Strategic Response or Strategic Blunder?
An Examination of AOL Time Warner 
and Vivendi Universal

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Two of the largest media mergers in history occurred early in the 21st century with the union of America Online (AOL) and Time Warner, followed a few months later by Vivendi with Seagram Universal. These two mergers were the subject of great hype and hope, not only for the dealmakers but also for the news media and business community, who viewed the merger as a major shift of power among media conglomerates. Yet both of these mergers never realized their potential, leaving employees and shareholders angry and raising many questions as to why these mergers—like so many others—did not work.

Merger Failure

According to data supplied by Thompson Financial, some 56,000 deals with a value of $6.4 trillion were announced between 1995 and 2000 (Adams, 2002, p. 53). Yet fewer than half of these mergers survived. Historically, less than one-half of mergers have survived, dating back to the inception of the merger process.

There are many reasons why mergers fail. One writer for a weekly business publication offers a cogent analysis:

“... mergers go wrong [because] companies sabotage their deals by making the same mistakes again and again: [they] overpay by offering a sizable premium, which hands the bulk of future economic gains from the merger to shareholders in the target company, [they] overestimate likely cost savings and synergies, setting themselves up for poor performance and shareholder disappointments in the future, [they] dither over integrating operations after the merger, frustrating customers and employees and delaying capturing potential benefits, [and they] obsess about cost-cutting, damaging the business by giving short shrift to maintaining revenues and keeping top salespeople” (Henry, 2002, p. 64).

While all of these reasons are accurate, they do not necessarily apply to every failed merger. In reality, there is no simple answer, but a progression of missteps that causes the downfall. The victims of a failed merger include employees,
whose numbers almost always decline as efforts to cut costs are enacted; shareholders, who see the value of their investments diminish; and the management team which usually is forced to resign or face termination by a Board of Directors, leaving a company in disarray for someone new to come in and try to repair.

The mega-mergers examined in this chapter were the result of both hubris and a failed vision. With AOL Time Warner, the marriage of old media to new media seemed a bellwether for the future as the dot-com euphoria reached a climax. No one could foresee the Internet bubble bursting or the terrible global economic effects of September 11, 2001. With Vivendi Universal, there seemed to be no stopping the grandiose vision former CEO Jean Marie Messier had for the company. Just two years following the mergers, the new entities retained less than 50% of their value as compared to the time the mergers were announced. The following paragraphs detail the failure of these two megamedia mergers.

AOL Time Warner

AOL and Time Warner appeared a perfect match, linking a major content provider with the distribution power of the world’s leading Internet service provider. The new company was expected to achieve numerous synergies that would deliver enhanced economies of scale and scope, increase revenues, and promote media convergence. Because the two companies were established leaders in their respective markets, there seemed little doubt the union would be successful.

Yet financial concerns were raised when the companies were assessed comparing market valuation to revenue valuation, even though AOL had only recorded its first operating profit in 1998. For the 1998 fiscal year, AOL posted revenues of $4.8 billion, while Time Warner reported revenues of $26.8 billion, more than five and a half times that of AOL (Media merger mania, 2000). Nevertheless, AOL was able to acquire 55% of Time Warner for $162 billion (Adams, 2002). The smaller, upstart AOL found itself in the drivers’ seat of the largest merger in corporate history.

Culture and Managerial Clashes

The fast-paced, youthful AOL represented a much different culture than Time Warner, and began asserting itself much to the chagrin of veteran Time Warner employees (Klein, 2003). There was a level of arrogance and disrespect for the institution AOL had absorbed. Prior to finalizing the merger, Time Warner employees were feeling the ominous presence of their new owner. After the merger was complete, there would be no stopping previous AOL employees from overtaking and dictating what they felt were appropriate measures. The approaches of each entity were completely opposite, especially regarding finances and management. Time Warner employees had long-time perks taken
away as well as a rather healthy profit sharing program. When the program was replaced with new stock options, the former Time Warner employees would not benefit as their predecessors had due to the incredible Internet growth seen in the years just prior to the merger.

