Cameron included that for member states outside the Eurozone measures to deepen the economic monetary union will be voluntary and that mutual respect between member states and states not participating in the Eurozone is ensured.

### 5.2 *Competitiveness (B)*

In general, the issue bucket *Competitiveness*, which is the only positively framed issue package, specifically enforces the core strategic purpose of the UK of being in the EU, namely to enhance trade in a European single market.

In detail, competitiveness includes the reduction of the burden of excessive regulation and the extension of the single market. Here the UK voters demand more competitiveness, which should be enhanced by cutting the red tape of the union.

Cameron therefore called for increasing efforts towards enhancing competitiveness and that EU institutions as well as member states will endeavour in strengthening the internal market and lowering administrative burdens.

### 5.3 *Sovereignty (C)*

In general, The issue bucket *Sovereignty* can be seen as a highly emotional issue package as it targets the phrase of the ‘*ever closer union*’ in the European treaties, which is clearly a major headache for the British, as they only want to follow London and not Brussels. In other words, the issue package demands to repatriate from Brussels and return it to national parliaments.

In fact, this reform tackles two major issues: the opting out of an ever-closer union with the EU and strengthening the role of the national parliaments in the EU legislation.

Cameron's draft deal therefore proposed that the UK should not be committed to further political integration into the European Union and that different paths of integration for different member states should be allowed. The part of strengthening the national parliaments included the possibility of a 'red-card' mechanism. This demands that if 55% of national parliaments agree, they would be able to effectively block or veto a commission proposal (Landale, 2016). So far the weaker 'yellow-card' mechanism is in place enabling to force the EU to reconsider a commission proposal.

#### 5.4 *Social benefits and free movement of people (D)*

In general, the issue bucket *Social Benefits and Free Movement of People* can be seen as the biggest hurdle during the negotiations due to its highly sensitive political nature and the direct link to the fundamental *four freedoms of the EU*.

### 6 The fourth sphere – the integrative issues

The fourth sphere is the extension of the third sphere from a small pie into a larger pie with more detailed issues, which are embedded and already addressed in the previous spheres. In fact, the integrative grey sphere represents the demands of the UK to address the conflicts discovered in the previous spheres.

The last field concerned with mobility and immigration included the issues of curbing the internal EU immigration and restricting benefits for EU migrants in the UK. This issue meant discussing a topic at the heart of the EU's internal market legislation. Also, the public demand for stronger border controls and the reduction of immigration levels came up in recent surveys. In the poll conducted by NetCen in 2014, 78% of respondents asked for greater control or even abandonment of the ability to work in other countries, 81% were in favour of a blocking period of four years before any claim of in-work benefits should be granted to migrants, and 88% were in favour of not paying child benefit to families living outside the UK. These issues emerged even though the UK had already negotiated a special status earlier by not being part of the Schengen Area (Wallace, 2012).

Cameron's demands therefore stated that EU migrants must live in and contribute to the country for a minimum of four years before claiming tax credits, child benefits or council housing – the so called *emergency brake*. Furthermore, no tax credits or child benefit is granted to migrant family members living abroad. Additionally, no job-seeking benefits are granted to migrants, and jobseekers that have not found a job within six months will be required to leave (Landale, 2016).

### 7 Legal issues

In fact, in all four spheres there is the underlying legal issue that the European treaties need to be adapted. As Mr. Hammond, reappointed foreign British secretary under Cameron, told the BBC: "The Prime Minister made clear that some of the demands that we are making require treaty change to make them irreversible and substantive". However, the legal changes in treaties could only be changed after the German elections in 2016 and French elections in 2017, which might cause additional issues to the

treaty change depending on the outcome of two elections This also begs the question of whether the deal would be legally binding if the UK decided to stay in the EU (Peers, 2016).

## **8 The big implicit issue – the EU structural change**

Certainly it is simpler to analyse issues that are explicitly addressed and presented in the case. However, when thinking further and looking beyond the expressed issues there is one core issue of implicit nature, which can be discovered in the case narrative, namely the strong desire for structural changes within the EU. Summarising the EU issues from the case, at the time of the negotiations the Eurozone crisis was still a major issue with Greece's problems unresolved but again postponed, the French, Italian, Spanish and Portuguese economy still weakened after the financial crisis, a geopolitical crisis including the refugee crisis and the Ukraine crisis directly at the EU's border, demanding new common defence and foreign policies. This sum of crises (re)addresses the urgently needed structural changes of the European Union. This big implicit issue is (un)consciously also in the minds of the other 27 EU member states and one can argue that these negotiations are not only a British matter, but have profound economic and geopolitical implications for all EU members, as well as for the whole of wider Europe (Owen, 2015).

Therefore, this bigger implicit issue serves the British with their negotiations in order to achieve the changes demanded, as they partly address the EU structural affair that is of interest to all 28 deciding EU member states in the CoE.

## **9 The negotiations**

In Cameron's speech in January 2013, he informed the public that if the Conservative party won in the elections in May 2015, he would renegotiate the UK's status with the CoE. This suggests that the main two parties of the negotiations are the UK, represented by David Cameron, and the CoE, represented by Donald Tusk (Foster, 2016). However, considering the fact that the CoE consist of 28 EU member state leaders, it is important to note that there are parties holding very distinctive attitudes regarding different issues than the two main negotiators in this case.

Thereafter, Cameron concretely addressed the outlined critical issues (Emerson, 2015) to be renegotiated in order to generate the political capital he needed to call a date for the in-out referendum and lead the campaign for the UK to stay in the EU. The British people would then be given the choice (by latest 2017) between accepting the renegotiated status of the UK within the EU and staying in or leaving the EU. If, before the referendum, no deal was reached during the renegotiations, Cameron and his Conservative party were expected to continue to support an eventual *Brexit*.

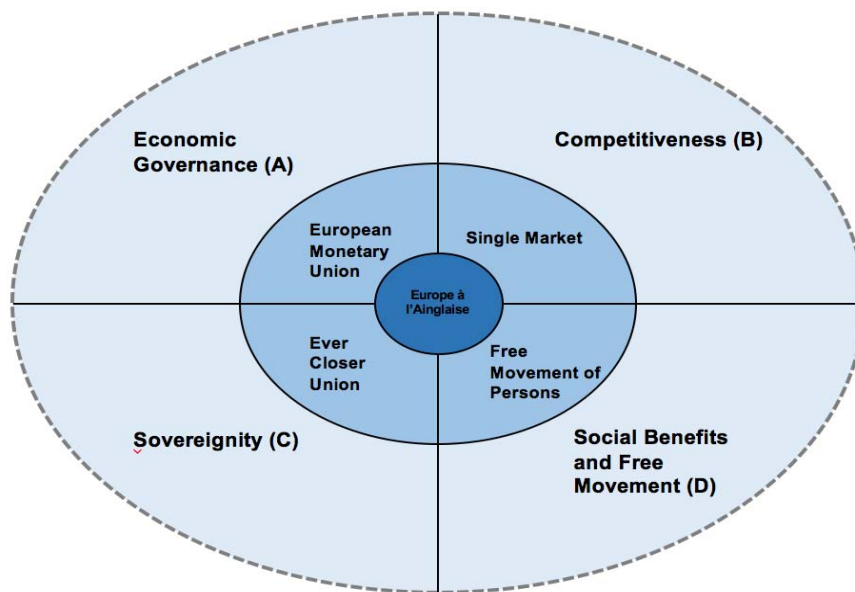
## **10 Bargaining mix**

“Negotiation often means distribution, dividing up the negotiation pie” (Saner, 2007). Certainly, one can ask to what extent the UK-EU negotiations had a distributive character

as the parties involved in these negotiations were not simply adversaries but strategic. However, having a look at the *spheres of issues in the EU-UK negotiations* (see Figure 1) as a pie, the author suggests that there is a potential bargaining mix.

To be more precise, the bargaining mix in this analysis is not about the issues within the buckets itself represented in the grey part of Figure 1 but purely the four major topics that are negotiated that address the underlying issues in the second dark blue sphere (see Figure 2), which needed to be simplified into the four major issue packages as one can see later in the analysis. In other words, this part of the paper focuses on how Cameron moved from the bargaining mix towards an integrative negotiation.

**Figure 2** The bargaining mix in the UK-EU negotiations



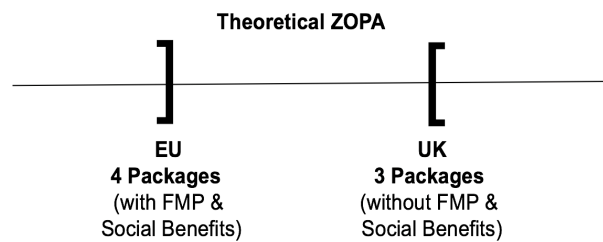
As previously pointed out, before engaging in the real integrative negotiations, Cameron had to make sure to simplify the agenda in manageable cluster of issues and ensure an integrative bargain that creates value. If these negotiations had failed all parties would have been losers as one can see later in this chapter. Therefore, the aim of the following section is also to analyse the starting basis of the negotiations, the following essential bargaining mix. Thereafter, the *zone of possible agreement (ZOPA)* and the *best alternative to negotiated agreement (BATNA)* including its three key outcomes are outlined.

## 11 The zone of possible agreement (ZOPA)

The initial demands of Cameron during his Bloomberg speech on January 2013 made the major issues clear to be discussed, however, Cameron waited to make clear suggestions. Only until after his charm offensive through Europe, where Cameron made sure that the package bargain could be avoided as none of the parties had an interest in letting

Cameron go home without having tightened the relationship, Cameron revealed his precise demands. Theoretically seen, there was one issue package perceived as most critical to be debated, namely the FMP that belongs to the four core freedoms of the EU. Hence, the limitation the FMP was seen as non-negotiable for most of the member states (Weiss and Blockmans, 2016). However, the FMP issue package was only theoretically at discussion or open for a bargain, due to the fact that it became soon clear the FMP in conjunction with the social benefits has to be discussed in order to achieve a solution.

**Figure 3** Theoretical ZOPA in the EU-UK negotiations



## 12 The BATNA from the bargaining mix

However, one may ask why the ZOPA was only theoretical. This question can be answered by explaining the BATNA of both parties, the one of the members of the CoE and the one of UK/Cameron.

After Cameron's successful (re)election campaign in May 2015, Cameron began to visit other EU Member States including the two major powers in Europe, Germany and France, and build a strong foundation for a formal multilateral negotiation. Over months of bilateral talks, Cameron achieved various agreements on the issues, which made him later the more powerful individual party at the CoE members' negotiation table. Additionally, Cameron's threat of leading the No-campaign if his demands were not met potentially put the CoE members into a weaker position attempting to force them into negotiating all issues including FMP.

### 12.1 Outcome of the bargaining mix

The CoE members soon realised that their BATNA would likely be the UK leaving the EU and as many members appeared willing to attempt to avoid this outcome, they were pressured into negotiating FMP in conjunction with the social benefits needed to be discussed thanks to the following factors:

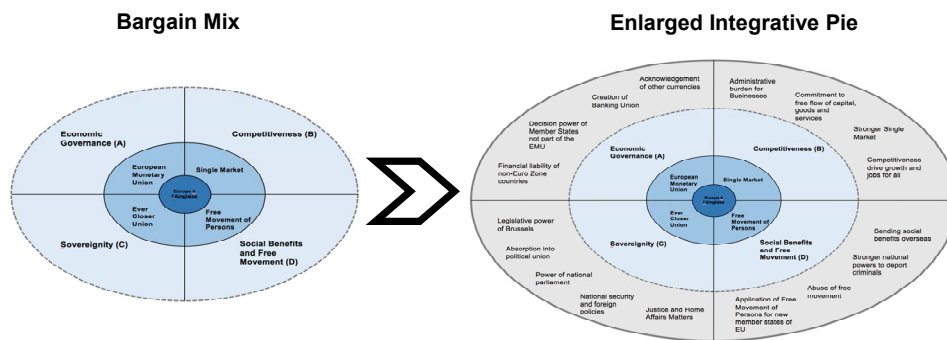
- 1 *Strong BATNA for Cameron coming from the issues* – If EU members would not comply with his demands to discuss the four issue buckets, he would lead the No-Campaign in the UK's In-Out referendum, claiming the EU would be willing to solve the underlying issues.
- 2 *Three simple issue buckets and one heavy issue bucket* – By offering three easy buckets to negotiate and one heavier issue package, Cameron might also have influenced the CoE members to discuss the heavier bucket, as the others are easy to negotiate

- 3 *British issues are European issues* – Cameron convinced during his bilateral talks that the four issue baskets he would like to present are European issues that address the implicit structural issue of Europe and therefore offered a common ground to negotiate.

### 12.2 Integrative bargaining

In fact, the package design offered the most important condition for an integrative solution of the fairly complex negotiations, as now the underlying issues were all bundled into four packages (light blue part in Figure 1). Thereafter, the next step of Cameron was to reveal the elements within those four packages that can be used as concessions against one another, which enlarged the pie as can be seen in Figure 4.

Figure 4 From the bargaining mix to an enlarged integrative pie



## 13 Discussion of integrative package design

The following section has a closer look at the issue package design by analysing the simple and difficult issues within the packages and how the issue agenda has been simplified looking closer at the initial suggestion by Cameron Tusk's reaction in the letter to the CoE and the final 'new settlement' presented on 20 February 2016, by Tusk.

The first step in analysing the integrative bargain is by distinguishing them between simple and difficult issues to solve, which are essential to create value and make trade-offs. Certainly, from the distributive bargain analysis one can identify three simple issue buckets and one particularly difficult, namely the *FMP and social benefits (D)*.

Starting with the simple issues, the simplest package to negotiate was *Competitiveness (B)*, which never caused any serious obstacle to reach an agreement as it addressed further market integration and liberalisation leading to a stronger single market and growth in jobs that is in interest for all EU member states. Moreover, it is the only package including positive framed issues. Nevertheless, the package is particularly important for the strengthening of the British core purpose of being in the EU.

The second simple package, *Economic Governance (A)*, contains one particularly difficult "simple" issue to solve, which is the British demanded for a British veto in the Banking Union. However, the elimination of the more difficult issue in advance gave enough leverage for other simpler issues to be negotiated namely the decision power of



non-Eurozone states in form of an emergency brake, the acknowledgement of more than one currency and the financial liability of non-Eurozone EU members. The third simple but highly emotional package, *Sovereignty (C)*, comes down to the wording ‘*ever closer union*’, which is essential for Cameron in order to convince the British that the UK is not being absorbed into a European super state. Therefore, granting Cameron this important political leverage by recognising in the Treaties that Britain is not committed to further political integration into Europe and acknowledging the British special status in the EU, gave the CoE members and particularly Tusk the chance to create new value to not diminish the legal competences of the EU institutions. Last but not least, in order to fully secure that the legal competences would not diminish, the CoE decided to accommodate the demand of the UK for the ‘red card procedure’ by changing it into a ‘green card procedure’, which introduces constructive ways for national parliament to take part in the EU decision making process with green cards instead of blocking the process with the red cards.

Looking at the most difficult package due to its political and social sensitivity, *the FMP and Social Benefits (D)*, the negotiators involved were aware that Cameron had to come back from Brussels with a demonstrable success, in order to give the Yes-campaign credibility. Therefore, concessions had to be made within the package. Despite the presumed non-negotiability of the FMP by the majority of CoE members, the final deal includes the possibility for member states to pull an emergency brake to limit the access for new workers, so called in-work benefits, for a total period of seven years, which however needs to be approved again by the CoE and therefore does not resolve the issue to receive stronger national powers on migration. This also applies to for the social benefits, particularly to child benefits.

Concluding this difficult issue, one needs to point out that this is the first time in EU history that the FMP rules have been limited and not extended (Booth and Ruparel, 2016). Nevertheless, Cameron’s desired four years ‘ban’ on in-work benefits has not been achieved. However, Cameron achieved more than he could have hoped for as there is actually no real relationship possible with the EU without making concessions towards the FMP.

In conclusion, the issue package design, including simple and difficult issues, offers opportunities and constraints to create value and make trade-offs, which is evaluated next.

## 14 Outcome

At the EU summit on 18–19 February 2016, after three days of hard bargaining and Greece trying to link any deal to the refugee crisis, arguing that it would only accept the resettlement plan if no country would close its borders, a deal was finally sealed. However, as expected, it did not include everything Cameron asked for. In summary, compromises had been made regarding migrants sending child benefits back home and the duration on the four-year curbs regarding in-work benefits of new arrivals (seven instead of 13). On financial regulations, a clause was added to satisfy, French, doubts that the UK was seeking a competitive advantage for London (Landale, 2016). Although Cameron had to compromise on some levels, he was positive the deal ensured that the UK would never be part of one big EU state. Nonetheless, critics, including Tories who are not satisfied with the agreement, argue the deal to be of little value, particularly

regarding the levels of immigration and returning powers from Brussels. Moreover, they warned Cameron that he risked “the long term future of the Conservative party” if he did not campaign for Britain to leave the EU. Rupert Murdoch and his press supported this approach, forming another important opponent of the deal negotiated and *pro-Brexit* activist:

*“Cameron’s deal with EU is a nothing. How can sensible Cabinet colleagues accept this? Loyalty to country more important than friendships”.*

Shortly after the new settlement for the UK was passed at the EU summit, it was announced that the referendum was to be held on 23 June 2016 – a historical turning point for both the future of the UK and that of the EU.

## **15 The bigger picture of the pre-Brexit deal**

In general, the final deal offered to the British public can be seen as the largest single shift in a member state’s position in the EU. However, the deal is neither a crowd pleaser nor a winner but important for four major reasons (Weiss and Blockmans, 2016):

- 1 The deal provided what Cameron had hoped for in order to receive enough political leverage to call a date for the in-out referendum and to lead a campaign for the UK to stay in the EU. In fact, the authors argue that the UK Government had achieved most what it intended to do.
- 2 The deal made clear that the *European Integration* project does not mean that every member state follows the same path of integration towards the *ever closer union*, which was essential for the UK in order to avoid further political integration (Booth and Ruparel, 2016).
- 3 The deal enabled changes in secondary EU legislation, such as the free movement of workers and the coordination of social security systems, which could be incorporated at the next treaty revision after the elections in Germany and France.
- 4 The deal set a model for other EU member states to negotiate better deals for their own countries or otherwise threaten to lead their country out of the Union.

In fact, Cameron and the CoE members were able to identify mutually valuable trades, which moved the frontier towards a feasible agreement between the UK and the EU. The demands by the UK addressed structural challenges within the EU with the overall aim to reorder the relationship between the UK and the EU and move towards the core strategic purpose of the UK to be part of the EU. However, at the same time, the demands address the overall implicit desire of the EU members to make structural changes. In fact, as mentioned earlier, Cameron made clear towards his negotiation partners that the issues addressed are not only British issues but also European issues that created a *common interest* for all negotiation parties and reduced a fundamental tension for the negotiators between cooperative and competitive efforts. Nevertheless, there are undoubtedly *trade-offs* that have been made on both sides. On Cameron’s side, the major trade-off lies in the Justice and Home Affairs and Foreign Policy, which was merely addressed by the parties, potentially resulting from the speed of the negotiations that made it hard to design another issue package and lay the groundwork. Furthermore, despite the essential win

that the UK would not be further absorbed into the *ever closer union*, the legislative power and overall decision power have not really been moved from Brussels to London.

## 16 Conclusions

In conclusion, from the analysis it can be seen that the web of issues that had to be negotiated between the UK and the remaining 27 EU members had strong emotional ties, which were embedded in current European issues. However, the creation of strong issue packages avoided a distributive bargain and therefore made it possible to reach an integrative bargain package based on the common interest that the negotiations are addressing European issues and not only British issues.

On the one hand, the pre-Brexit renegotiation was expected to shape the perceptions of undecided citizens and the overall results of the upcoming referendum, especially the politically critical and emotional topics of Sovereignty and Mobility. The resulting pro-Brexit vote supports the position of the Eurosceptics claiming that the UK is now better off and able to economically survive outside the European Union. In addition, having extended major concessions to the UK during the pre-Brexit negotiations to no avail since the majority of UK voters voted anyhow to exit the EU left some of the remaining EU members with a bitter taste of having comprised on core EU values for nothing or worse resulting in sentiments in some of the remaining EU members of wanting to claim pre-Brexit rights especially in the field of migration and free movement. Therefore, the statement made by Martin Schulz, then President of the Parliament, echoes as he declared:

*“The method that ‘I tell you what you have to give me so that we stay’ won’t work”.*

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## **The Alliance of Small Island States (AOSIS) during the COP 18 negotiations**

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**Abstract:** This paper provides an analysis of a multi-actor negotiation in the context of the United Nations Framework on climate Change Convention (UNFCCC) and describes the negotiation of the Alliance of Small Island States (AOSIS) during the UNFCCC negotiations in 2012 in Doha. Despite the fact that the AOSIS states have a significant power disadvantage compared to the main industrial countries, the group of small island states was able to influence the negotiation process considerably. The authors describe the alliance building of the AOSIS group thereby contributing to the understanding of alliance building in multi-actor negotiations such as the UNFCCC.