Management styles between the two firms clashed from the onset. AOL utilized a top-down style of management, whereas Time Warner consisted of self-governed multiple units, and there was little evidence of cohesion post-merger. AOL CEO Steve Case became Chairman and COO, while Time Warner’s Gerald Levin became CEO. Key positions held by Time Warner employees were quickly reassigned to AOL employees. The atmosphere was one of non-conformity and control. The previous Time Warner employees were so oppressed that they even rebelled against using AOL’s e-mail system, stating the system was not able to handle the needs of business, only home-users. A mandate to move offices into one location in each city was designed to make productivity more efficient, however, the results created more tension and frustration for AOL and Time Warner employees alike.

Financial Challenges for AOL Time Warner
Market expectations also put early pressure on the merger. Even though the economy was showing signs of contracting, Case and Levin predicted outrageous earnings, “vowing that the new entity would easily generate $40 billion in revenues and $11 billion in cash flow in its first year” (Yang & Lowry, 2001, p. 98). The merger masked the fact that growth at both AOL and Time Warner was declining. AOL was suffering stagnant subscriber growth with its online service, while the looming recession was hurting Time Warner advertising sales. However, the decline became apparent when 2001 second quarter earnings were reported to be $500 million less than analyst estimates (Yang & Lowry, 2001). That proved to be a minor problem.

In the first quarter of 2002, AOL/Time Warner announced a record $54 billion accounting adjustment, reflecting value lost as a result of the merger. The combined company was valued at more than $180 billion when the merger was announced in January 2000 and valued at near $105 billion when it closed a year later (Mermigas, 2002a). By April 2002, AOL Time Warner stock had diminished 50 percent; falling to 60 percent as of July 2002. In October 2002 the stock bottomed out, falling in to the single dollar range, but since rebounding to trade around $15-16 a share by September 2003 (See Figure 1). Wall Street was unforgiving concerning the overvaluation combined with the failure for AOL Time Warner to meet financial projections.

By the summer of 2002, AOL Time Warner was quickly becoming a huge financial disaster. Yet key executives remained financially untarnished from this downward slide, selling large amounts of stock at optimal times. In September 2002, previous Time Warner employees decided to take matters into their own hands and filed a lawsuit against the former officers and directors of AOL, the outcome of which is pending (Robbins, Umedia & Fink, 2002).
Merger Fallout

The company continues to engage in post-merger damage control involving numerous changes in the leadership of AOL Time Warner, led by the ouster or resignation of key personnel, including CEO Gerald Levin, President Bob Pittman, Chairman Steve Case and Vice Chairman R. E. “Ted” Turner. Veteran Time Warner Director Richard Parsons became the new CEO of the company, resulting in “[a] new top-tier management with deep Time Warner ties…restructur(ing) corporate hierarchy that reduces a humbled AOL to a unit within a division…AOL/Time Warner Inc. is being genetically reverse-engineered to bear Time Warner markers” (Ahrens & Henry, 2002).

The question remains, what went wrong? The cultures of the two companies were obviously too diverse to combine into one entity. Additionally, the arrogance put forth by AOL management in its initial takeover was quite detrimental. Resentment towards employees and architects of the merger kept Time Warner employees enraged. In fact, the Boards of both companies were only informed of the merger days prior to the official announcement (Klein, 2003). The company who guaranteed so much promise turned out to be an albatross, losing any aspects of being an innovator and struggling to rebuild the value of its assets.

Even though the former Time Warner suffered under AOL’s misguidance, economic troubles remain for the media giant. Time Warner has been accused of having a “modus operandi [which] has been to house isolated fiefdoms that have clashed more than they have meshed…”Any return to the old Time Warner should not be acceptable to any investor,” according to Sanford
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Bernstein analyst Tom Wolzien, citing its history of ‘fractious division, [and] internecine warfare…[as well as] its own ‘routine’ inflation of financial results ‘by including sale of small cable operations and operating profits’” (Mermigas, 2002b, p. 25).