**Keywords:** AOSIS; The Alliance of Small Island States; multilateral negotiations; United Nations Convention of Parties 18; UNFCCC; United Nations Framework on climate Change Convention.

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## 1 Background to case study

Negotiations at the United Nations Framework on climate Change Convention (UNFCCC) have been conducted on an annual basis since the signing of the Kyoto Protocol in 1997. The goal of these negotiations has been to reach an agreement on how

to keep a global temperature rise this century well below 2°C above pre-protocol levels of 1997. The annual negotiation meetings are called Conferences of the Parties (COP). The Doha meeting was COP 18.

## **2 Introduction to complex negotiations**

Saner (2013) defined multi-institutional negotiations as ‘... a complex form of negotiations, wherein not only are several parties involved, but the negotiations take place in a number of rounds at a number of different locations’. The United Nations Framework on Climate Change Convention (UNFCCC) is a good example of such multi-institutional negotiations. Entering into force on 21 March 1994, the UNFCCC came into being after it was ratified by 195 parties, also called Parties to the Convention (UNFCCC.Int, 2015a). The many issues covered and the very structure that governs UNFCCC contribute to the complexity of the negotiations (IPIECA, 2008).

While the Convention of Parties (COP) is an annual event, on average, there are four negotiation sessions taking place in a year. Ordinary sessions of the COP are held once every year, and the Subsidiary Body for Scientific and Technological Advice (SBSTA) and the Subsidiary Body for Implementation (SBI) usually meet twice a year, once in conjunction with sessions of the COP. If countries feel they need more time to complete their mandated work before a COP, they request and agree on additional sessions (UNFCCC.Int, 2015b).

## **3 AOSIS**

Alliance of Small Island States (AOSIS), which was founded in 1990, is an ad-hoc negotiating bloc representing the voice of its 44 members in the international negotiation under UNFCCC. These small islands are a highly heterogeneous group with stark social, political, economic, historical and geographic differences. The alliance, however, shares certain physical and structural development challenges, including small territories and geographic remoteness, small population size, environmental fragility and vulnerability to natural disasters and difficulties with full participation in international relations. After building a bloc, AOSIS could fully participate in and shape the negotiation process, gaining visibility and political influence. Through building a cohesive alliance, AOSIS has become one of the key players in the climate change negotiations. Given AOSIS’s limited size and overall resources, the recognition and influence it wielded on the negotiation process within the UN Framework Convention on Climate Change are remarkable (Betzold, 2010). AOSIS was aiming for a more ambitious, renewed commitment by the developed countries to reduced gas emissions through the Kyoto Protocol but the negotiations in the COP/UNFCCC context were difficult and were often described using a biblical analogy as a ‘David vs. Goliath’ negotiation.

#### **4 The UNFCCC as a complex, multi-institutional negotiation**

‘It’s like 195 authors trying to write a book together’, Ahmed Sareer representative of the Maldives, chair of the 44-nation AOSIS, stated during the climate change talks in Geneva in February 2015 in preparation for the COP 21 meeting in Paris the same year (Reuters, 2015) thereby capturing the complex nature of multi-actor negotiations that typifies the United Nations Framework Convention on Climate Change (UNFCCC) negotiations.

The UNFCCC’s ultimate objective is to stabilise greenhouse gas concentrations ‘at a level that would prevent dangerous anthropogenic (human induced) interference with the climate system’. Furthermore, ‘such a level should be achieved within a time-frame sufficient to allow ecosystems to adapt naturally to climate change, to ensure that food production is not threatened, and to enable economic development to proceed in a sustainable manner’ (UNFCCC.Int, 2015).

The convention also puts the burden on developed countries to lead the way towards an ambitious climate treaty. This is because the developed countries are the source of most past and current greenhouse gas emissions, industrialised countries are expected to do the most to cut emissions on home ground. They are called Annex I countries and belong to the Organization for Economic Cooperation and Development (OECD).

Apart from agreeing to lead this commitment, industrialised nations also agree to support climate change activities in developing countries by providing financial support for action on climate change, above and beyond any financial assistance they already provide to these countries. A system of grants and loans has been set up through the convention and is managed by the Global Environment Facility. Industrialised countries also agree to share technology with less-advanced nations.

#### **5 The Doha Climate Conference (2012)**

The 2012 United Nations Climate Change Conference was the 18th annual session of the Conference of the Parties (COP) to the 1992 United Nations Framework Convention on Climate Change (UNFCCC) and the 8th session of the Meeting of the Parties (CMP) to the 1997 Kyoto Protocol. The conference took place from Monday 26 November to Saturday 8 December 2012 at the Qatar National Convention Centre in Doha with a projected attendance of 17,000 participants.

Prior to the official start of the conference, pre-sessions or preparatory meetings were held by various groups. These preparatory meetings allow groups to clarify key issues, refine and solidify their positions in the negotiations and update themselves for any key developments. In the Doha climate conference, the rules for that second commitment period were finally agreed upon, allowing it to move forward for another 8-year period (2013–2020). AOSIS belonged to the advocates of the new commitment period and negotiated additional features of the new commitment period, for example countries, which agreed to the second period, have to revisit and increase their commitments in 2014 (Morgan, 2012). Due to the lack of participation of Canada, Japan, Russia, Belarus, Ukraine, New Zealand and the USA and due to the fact that developing countries like



China (the world's largest emitter), India and Brazil are not subject to any emissions reductions under the Kyoto Protocol, the outcome of the negotiation was only a small success.

Apart from the second commitment period of the Kyoto Protocol another urgent topic negotiated during the Doha Climate Conference was 'loss and damage', that is developing countries should get financial help to meet the cost of climate change adaptation. However, the parties were not able to negotiate clear guidelines – they only started to discuss the compensation of developing countries.

The most important issues and decisions arrived during the Doha Climate Conference were that the parties:

- 1 strengthened their resolve and set out a timetable to adopt a universal climate agreement by 2015, which will come into effect in 2020.
- 2 streamlined the negotiations, completing the work under the pdf-icon Bali Action Plan to concentrate on the new work towards a 2015 agreement under a single negotiating stream in the Ad hoc Working Group on the Durban Platform for Enhanced Action (ADP).
- 3 emphasised the need to increase their ambition to cut greenhouse gases (GHGs) and to help vulnerable countries to adapt.
- 4 launched a new commitment period under the Kyoto Protocol, thereby ensuring that this treaty's important legal and accounting models remain in place and underlining the principle that developed countries lead mandated action to cut greenhouse gas emissions.
- 5 made further progress towards establishing the financial and technology support and new institutions to enable clean energy investments and sustainable growth in developing countries.

Based on the above listed decisions, this case study focuses on the decisions 3, 4 and 5. The different parties' position on these different issues and decisions is captured in Table 1.

### *5.1 The parties of the negotiation*

The major players in the UNFCCC negotiations are big coalitions or groups of countries, namely the EU, G77/China, AOSIS and African Group and big countries such as the USA, China, India and Russia. For an overview of the major parties and their positions during the Doha negotiation, a table adopted from Saner (2013) was created, showing the different parties and their positions on different issues.

For the most part, this case study focuses on the position of AOSIS against the USA and China, two of the biggest emitters of GHGs but who were unwilling to make concessions in the negotiations in terms of commitment to emission reduction and providing finance for the Green Climate Fund (GCF). Meanwhile, the positions of the EU and other groups, that is G77/China, are also partially touched upon in this paper.

**Table 1** Major parties and their positions towards main issues

<i>Issues</i>	<i>Major parties and their positions</i>				
	<i>AOSIS</i>	<i>China/ G77</i>	<i>Kenya/African Nations</i>	<i>EU/Annex 1 countries</i>	<i>Saudi Arabia/ OPEC</i>
<i>Finance</i>					
Work program on long-term finance	-	-	-	+	-
Standing Committee Report	0	0	0	0	0
Green Climate Fund (GCF) report and COP guidance	-	-	-	-	-
Arrangements between the COP and GCF	-	-	-	-	-
Further Commitments for Annex I Parties under the Kyoto Protocol (AWG-KP 17)	-	-	-	+	+
Long-term Cooperative Action under the UNFCCC (AWG-LCA 15)	++	-	+	++	+
Durban Platform for Enhanced Action (ADP 1)	+	-	+	+	+

*Source:* Adopted from Saner (2008)

*Key:* ++ strongly favourable, +favourable, 0 neutral, - unhappy, -very unhappy

As can be seen from Table 1, AOSIS was not happy with the turnaround of the new commitments to the Kyoto Protocol towards a more ambitious emission reduction along with the financing aspect of the negotiations, two crucial agenda items that AOSIS had been trying to advance since the start of the climate change negotiations.

## **6 The AOSIS at the Doha Conference**

Prior to the Doha Conference, the AOSIS group made their agenda known through a declaration by its ministers on the sidelines of the 67th United Nations General Assembly that called for urgent action to address the climate change crisis. The declaration called for the ‘Adoption and provisional application of the Doha Amendments to the Kyoto Protocol pending their entry into force that: Ensure the widest participation of Annex I parties in a second commitment period; Establish a five-year second commitment period to run from 1 January 2013 to 31 December 2017; Establish more ambitious quantified emission limitation or reduction commitments for all Annex I Parties to the Kyoto Protocol; and limit the use of surplus carry over units in the second commitment period of the Kyoto Protocol to ensure environmental integrity’. How AOSIS worked towards the realisation of their agenda in the Doha round is examined below by taking a closer look at various aspects which influence the AOSIS negotiation positions.

## **7 Strategy and tactics**

As the AOSIS states were negotiating for their survival, a good strategy was vital to ensure the realisation of the group's main objectives in the negotiation. Based on analysis of AOSIS' approach against the USA and China, it can be said that AOSIS in the context of the Doha climate change conference had adopted a mix of strategies to negotiate with the USA and China. Specifically these strategies are combinations of competitive, avoidance and compromising positions. The AOSIS was not willing to change its position due to the fact that the physical existence of the AOSIS members is threatened or their survival is at stake. The USA and China were also not willing to agree on a reduction of their CO<sub>2</sub> emissions because of their economies' dependency on the use of coal and fossil fuels. Therefore, AOSIS and as well the USA and China failed to find a compromise with each other. These positions also explain the competitive position of AOSIS which had to push hard to get what it wanted, that is to get the agreement of the reduction of the USA and China.

While their power could be seen as low, the AOSIS group leveraged this through its careful tactical choices. In the Doha round, notably, AOSIS invoked the power of coalition building by rallying the support of Least Developed Countries (LDCs) and the African Group, together representing 100 countries and 1.4 billion people. These are the groups which closely share AOSIS' situation as the most vulnerable to the adverse effects of the climate change. Apart from negotiating for their survival, these groups hope to be compensated in the form of mitigation and adaptation fund. AOSIS is also known to have enlisted the support of the European nations and some forward-looking parties in the G77 group.

Secondly, AOSIS made strong statements and arguments which are solidly founded on science. Rather than simply appealing its cause based on emotional arguments given its 'victim' status, AOSIS provided information with scientific basis to back its claims. This allows AOSIS to continuously highlight the vulnerability of small island states against the negative consequences of a warming planet and demand for adaptation and mitigation funding. AOSIS was able to support their arguments with science through the help of NGOs and by referring to research produced by the IPCC. Finally, AOSIS did not only highlight its specific interest but the common interest of all parties in the UNFCCC negotiations – that is all countries worldwide will suffer from the negative effects of climate change. AOSIS, gained moral leverage given the truth and justness of its cause in the whole climate change negotiations.

## **8 Composition of delegation**

In UNFCCC negotiations, several delegations are present. An obvious differentiation between delegations is their size. Some countries were present in Doha with a one-person-delegation (Azerbaijan), other like the USA sent 52 persons, China even 142. The difference in size can depend on one side on the available resources (financial and time), on the importance of one party of the points to be negotiated and even aspects like culture may play a role. For example, in China the size of a delegation is a sign of respect and honour. A not to be underestimated aspect is power as large delegations may be seen as more powerful than small ones. It makes sense therefore that countries having to face similar issues would form an alliance as the small island states did.

The size of the delegation of the member states of AOSIS in Doha 2012 varied between two for the Bahamas, Mauritius as well as St. Kitts and Nevis and 30 participants for Singapore. It is remarkable that each AOSIS member state sent a delegation and that with non-governmental delegates – the whole AOSIS group added up to 327 delegates.

The strength of AOSIS can also be seen in the cohesion of its members. Those members can be described as heterogeneous as they differ in several points as geographical location, culture, religion, political systems as well as for their state of economic development. Their common point is that they are small island states vulnerable to the effects of climate change. The objective of AOSIS is principally as lobbyist but also to be the negotiating voice for the Small Island Developing States (SIDS) within the UN.

In order to ensure cohesion, the AOSIS group agreed on decision-making based on a consultation and consensus approach. The objective of such an approach is to reach a position or an opinion as a group. To do so members deliberate as long as it takes until the members all support a common agreement. The consultation and consensus approach is known to be time consuming, an aspect to be considered but it has an advantage, which AOSIS is making use of: consensus based outcomes tend to be more innovative and creative as several perspectives and numerous inputs are considered up to the point of the final decision and this can result in increased quality of decision-making. It is also favourable to group development as the solidarity of the members increase through the decision-making process.

Even if the role of each individual could not be recognised separately, it still can be alleged that the tasks within the group were clearly structured and distributed. It is a matter of fact that AOSIS has definitely a voice within the UNFCCC. Interventions of the alliance are often mentioned in the meeting reports. The same degree of action and power would certainly not have been achieved if the member countries of AOSIS had not formed an alliance.

## **9 Finance**

While AOSIS' finance target fell short in the negotiations, it was however successful in the establishment of a new mechanism to address 'loss and damage' from extreme weather and slow-onset climate impacts such as sea level rise. The formalisation of 'loss and damage' language did not go well with all the parties especially the USA which succeeded in blocking any language hinting that such a mechanism would provide direct compensation for losses suffered. The conclusion of the negotiations, many parties and observers expressed concern over low levels of ambition on mitigation and finance.

## **10 Arguments used by the AOSIS alliance – the need for shelter and safety**

During his opening speech at the Doha Conference, H.E. Keke stated, 'the positions AOSIS has taken here are based on the agreement we reached in Durban and derived from an indisputable fact: unless we commence ambitious action across all areas of the negotiations some of us will not make it to the end of the century' (Keke, 2012).

The Doha Conference comes in the wake of disasters that offered an alarming glimpse at what life on a warming planet looks like. A failure to build on the progress have made at this critical juncture could be a set back from which many may never recover (AOSIS, 2012a).

In 2004, Ambassador Enele Sopoaga from Tuvalu proposed that climate warming should be part of the reform agenda of the Security Council. He stated that security, which tends to be associated with military threats, should be viewed in its multi-dimensional nature. He pointed to the external forces that threaten his country. 'The impact of climate change has the potential to threaten the survival of our entire nation. Subsequently, we firmly believe, and I am sure I share the sentiments of many vulnerable island countries, that these environmental concerns should be part of the reform agenda of the Security Council' (Sopoaga, 2004).

Although, AOSIS represents one-fifth of total UN membership and over one-quarter of developing countries, the combined territory amounts to less than 1% of world land area, population less than 5% of world population and GDP less than 0.01% of global GDP. Ironically, the island states are micro-contributors to anthropogenic greenhouse gas emissions, the root cause of anthropogenic climate change. As a whole, they are responsible for less than 0.06% of global emissions. Unable to reduce emissions on any meaningful scale, and lacking the financial and technological means to adapt to adverse impacts, AOSIS members depend on other larger countries for both mitigation and adaptation (Betzold, 2010).

In 2004, the impacts of the devastating tsunami underlined the vulnerability of these island nations. Motivated by this environmental catastrophe, AOSIS drafted the Mauritius Declaration which 'recognizes that the tragic impacts of the Indian Ocean earthquake and tsunami that occurred on 26 December 2004 and the recent hurricane season in the Caribbean and Pacific highlight the need to develop and strengthen effective disaster risk reduction, early warning systems, emergency relief, and rehabilitation and reconstruction capacities' (United Nations, 2005). It is a pro-active policy strategy declaration that outlines the small island states struggle to exist in the face of the threat of climate change. These nations gathering at the UN Conference on Small Islands in 2005, adopted the Mauritius Declaration and reaffirmed and expanded the Barbados Programme of Action (Brindis, 2007).

## **11 The needs to be recognised and respected**

The inclusive format of multilateral negotiations provides extensive opportunities for AOSIS delegates to raise awareness and build support within larger coalitions that include the G77/China and the European Union. By developing one cohesive voice, AOSIS member states have increased their influence within the UN system as a whole (Larson, 2003).

Ms. Marlene Inemwin Moses mentioned in her speech at the Australian National University, 'AOSIS earned a reputation for advocating for policies that are rigorously based in science and calculated to reduce emissions to a level that is consistent with the survival of all our members. In fact, the first UN proposal calling for a multilateral approach to tackling the dilemma, what would eventually become the Kyoto Protocol, was drafted by Nauru and submitted under the chairmanship of Trinidad and Tobago in 1994' (Moses, 2013).

## **12 AOSIS negotiation objectives and positions**

By analysing press releases, official statements and literature reviews, the authors have identified the following AOSIS positions for COP 18:

- 1 To support and commit to second commitment of the Kyoto Protocol (IISD, 2012; Third World Network, 2012; UNFCCC, 2012a).
- 2 To establish a 5-year second commitment period to run from 1 January 2013 to 31 December 2017 (AOSIS, 2012b).
- 3 To ensure the widest participation of Annex I Parties in a second commitment period (AOSIS, 2012b).
- 4 To establish more ambitious quantified emission limitation or reduction commitments for all Annex I Parties to the Kyoto Protocol (AOSIS, 2012b).
- 5 To limit the use of surplus carry over units in the second commitment period of the Kyoto Protocol to ensure environmental integrity (AOSIS, 2012b).
- 6 To commit to global warming below 2°C in 2020 (IISD, 2012).
- 7 To expedite the operationalisation of the GCF (IISD, 2012; UNFCCC, 2012b).
- 8 To initiate an early and adequate financial replenishment process (GCF.net, 2012; IISD, 2012).
- 9 To ensure institutional mechanisms to address loss and damage (UNFCCC, 2012c) and directly address and redress loss and damage to SIDS, LDCs and other developing countries particularly vulnerable to the adverse impacts of climate change caused by increasing greenhouse gas emissions (UNFCCC, 2012d).

The emphasis was on the second commitment of the Kyoto Protocol where, H.E. Kerien Keke in his Doha Conference opening speech on behalf of AOSIS stated, ‘our position on the second commitment period under the Kyoto Protocol, for example, is not arbitrary, it is the legal embodiment of the ambition we know is required’ (2012, p.2). If hard decisions to dramatically cut emissions are not made now, developing countries will be forced to confront adaptation and damage on a previously unimaginable scale (AOSIS, 2012a).

## **13 Negotiation strategy and tactics**

This section will look into the tactical repertoires employed by the AOSIS group in advancing its agenda and solidifying its various positions in the UNFCCC negotiations since its inception up to the Doha round in 2012.

## **14 Mixed strategies in UN climate change negotiations**

AOSIS’ strategies in the Doha round illustrate the use of mixed strategies of hard and soft bargaining as manifested through its mixed positions of competitive and avoidance (hard bargaining) and compromising (soft bargaining) in the negotiations. Furthermore,

the strategy analysis shows that AOSIS lagged behind in terms of power position against the USA and China, for example. However, be that as it may, AOSIS crafted a compelling strategy of leveraging power from the powerful to realise its objectives in the negotiations. A closer look at AOSIS' tactical choices can shed light on how these strategies were translated into actions during the course of the negotiations.

## 15 AOSIS' soft bargaining tactics

As part of its mixed bargaining tactics, AOSIS has exercised soft bargaining tactics to advance its agenda in the UNFCCC negotiations.