What about the two men who instigated the merger? Were the egos of these companies too heady to think this merger through? “Analysts believe that Case sold Levin on the merger by convincing him that AOL could effectively market Time Warner’s content, and also by appealing to Levin’s desire to captain the biggest ship” (Ahrens & Henry, 2002). Levin “always yearned to be on technology’s leading edge” and previously tried to become “a central player in the digital age” (Roberts, 2002, p. 54). Additionally, “Levin was worried that Time Warner’s culture would prevent him from operating on Internet time. AOL would help him get there” (Roberts, 2002, p. 54). In opposition, in “Time Warner, Case saw what his company was missing: real assets, particularly a media company, with big, steady revenues and profits” (Roberts, 2002, p. 55).

Disappointed with the numerous financial problems plaguing the company, Gerald Levin resigned in December 2002. Richard Parsons became CEO with Levin’s departure. On January 12, 2003, Steve Case announced his resignation as Chairman of AOL/Time Warner in May 2003. Parsons was subsequently named the new Chairman of AOL Time Warner, and faces a tremendous challenge in rejuvenating the company and restoring the confidence of Wall Street (Bianco & Lowry, 2003).

The two men who brought together old and new media failed to make their vision reality. The demise of AOL Time Warner has led many companies to rethink their strategic plans in regards to the Internet and a converged media world. No one seems to be discussing any transactions between traditional media and new media, largely because of the failed promise of AOL Time Warner. If these two giants failed, how could smaller companies succeed?

Vivendi Universal

The second major media merger of the 21st century was the union of French-based Vivendi with Canadian-based Seagram Universal. The transaction took place December 8, 2000 when Vivendi purchased Seagram and the remaining part of Canal Plus, for $52.3 billion. Driving the merger was the uniting of Vivendi’s telephone company, Internet provider and cable system with Seagram’s Universal Studios and Universal Music Group. “The real convergence in this deal would be the alliance of Universal’s vast film and recorded music holdings with Vivendi’s sprawling Internet, pay-TV and software publishing properties…Seagram possessed the kind of content producing assets that Messier’s distribution channels thirsted for” (Greenwald, 2000, p. 43). As in the AOL Time Warner merger, stock would be swapped at a value higher than the acquired company’s then current price.
However in merging these two companies, CEO Jean Marie Messier not only had the task of combining old and new, but combining two vastly different industries, utilities and communications. Vivendi was described as “a sprawling conglomerate whose activities ranged from sewers to theme parks and motorway cafes” (Andrews, 2000, p. 19). Messier’s solution was to reduce the workforce by 10%, and consolidate the company into two core groups: environmental services (consisting of Vivendi’s water, energy, and waste-management divisions) and communications, which consisted of all the media assets (Andrews, 2000).

While Seagram and Vivendi were in good financial shape when the merger was announced, Vivendi’s stock fell following the merger. Stockholders were confused as to the direction Messier was taking the companies and larger shareholders sent a direct message by unloading stock. Investors were leery of the tremendous number of hurdles the company would have to go through in order to see Messier’s vision as the media company of the future build to fruition.

**Vivendi’s Vision and Acquisitions**

The initial plan was “to make Vivendi Universal a powerhouse in the Internet’s fastest-growing markets” (Mattack, 2000, p 54). Messier sought to capitalize on Universal Music, using the sound library to take advantage of the growing online music industry. Adopting the stance of other futurists, Messier hoped to deliver music via Internet-enabled cellular phones (Mattack, 2000). Messier initiated a joint venture with Vodafone to create a service called Vizzavi, yet at the time there were many competitors already established in the market as a portal for music downloads. Vizzavi was unable to deliver the product at a rate acceptable to consumers. Web-enabled phones were not widely utilized, limiting the potential of the new service. Moreover, “to win European antitrust approval, Vivendi had to promise that Universal’s content would be freely available to competing distributors” (Mattack, 2000, p. 55). Without control of their own content, and being far behind the market in cell phone innovation placed Vivendi in a detrimental financial situation. Concomitantly, Canal Plus was also suffering huge financial losses because of some poor investments. Leaders of the pay-TV network were concerned the merger would ultimately destroy the network they had nurtured and developed into one of the leading channels in Europe.