- *Taking initiative and first mover advantage*: One of the prominent tactics employed by AOSIS which fall under this category is the group's strong initiative in the UNFCCC negotiations. And this tactic did not go unnoticed as literatures in climate change negotiations credit AOSIS and the EU/Annex 1 countries as those who showed strong commitment in the realisation of the UNFCCC from its early phase. Above all, AOSIS went on to become one of the major players in the negotiations. AOSIS' strong motivation towards an ambitious climate treaty can be attributed to the fact that it is negotiating for its own survival being the most vulnerable group to the adverse consequences of climate change. This extreme sensitivity of small islands to the consequences of climate change gives AOSIS moral leverage. A corollary to taking initiative is being able to gain first mover advantage and AOSIS achieved this especially in the early parts of the negotiations as evident in its recognition in the UNFCCC.
- *Charm and leadership*: It also helps that AOSIS had some of the most charismatic leaders. Charm as a tactic was evident in Tuvalu (a member of AOSIS) and its representative Ian Fry who were the toast of the thousands of environmentalists at the Copenhagen Conference, who held a noisy demonstration in support of the island state's position. Refusing to support the final agreement reached by the Conference, describing it as '30 pieces of silver to betray our future and our people', after delivering a final plea in a speech with tears in his eyes, concluding 'The fate of my country rests in your hands'. His tear-jerking performance prompted wild applause among the crowded Copenhagen Conference floor. Moreover, the success of AOSIS in the early part of negotiations was credited by observers to the strong and skilled leadership of AOSIS's first chair, Vanuatu ambassador, Robert Van Lierop (Davis, 1996).

Another instance where charm as a tactic worked was in the Montreal round when Mostafa Tolba filled the role of a charismatic Chair who could relate to the G77 and China on a level that made them comfortable and willing to fully enter negotiations (Spector, 2012). Most recently, in the Warsaw Conference of 2013, Philippine envoy, Yeb Sano, delivered a powerful and moving speech during the opening session of the conference as he successfully highlighted the adverse effects of climate change in light of super typhoon Haiyan's devastation of the Philippines which occurred a day or two before the conference began (Aljazeera, 2013).

## **16 AOSIS' hard bargaining tactics**

While conventions say that these tactics are reserved to countries which have strong bargaining power, AOSIS adopted a strategy of 'borrowing power' which allowed it to employ hard bargaining tactics.

- *Flooding of information that has solid scientific basis:* Underlying AOSIS's argumentation was a strong reliance on scientific evidence, which was considerably facilitated by NGOs. NGOs provided not only technical information, but also legal advice and capacity, without which AOSIS would not have been able to establish itself as a serious negotiating partner. According to Nurse and Moore (2007), to be convincing, AOSIS's argumentation must 'be informed by the best available science and must be both robust and credible'. It is thus not surprising to observe that AOSIS constantly referred to the Intergovernmental Plenary on Climate Change (IPCC) reports and other scientific findings.
- *Defensive coalition building:* Another notable hard tactic that AOSIS used is building a winning coalition with forward-looking parties, particularly the European countries and key developing nations. AOSIS 'tried to play a sort of bridging role between developed and developing countries to appeal to the common objective that both sets of parties had, which was to achieve a safe climate'. Larson (2003) argues that AOSIS successfully highlighted their strong exposure to changing climatic conditions, as well as the negative effects of climate change for all countries worldwide, which helped to forge coalitions with more powerful groups of countries, especially the EU and more progressive countries within the G77 and China.
- *Regulations and standards and invoking precedents:* 'AOSIS's interests are everyone's interests' (Teuatabo et al., 1992). This line of argument was strengthened by referring to agreements with other delegations, especially the Europeans, whose support was crucial for AOSIS. Furthermore, propositions are regularly embedded in international consensus, as indicated by references to earlier decisions or supportive statements. AOSIS in so doing tried to isolate 'obstinate and obstructionist' countries while building a winning coalition with forward-looking parties, particularly the European countries and key developing nations.
- *Control of the agenda:* AOSIS as a group very actively participated in the process, making many submissions and interventions in the various groups and meetings (McMahon, 1993). Meanwhile, the same study cited AOSIS' overwhelming number of interventions a total of 231 interventions, as a means to compensate their lack of size in the UNFCCC negotiations.

## **17 Composition of the negotiation team**

Political negotiations are complex as many stakeholders are involved. In the case of AOSIS it is even more complex as the alliance is composed of 39 member nations and five observers' nations (see <http://aosis.org/about/members/>).

An evident aspect of a negotiation team is its size. The latter may depend on several aspects. On one side financial aspects can play a role. Furthermore, the size of the delegation may depend on the strategy behind the negotiation. A large negotiation team



may be seen as more powerful due to its size (more imposing), tasks can be divided under more people. However, it may be unnecessary to bound resources to a negotiation, which has no priority or relevance to your agenda.

**Table 2** Participation statistics

	<i>States/organisations</i>	<i>Registered participants</i>
Parties	189	4343
Observer States	3	13
Total parties + observer States	192	4356
United Nations Secretariat units and bodies	24	209
Specialised agencies and related organisations	19	135
Intergovernmental organisations	52	329
Non-governmental organisations	536	3292
Total observer organisations	631	3965
Media	344	683
Total participation		9004

*Source:* UNFCCC, COP 18

According to participation statistics published by the UNFCCC (see Table 2), out of the total 9004 participants to COP 18, 4356 were members of a delegation (party or observer state). As it was to be expected, the list of participants to the Doha Conference shows that the size of delegations is heterogeneous. AOSIS does not appear as a single negotiation group as each of its member country sent its own delegation at the conference. From the 39 AOSIS members, all sent a delegation to Doha. Also within AOSIS members, the delegation size varied from one country to the other. The smallest delegations on AOSIS side were the one of the Bahamas, Mauritius and St. Kitts and Nevis each with two participants. There were also larger delegations as for Singapore (30 participants), Papua-New Guinea (29 participants), Nauru (25 participants) and the Fiji (21 participants). The creation of an alliance supports its members to gain more power as a group as they would have as an individual. In 2012, from all AOSIS member countries, 327 people were sent to Doha. Thanks to the alliance, the AOSIS members have a greater impact in the negotiation process, as they would negotiate on a single level.

Unfortunately, the exact role definition within AOSIS does not appear on the documents available to the public. Based on the summary of COP 18, the following parties did speak for AOSIS: Barbados, Nauru and St. Lucia. The most active were Barbados and Nauru. This fact shows that for AOSIS, the size of a single delegation does not influence on the voice its members are given. For AOSIS, it can therefore be assumed that role definition is not based upon the size of the country or delegation sent. As mentioned above, thanks to the alliance, AOSIS members were represented by 327 persons of whom the most experienced can be given an active role in the negotiations. This seems to be the case as AOSIS can rely on a solid and consistent experience. AOSIS was created in the early 1990s out of the SIDS. AOSIS' group achievement can be recognised through its existence and consistency. Since 1991, nine chairmen have led the AOSIS Diplomatic Mission. It shows a consistency in the team. H.E. Marlene Moses of the Republic of Nauru and H.E. Ahmed Sareer of the Maldives began in their respective

positions in 2012, also in the year of the Doha Conference (AOSIS). Although she was new to that position, it can be assumed that she had already by that time a high level of knowledge. Moses is since 2005 UN Ambassador of Nauru in New York. Therefore, Moses was by the time of her nomination in 2012 already familiar with both the work of AOSIS and also the UN Mission in New York. Sareer is Ambassador to the USA since February 2012. Before he went through different positions in the Maldivian Foreign Ministry, as a Deputy High Commissioner in Sri Lanka, chargé d'affaires to the European Union, Deputy High Commissioner to the UK and also High Commissioner to Bangladesh. Also, his career path shows a solid experience in the diplomatic work. Moses' and Sareer's background can be seen as favourable to have a functioning group.

However, experience is not alone playing a role in the success of AOSIS. What also strengthens the negotiation skills is the decision-making process within AOSIS.

## **18 Decision-making process**

According to the AOSIS' homepage 'AOSIS functions on the basis of consultation and consensus. Major policy decisions are taken at ambassadorial-level plenary sessions. The Alliance does not have a formal charter. There is no regular budget, nor a secretariat. With the permanent representative, AOSIS operates, as it did under previous chairmanships, out of the chairman's Mission to the United Nations' (Anon, 2017). The consultation and consensus-approach is important in order to understand the way decisions are taken within AOSIS. The basis allows member of the group to be aligned on their positions previous to the negotiations. Through the consultation and consensus, aspects like affiliation to the group, understanding between members and last but not least a common chosen strategy is strength in the negotiation process. It allows members of a delegation to raise discussions between alliance members prior to the negotiation and concentrate on their tasks while negotiating.

## **19 AOSIS financial issues of the AOSIS and negotiating partners**

An ironic tragedy of climate change is that the countries least responsible for climate change are the most impacted. According to Saner (2013) 'Once we have discovered the real interests, needs and values of our adversary'. This gives the foundation and grounds for 'how can they be used for our negotiation, as far as possible to the advantage of both sides'. The main objectives of the AOSIS were to ensure a feasible future, extending the commitment to the Kyoto Protocol and to a strong climate finance mechanism to deal with loss and damage and solidarity and support from the public. These objectives are briefly discussed as under.

- *Commitment to extend Kyoto Protocol:* AOSIS wanted to get extension and a very strong second commitment period of the Kyoto Protocol (KP). AOSIS wanted to have a meaningful second commitment period limiting global warming to 1.5 degrees. They wanted the agreement of developed countries to decrease their greenhouse gas emissions over the next 5 years.
- *Strong climate finance:* Following the Cancun and Durban the developed countries have consented for paying \$100 billion a year by 2020, for the adaptation and

mitigation in countries affected by the effects of the climate change. The USA insisted that they had already pledged \$30 billion in fast-start finance (FSF). However, the AOSIS demanded new legally binding climate financing from the developed countries.

## **20 An international system to deal with loss and damage**

AOSIS was strongly persuading the developed countries for devising mechanism loss and damage, better insurance and reimbursement of losses. Because, AOSIS is struggling for their survival. There was a demand for quick implementation of proposed system by the international community.

## **21 Work program of the long-term finance**

Saner (2013) argues that it is not possible to ignore the economic inequality of the northern and southern parts of the world. Developed countries often exercise their economic and political powers over the developing states like in the colonial era. Funding is a decisive tool used by the negotiating parties. In the Doha Conference, the AOSIS requested developed countries for funds, technology and capacity-building, according to decision 1/CP.16.

## **22 Green Climate Fund**

Under Article 11 at COP 16 in Cancún, GCF was established as an operating entity of the financial mechanism of the Convention. The World Bank was the interim trustee of the GCF to administer the GCF assets, until it becomes fully operational. In Doha, the Republic of Korea was endorsed as the host of the GCF. The arrangements between the COP and the GCF have critical issue and were supposed to be resolved through COP 18 but remained a contentious issue. It was agreed that the Standing Committee and the GCF Board should develop arrangements in accordance with Convention Article 11.3, decision 3/CP.17 and the GCF governing instrument (Decision 7/CP.18).

## **23 Long-term finance**

The work program on long-term finance, agreed at COP17 in Durban, was implemented. It aimed at scaling up the mobilisation of climate change finance after 2012 and the 'Parties decided to extend the work program on long-term finance for one year' in Doha (4/CP.18). In Doha, the developed countries were requested for an increase in climate finance, and diversifying the sources of funds to achieve the target of US\$ 100 billion by 2020. The EU promised 'voluntary' climate finance contributions of EUR 5.5 billion. Saudi Arabia pushed China not to set a precedent for developing countries by contributing to the GCF (King, 2013).

## 24 Fast-start finance

At Copenhagen climate change negotiations, the developed countries committed for major funding to help developing countries for coping with the adverse climate effects. A commitment was made for US\$ 30 billion for fast-start climate finance, but these funds did not materialise fully as pledged even at the end of the COP 18, also the end of the fast-start period (IIED policy briefing, November 2012).

**Table 3** Meeting promises

<i>Country</i>	<i>Fast-start finance commitment (US\$ millions)‡</i>	<i>Fair share</i>	<i>% adaptation</i>	<i>% grants</i>	<i>% through UN funds</i>
Norway	710	492%	9–11%	100%	1%
Japan	9600	291%	12–18%	21%	1%
New Zealand	69.8	88%	32–35%	100%	0%
Canada	1015.6	84%	9–12%	25%	2%
Switzerland	135.5	75%	39%	100%	11%
Australia	603	74%	52%	100%	7%
Liechtenstein	2.1	70%	67%	100%	0%
EU	6390	54%	32%	55%	3%
USA	5100	43%	17%	67%	2%
Iceland	1	15%	23–47%	100%	13%
Total	23,627	79%	20–22%	45%	2%

Source: IIEB Briefing November 2012

The figures indicate that FSF commitments were met; transparency about fast-start climate finance has been relatively weak, and funding for adaptation remains insufficient. Funding was mostly not channelled through multilateral funds; additional funds remain questionable and the vulnerability of countries was not addressed (Ciplet et al., 2012).

## 25 Finance promises and actual input

For the 2010–2012 periods, developed countries committed themselves to providing new and additional resources approaching US\$ 30 billion with balanced allocation between adaptation and mitigation (fast-start financing). Table 4 provides an overview of the fast-start contributions as reported in Parties' submissions to the UNFCCC Secretariat by 11 September 2013. The total amounts reported amount to more than US\$ 33 billion for 2010–2012 (Fransen and Nakhooda, 2013).

The overall numbers reported by countries indicate that FSF commitments were fulfilled though transparency about fast-start climate finance has been relatively weak.

### 25.1 Pledges for the mitigation of the AOSIS

In Doha, COP18 decided to establish a work program to further understanding of the diversity of nationally appropriate mitigation actions (NAMAs) from developing countries. It was decided to establish a fully functional registry to record NAMAs.

NAMAs has the task of seeking international support and to facilitate matching of finance, technology and capacity-building support for these actions.

**Table 4** Fast-start finance provided in 2010–2012

	<i>Disbursement 2010–2012</i>	<i>Commitment 2010–2012</i>
EU	EUR 7.34 billion	EUR 7.2 billion (US\$ 9.6 million)
USA	US\$ 4.7 billion (Congressionally Approved Assistance) US\$ 1.99 billion (Development finance) US\$ 0.75 (export credits) Total: US\$ 7.44 billion	US\$ 7.5 billion
Australia	US\$ 0.551 billion (AUD \$0.559 billion)	US\$ 0.551 billion (AUD \$0.559 billion)
Canada	US\$ 1.2 billion (CAD\$ 1.2 billion)	US\$ 1.2 billion (CAD\$ 1.2 billion)
Iceland	US\$ 0.001 billion	US\$ 0.001 billion
Japan	US\$ 17.6 billion (including public and private financing) US\$ 13.5 billion newly implemented finance between 2010 and 2012	US\$ 15 billion, of which US\$ 11 billion public
Liechtenstein	US\$ 0.001 billion	US\$ 0.001 billion (CHF 0.001 billion)
New Zealand	US\$ 0.72 billion (NZD 0.09 billion)	US\$ 0.72 billion (NZD 0.09 billion)
Norway	US\$ 3.4 billion bilateral and multilateral ODA, including climate finance (US\$ 1.2 billion went into REDD + activities)	US\$ 1 billion
Switzerland	New and additional: US\$ 0.15 billion/CHF 0.14 billion Total fast-start finance from public sources: US\$ 0.44 billion/CHF 0.4 billion (US\$ 0.16 billion/CHF 0.15 billion allocated, US\$ 0.12 billion/CHF 0.11 billion disbursed)	New and additional: US\$ 0.15 billion (CHF 0.14 billion)

*Source:* Figures as reported by the parties in their submissions to the UNFCCC Secretariat September 2013.

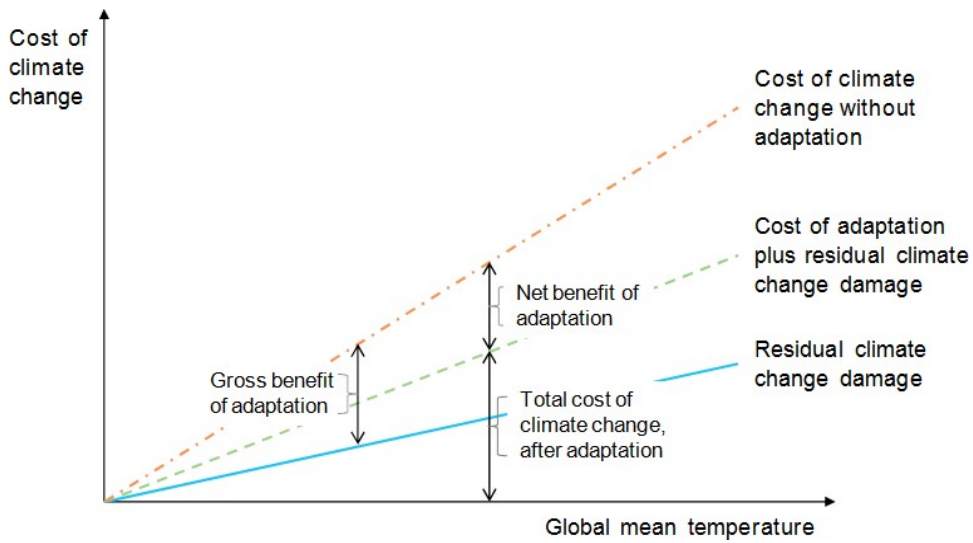
## 25.2 *Technology and technology transfer*

To maximise benefits and minimise risks, ‘UNCTAD suggested a global partnership to promote low-carbon investment which could establish clean-investment promotion strategies, enable the dissemination of clean technology, secure international investment agreements’ contribution to climate change mitigation, harmonise corporate greenhouse gas emissions disclosure practice and set up an international low-carbon technical assistance centre’ (UNCTAD World Investment Report 2010).

### 25.3 Loss and damage

Loss and damage under the convention refer to the residual costs not avoided through adaptation and mitigation. Figure 1 shows how climate change could increase the adversity of climate-related loss and damage, shown by the dashed and dotted lines. The figure describes how adaptation while reducing loss and damage (moving from the dashed and dotted lines to the solid line), also liable to costs. If we see the dashed line is higher than residual climate change damage but lower than climate change damage without adaptation.

**Figure 1** Adaptation reduces gross damages, leaving residual damages



Source: Adapted from Stern (2007)

## 26 Demands and offers by AOSIS and developed countries

UN Secretary-General Ban Ki-moon stated that the GCF will be an empty achievement until it can start delivering funds, and has called on rich countries to indicate how it will ramp up towards its target of raising \$100 billion a year (Fen, 2013). Developing countries had been combating hard for the special consideration at the fortnight-long UN climate change talks among 195 nations in Qatar. For the first time, developing countries have received a promise, and the very first time the phrase ‘loss and damage from climate change’ has been included in an international legal document (Fiona Harvey in Doha, *The Guardian*, 8 December 2012).

Developing and poor countries have won historic recognition of the plight they face from the devastation of climate change, soaking a pledge from developed countries that they will receive funds to restore the ‘loss and damage’ incurred. The USA had strongly opposed the initial ‘loss and damage’ proposals, US negotiators also made certain that neither the word ‘compensation’, nor any other term connoting legal liability, was used to avoid opening the floodgates to litigation, instead, the money will be judged as aid.

Developing countries wanted a new institution, like a bank, but the USA is set against that, preferring to use existing international institutions.

Mr Kieren Keke, Minister of Foreign Affairs, delivered the final statement on behalf of AOSIS, he said that ‘AOSIS came to “Doha” to protect our interests based on the science and international law’. He added that ‘we see the draft package before us as extremely deficient in mitigation ambition and finance’.

## **27 Conclusion and looking ahead**

The AOSIS group was not satisfied with the outcome of the Doha climate conference, which was dubbed as the Doha Climate Gateway. AOSIS spokesman, Ronald Jurneau, recapped the outcome of the COP 18 Doha round as follows: ‘We see the outcome as deeply deficient in mitigation (carbon cuts) and finance. It’s likely to lock us on the trajectory to a 3, 4, 5°C rise in global temperatures, even though we agreed to keep the global average temperature rise of 1.5°C to ensure survival of all islands’ (Harrabin, 2012). While AOSIS may not have achieved its main objectives in the Doha round, AOSIS was still a key player during the negotiations and was able to put some important topic like ‘loss and damage’ on the agenda.

Furthermore, the re-commitment of some countries to the Kyoto Protocol while set to an 8-year extension against AOSIS’ target of 5 years before the second commitment is formalised can be seen as another value of the negotiation.

In complex negotiations, such as UNFCCC, AOSIS achieved much relative to its peers particularly the LDCs who themselves are limited in power resources and also exposed to the adverse consequences of climate change. While AOSIS might not be very successful in realising its agenda, it was not because it did not do well in the negotiations, it was more of the nature and the challenge of a multi-lateral and multi-institutional negotiations such as the climate change negotiation.

Todd Stern, the US Climate Change envoy, expressed the challenges with the UNFCCC process by saying, ‘Climate change is not a conventional environmental issue...It implicates virtually every aspect of a state’s economy, so it makes countries nervous about growth and development. This is an economic issue every bit as it is an environmental one’. Explaining further, he said that the United Nations Framework Convention on Climate Change is a multilateral body concerned with climate change and can be an inefficient system for enacting international policy. For one, the framework system includes over 190 countries and because negotiations are governed by consensus this allows small groups of countries to block progress.

An important subsequent meeting was COP 21 in Paris in 2015, which led to the Paris Agreement. The Paris Agreement’s central aim was to strengthen the global response to the threat of climate change and to pursue efforts to limit the temperature increase to 1.5°C. The Paris Agreement entered into force on 4 November 2016 when 134 Parties ratified the agreement out of a total of 197. The next meeting was held in 2016 in Marrakech (COP 22) and another meeting was held in Bonn in November 2017 (COP 23) (UNFCCC, 2017).

The COP 23 scheduled to be held in Bonn in November 2017 is chaired by Fiji, a key member of the AOSIS alliance which will offer further opportunities to AOSIS Parties to move the climate change negotiations in the direction they highly recommended at COP 18 in Doha.

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## **Negotiating international strategic alliances: success and failures – some closing thoughts**

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**Abstract:** This special thematic issue of the *European Journal of International Management* focuses on the analysis of case examples of negotiation processes of strategic alliances. This thematic issue applies a multi-lens approach in which a range of theories and models are selectively applied to specific cases to gain better insight into the business case, the development of the negotiations and to identify lessons for future negotiators of strategic alliances. Negotiation theory is applied to concrete M&A as negotiations as well as to other forms of negotiations of strategic alliances, for instance between governments, between private sector companies and cross-sectoral alliance negotiations between private sector actors and other actors such as governments. Special attention has been paid to analysis of business diplomacy and trust development.

**Keywords:** strategic alliances; merger and acquisition; negotiation; trust; diplomacy; business diplomacy.

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## **1 Introduction**

The aim of this thematic issue is to deepen the current understanding of the negotiation process of strategic alliance negotiations through the application of a multi-lens approach in which selected theories and models were applied to specific cases to gain richer insights into the business case and the negotiation process and to identify lessons for future negotiators of strategic alliances. Negotiation theory, trust theory and business diplomacy are applied to a range of strategic alliance negotiations including private sector M&A, negotiations between governments, and cross-sectoral alliance negotiations between private sector actors and other actors such as regulatory agencies.

There are, of course, some challenges to such an interdisciplinary approach. Authors often have to work with incomplete or partial data since key actors of strategic alliance negotiations are often not directly available for comment or confirmation of initial findings. However, the alternative, namely to avoid any analysis until complete data is available, is not feasible since complete data may never be available.

Following the introduction which delineates the frame of this thematic issue's research focus, two opening chapters by the guest editors reflect on two knowledge fields which can provide insights into the understanding of strategic alliance negotiations and enrich classic negotiation and conflict resolution theories. One of the introductory chapters introduces concepts of business diplomacy and diplomatic aspects of international cross-border negotiations relevant for strategic alliances. The second opening chapter focuses on trustworthiness and trust development and their relevance for the successful negotiation of strategic alliances.

In all four cases in this thematic edition, the ability of key protagonists to negotiate effectively, to demonstrate trustworthiness (Mayer et al., 1995), generate process trust (Clases et al., 2006) and build trust amongst stakeholders within the context of diplomatic or business diplomacy negotiations (Saner et al., 2000) played a central role in the success or failure of the proposed strategic alliances. Two of the cases, AOSIS and the pre-Brexit negotiations, are themselves examples of political negotiations; the remaining two AstraZeneca Pfizer and Lafarge Holcim are proposed mergers. Two may be considered successful in as far as their initial goals were broadly achieved; in the other two vigorous opposition ensured the failure of the negotiation by the UK government and Pfizer respectively. Two cases focus on diplomacy between nations and two on negotiation and diplomacy including private sector MNC actors and national regulatory or political bodies.

## **2 AOSIS**

The authors of the case analysis of the AOSIS negotiations, Arshad Ali, Seraina Engert, Corinne Geiger, George Londob, and Steve Rubin, focused on the negotiation dynamics of a multi-actor and multi-stakeholder negotiation.

The comparative success of AOSIS up to now has been grounded in their ability to build coalitions of the willing to support their positions in climate change negotiations. The alliance's negotiating strategies have consistently employed consensus-based decision-making processes, coalition building and alliances in the service of their

common interest. While the power of each of these small island states individually is small, they have been able to magnify their influence through intelligent and effective diplomatic negotiations.

As small island states AOSIS members have highlighted the risks of climate change to their very existence and sought to use UN mechanisms to respond to these dangers. “The Alliance of Small Island States (AOSIS) is a coalition of small islands and low-lying coastal countries that share similar development challenges and concerns about the environment, especially their vulnerability to the adverse effects of global climate change. It functions primarily as an ad hoc lobby and negotiating voice for Small Island Developing States (SIDS) within the United Nations system” (<http://aosis.org/about-aosis/>).

AOSIS’ arguments focused on planetary risk and their consistent approach to multilateral UN negotiations across rounds and issues and their reliance on broadly accepted scientific data mirror the trust development process itself. If trust is a response to managing risky situations in which the trustee decides to take a risk and make a leap of faith because of their confident expectations of positive outcomes based on the perceived trustworthiness of the potential partner, then the AOSIS strategy is clearly well designed to engender trust.

AOSIS’ consensus-based decision-making approach supports the development of process trust (Clases et al., 2006) and reduces the impact of perceived national cultural difference on trust development (Jeive, 2016). AOSIS member countries bolstered their perceived ability and expertise through close collaboration with NGOs and climate scientists to ensure that arguments are supported by powerful data. AOSIS’s arguments were informed by the best available science and were robust and credible. While their arguments address specific and urgent risks to small island and low-lying coastal countries, the same arguments can be applied to coastal cities, alpine environments desert environments et cetera making them globally relevant – ‘AOSIS’s interests are everyone’s interests’ (Teuatabo et al., 1992 in Betzold, 2010).

AOSIS’ negotiating ability and credibility were enhanced by the support of climate change scientists and non-state actors like NGO’s who contribute to the scientific data which in turn supports the consensus-building process in suggesting required actions. The alliance’s benevolence and integrity can be considered on at least three levels: within the alliance, in relations between the alliance and its broader partners and in its dealings with its potential opponents. At the first two levels their benevolence is communicated through their commitment to fighting perceived common risk (and at times perhaps strengthened by the effective perception that the weak and most at risk are fighting for humanity while the strong are less committed, allowing partners such as the EU to support and promote AOSIS for the EU’s own agenda).

The scientific arguments have long been known and often rehearsed. AOSIS’s consistency in applying these arguments is certainly important, the ability of the alliance members to put forward effective arguments showing the scale of the impact they would face and their inability to solve or ameliorate these impacts without the support of the largest economies and polluters is also central. By emphasising the global risk of climate warming, the AOSIS alliance was able to broaden the negotiation space and prepare the stage for inclusive consensus making. Initial scientific arguments like cost benefit level of remedial climate reduction efforts, the effective arguments promoted the development of knowledge-based inclusive negotiation solutions. The development of trust, especially the higher levels, feeds back into the perceptions of trustworthiness and propensity to

trust. This process was further enhanced by the decision of major powers, most notably China, to move from climate change scepticism to support for UN climate change initiatives changing the situational domain specific level of inputs needed for more inclusive negotiation solutions.

Overall AOSIS is a good example of how coalitions of weaker states or weaker players can use coalition building tactics, trust-building and diplomacy to constructively influence large, complex, multilateral negotiations.

### **3 Cameron & the pre-Brexit negotiations**

The authors of the second case example, Max de Boer, Miriam Mendelberg, Daniela Stammbach and Nathanael Hausmann, analysed the second multi-stakeholder negotiation case example namely the one concerning the pre-Brexit negotiation of then UK Prime Minister David Cameron.

The authors' analysis shows that former PM Cameron underestimated the dynamics in the UK and the EU that were part of the whole multi-actor negotiations but which in the end led to the rejection of the deal Cameron negotiated with the other EU member countries.

Prior to his decision to allow a referendum on Britain's future relationship with the European Union, Cameron had allowed earlier a referendum on Scotland's independence from the UK. The narrowness of the margin of defeat of this referendum and the perception that Cameron and the Conservative Party had been saved from an embarrassing and damaging defeat by former Prime Minister Gordon Brown and other members of the Labour Party had placed Cameron's leadership under increasing scrutiny both within the UK and in Europe.

In 2014, support for the UK Independence Party had risen significantly only months before the Scottish referendum. The rise of UKIP was widely seen as a threat to the Conservative Party and potentially to Cameron's premiership. In campaigning for the 2015 election, Cameron allowed his party to put forward a more populist position including the decision to allow a UK referendum on withdrawal from the European Union, quickly dubbed Brexit. This was widely seen as a political manoeuvre to strengthen his position within the Conservative Party and in the country as whole during the 2015 UK General Election. The question of the UK's membership of the European Union (and its predecessor organisations) had been a hugely divisive issue within the Conservative Party since the 1970s and many political commentators saw Cameron's support for the referendum as a sop to the increasingly vocal anti-Europeans within his party and an attempt to woo UKIP supporters. At the time, polls suggested a close election with no party reaching absolute majority. Some commentators consider this factor influenced Cameron as a future coalition partner could potentially have influenced the process and wording of a future referendum. However, once votes were counted the main opposition parties had suffered particularly poor results and Cameron's Conservatives held the majority. Cameron not only confirmed his pledge to hold a referendum but also announced the referendum question would be a simple in/out. As shown in detail in the case study, he then embarked on a series of negotiation rounds with the European Union to attempt to negotiate new arrangements for the UK within the bloc which would garner the support of a majority of EU governments and the UK population.

As discussed in the introductory articles and drawing on Mayer et al. (1995) amongst others, trustworthiness includes perceived ability, perceived benevolence and perceived integrity. Despite his victory in the 2015 election, Cameron's ability was constantly under scrutiny. Within his own party he was constantly criticised for being too pro-European, outside his party criticised for the weak performance during the Scottish referendum and his apparent willingness to acquiesce to aggressive populist voices both within his party and to the right of it in order to strengthen his own personal position. Further criticism of his relationships with large media and financial institutions and their influence on his policy and staffing decisions further weakened the perception of Cameron as strong and able leader.

Applying diplomacy concepts, the authors show that increasing criticism of Cameron and the senior members of his government focused on the perception that policy decisions were being made simply in order to ensure the survival of the government. In such circumstances, the perceived ability of a prime minister to lead effectively comes into question. When Cameron attempted to negotiate with the EU his preferred strategy, or perhaps that of the Foreign Office, was a form of shuttle diplomacy attempting to persuade selected EU governments to support specific parts of his plan for the UK's new arrangement with the EU. Cameron's decision to allow a referendum on the UK's withdrawal from the EU created significant risk not only for the European Union itself but for wider international political and economic cooperation.

At a time when the impacts of the financial crisis were still significant in Europe both economically and politically as evidenced by the rise of populist forces in southern Europe, Central Europe and even the most developed parts of Western Europe such a decision was hardly likely to be seen as in the interests of the EU. Southern left-leaning populists could question the UK's willingness to participate fully in the social protection for workers or solidarity with southern states who had suffered most in the crisis; Central European countries strongly resented Cameron's desire to end the free movement of people; while centralisers saw the UK's action as threatening further integration and of potentially legitimising right wing populism in countries such as the Netherlands, Austria and France. Cameron's perceived ability to make intelligent judgements within the EU political realm was questioned almost universally; his benevolence towards the EU, its founding ideas and institutions, its nations and its peoples was not apparent; and his integrity questioned by his willingness to follow whatever political tack was most likely to ensure his own and his party's survival rather than the interests of his country or of the EU. Overall, Cameron's trustworthiness was far from ideal and furthermore he had managed to alienate or damage his relations with the majority of powerful actors. At the same time he was continually under pressure from anti-European populists at home with ever greater demands for repatriation of sovereignty and financing from the EU.

Despite the efforts of the Foreign Office and some limited support from some EU governments, Cameron's lack of trustworthiness contributed to the unwillingness of EU governments or institutions to take greater risks in supporting the UK's positions both as such support would not necessarily result in a positive outcome of the referendum and as it would embolden other EU governments to demand their own bespoke deals. It was not apparent to Europeans that the UK or Cameron were working towards any perceived European common project, but rather pandering to the demands of their own populist wing and demanding improved treatment for the UK regardless of the impact on the EU. In a context where populists in the South, the East, and Western Europe were all demanding special terms, particularly generous treatment of the UK could risk opening

the floodgates to innumerable further attacks on the EU project. It was hardly surprising that what might be perceived as an unnecessary referendum was not welcome and that Cameron was unable to negotiate a deal which would have garnered a significant majority in the upcoming UK referendum.

Once Cameron returned to the UK with a weak agreement, his chances of winning the referendum were much reduced particularly in view of the fact that the other EU member countries did not agree to Cameron's request to reduce EU internal mobility of EU citizens. He had limited backing from his own party as opponents and supposed supporters alike chivvied for position as his successor while the main opposition also failed to mobilise due to their own internal splits on the issue. Furthermore it soon became clear that his poor understanding of the EU political environment was matched by his ignorance of the mood of UK voters.

#### **4 Lafarge Holcim**

As shown in the case by Eva-Maria Knittel, Juan David Berdugo, Kamontip Cheevavichawalkul, and Marya Imbach, Lafarge and Holcim facing an increasingly challenging global business environment committed to an apparent merger of equals in order to create new, larger more powerful company better placed to compete internationally. As shown in the case, the strategic alliance and merger negotiations between the two companies appear, at least initially, to be based on a willingness to compromise rather than directly generate value within the negotiation process itself. Each company's individual short-term needs were subordinated to the larger goal of the successful merger.

In this context, perhaps the most interesting part of this case is how the two companies managed the potential anti-trust investigation from the EU. The willingness of the companies to accept the EU anti-trust regime without challenge and take pre-emptive action to demonstrate their willingness to work within the regulatory framework resulted in phase 1 approval and allowed the two companies to proceed with the merger speedily avoiding the intense press and public scrutiny would almost certainly result from a drawn out regulatory process.

The willingness of the two companies to develop a divestments plan immediately acceptable for the EU anti-trust regulators even if this meant slightly greater divestments might otherwise be necessary appears to have promoted the EU's perception of their trustworthiness and engendered confident expectations of their behaviour during and after the merger process. The two companies approached the regulatory process consistently, communicated clearly and as one, and did not diverge from their strategy. As the approach was entirely consistent with the EU regulatory framework, it left the regulators with little need or requirement to intervene. The clarity of this approach can be seen as reducing the perceived risk in the situation for the companies, the regulator and the shareholders.

At an advanced stage in the merger negotiation, Holcim's challenge to the original agreement between the companies could be dealt with remarkably quickly. Potentially, a significant change in the exchange rate of the Swiss Franc vis-à-vis the Euro provided an opportunity for Swiss shareholders opposed to the deal to challenge its value. However the speed at which the agreement was reached did not give them time to organise. It also



seems clear by this point that the senior management and shareholders of Lafarge were willing to make a compromise to ensure the success of the deal even if this meant slightly higher price and the need to jettison the CEO.

Lafarge and Holcim demonstrated considerable ability and integrity (consistency, acceptance of the framework etc.) throughout the regulatory process. They communicated clearly and as one reducing uncertainty and potential risk for their key stakeholders to ensure that the merger could pass as quickly as possible and the merged entity would be ready to compete in an increasingly challenging global environment.

## **5 Pfizer/AstraZeneca**

While the Lafarge-Holcim merger might be seen as a case study in effectively managing stakeholders, the Pfizer AstraZeneca proposed takeover is very different. The authors of this case analysis Asja Hot, Matthias Mähltz, Patrizia Nicolini, and Roman Stegmüller, indicate that Pfizer's initial approach for AstraZeneca appeared confident. While we cannot be sure of the exact terms of the discussion, what we do know it seems to focus on the potential benefits to Pfizer, the shareholders of the two companies, and possibly some senior managers from AstraZeneca. The evidence available gives the impression that Pfizer had not considered the impact of a broader group of stakeholders within the UK, changing public attitudes and political positions or the impact of Pfizer's own reputation.

At the time of the proposed takeover, the UK government was attempting to promote a range of new initiatives to strengthen the UK's science and technology base. These included tax breaks for research and development, promoting greater investment into high-tech industries including pharmaceuticals and biotechnologies and supporting high-tech clusters. Pfizer's previous takeovers had resulted in some increased profits and returns, but there was a perception that these increased returns had been generated by aggressive cost-cutting especially in research and development. In comparison to many European pharmaceutical companies Pfizer's annual research and development investment was significantly lower and its strategy appears more focused on buying in new molecules, treatments or research rather than developing these within the organisation. The perception of Pfizer's approach that it was driven more by short-term financial goals rather than longer term research outputs was further emphasised by the suggestion that Pfizer might have chosen to situate its global or European HQ within the UK to use tax inversion procedures to benefit from tax breaks.

These factors allowed critics of the takeover to paint Pfizer as a company with weaker research than AstraZeneca driven by short-term greed. Pfizer's ability to develop new drugs and its pipeline were critically examined; its history of aggressive job cuts in R&D and closures post-takeover was cited as evidence of its lack of benevolence; its planned tax inversion as evidence of his lack of integrity. Not only AstraZeneca, but also figures from the UK government, the UK pharmaceutical industry, employees associations and the press strongly stated their expectation that should Pfizer take over AstraZeneca it would have negative net impacts on the UK's pharmaceutical industry. AstraZeneca's stakeholder management and communication processes were instrumental in this process, and the lower level of trust and trustworthiness enjoyed by Pfizer clearly also contributed to the success of the defence. When the Pfizer CEO, Ian Read, was called to speak to the UK government select committee discussing the takeover, he failed to communicate a persuasive narrative and reverse these negative perceptions. At the

same time AstraZeneca increased pressure on Pfizer by announcing a new research driven strategy and significantly higher expectations from new drugs in the pipeline.

While it may be exaggerating to say that ultimately Pfizer allowed themselves to be (mis)represented as a rapacious interloper driven by short-term greed and allowed AstraZeneca to (misre)present themselves as a paragon of research for the betterment of humanity, it is not so far from the truth as to be completely absurd.

Had Pfizer been more willing to engage with the wider group of stakeholders, been willing to guarantee R&D positions for more than five years and had held off on the tax inversion, perhaps the takeover could have been successful. Alternatively, had they a proposed merger rather than a takeover they may have reduced the opposition from AstraZeneca's senior management.

It seems Pfizer paid far too little attention to the question of trust or why business diplomacy within the UK context at that time.

## **6 Final words**

This thematic issue seeks to investigate cases of current strategic alliance negotiation through the application of negotiation and conflict resolution theories and models and to enrich these with the additional application of trustworthiness, trust development theory and business diplomacy.

The interdisciplinary approach applied by the authors to the four case studies describes the factors which facilitate or hinder multi-stakeholder and multi-actor strategic alliance negotiations. The cases demonstrate that an interdisciplinary approach which also integrates a detailed understanding of the social, political and economic context delivers a richer understanding of individual cases and of how different cases helps us understand a particular historical moment.

For both scholars and practitioners, the application of models from outside the normal negotiation canon can provide greater insights. Scholars can develop a richer and more nuanced understanding of the negotiation context and process and provide practitioners from the field of strategic alliance negotiations with insights into how diplomatic negotiations and trust development are applicable to the strategy development process and for their learning and understanding during actual negotiation processes. Whether analysing or planning negotiations, the initial research and planning phase must also consider the social, political and economic circumstances, the key stakeholders and their relationships and how these may impact the negotiation process. Negotiators may also consider how to manage their communication and their stakeholder engagement process to maximise their perceived trustworthiness and engender trust in the process and potential outcomes and learn to effectively apply the lessons of trust theory, business diplomacy and negotiation theory.

This thematic addition also proposes greater engagement, greater timeliness, and an interdisciplinary approach. In Europe, the USA and elsewhere, societies face important challenges and we believe that academics, scholars and experts can play a role in supporting future development of our societies through an informed engagement. Of course we must confront the fact that engagement with current affairs means that we will not always have access to all the data we would like to have; that our findings may be provisional and that we may need to revisit them as new data comes to light. However,

the alternative, only engaging when we have all data, or designing all research questions based on the data we can access, risks making our scholarship ever less relevant to the lives of those outside academia.

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