As Vivendi Universal’s first year of business came to a close, Messier began moving assets like chess pieces starting in December 2001. Vivendi sold 9% of its stake in Vivendi Environment for $1.1 billion (Associated Press Online, 2001), as well as $1.5 billion shares of British Sky Broadcasting (Harding, 2001). Ten days later Vivendi Universal and EchoStar Communications announced a strategic alliance with Vivendi obtaining a 10% stake in the home satellite operator for a $1.5 billion (Morgan, 2001). Hoping to tap into the market for Internet-delivered music, Messier also acquired MP3 for $372
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million (Hu, 2002). Only days later the company acquired USA networks, consisting of lucrative satellite channels like the USA and Sci-Fi Channels— bringing about a new division, Vivendi Universal Entertainment (Business Wire, 2001). The board of directors approved all of these transactions, as Vivendi was quickly transforming itself into a media giant, believing to have strong economic potential.

However, the 2002 first quarter earnings reports showed a much different picture. Vivendi Universal shares had fallen 59% while the company accumulated $29 billion in debt and posted $15.34 billion in losses (Orwall, 2002). Messier’s shopping spree helped create one of the world’s biggest media firms in terms of assets, but harmfully saddled the company with huge debt leading to numerous problems with the financial and investment communities (Keaten, 2002). Like AOL, Vivendi’s stock price began a free fall from a pre-merger high of over $75 a share to a fall to the $16-$18 range by September 2003 (see Figure 2).

Certainly the sluggish global economy and terrorist attacks contributed to Vivendi’s problems, as the major investments designed by Messier did not work out as planned. The convergence of content and distribution were never fully implemented, leaving Messier’s grand vision in ruins. Although Messier tried to retain control, he was forced to resign only a year and a half after the Vivendi Universal merger took place, in early July 2002; he was replaced by Jean Rene Fourtou.

Vivendi after Messier: Divestiture

By the end of 2002, shares of Vivendi stock declined over 70%, causing stockholders to sue Vivendi Universal and Messier. Interestingly, the suit specifically targeted Messier and his actions both during Vivendi’s acquisition spree and the months following. Messier is alleged to have covered up the severity of the situation, not fully disclosing the financial problems to his Board until it was too late. Vivendi released a statement to the Wall Street Journal on July 3, 2002, in which the company declared a short-term liquidity issue. Vivendi would have to repay creditors $1.8 billion Euros by the end of July 2002 and additionally, Vivendi had $3.8 billion Euros in credit lines that were up for renegotiation (Orwall, 2002). The stock price plummeted even further.

Since Messier’s ouster, Vivendi placed its publishing division up for sale, as well as selling their stake in Vivendi Environment, the water and waste unit. When denied additional credit to purchase majority control of the French telecom group Cegetel, analysts thought that the move “cements Vivendi Universal’s push for cash to make more ‘media’ buys, such as its Universal Entertainment unit” (Engineering News Record, 2002, p. 14).
Messier’s hubris led to him building a media company that was being rapidly dismantled by Fourtou (Carney, 2003). Several suitors emerged as potential buyers of Universal Entertainment, including former Paramount Pictures owner Marvin Davis, former Seagram head Edward Bronfman, MGM, Liberty Media, and General Electric’s NBC unit. In September 2003, Vivendi reached a partnership agreement to combine its entertainment assets with NBC in a $14 billion transaction (Orwall, Nelson & Flint, 2003).

**Implications and Conclusions**

With the highly publicized failure of these two media mega-mergers, any hopes of ushering in a new era of media convergence appear to be years—if not decades away (Rattner, 2003). Sluggish economy, corporate scandals, threats of further terrorism and global conflict are keeping media companies—and investors on edge. Few investors will risk the public and private scrutiny that goes hand in hand with large-scale acquisitions. “The absence of corporate integrity and the intense lack of investor confidence are powerful adverse forces even the most faltering media merger has never had to face” (Mermigas, 2002b, p. 24).

When might happen to companies like AOL Time Warner and Vivendi Universal following the debacle of these failed mergers? Diane Mermigas of Electronic Media suggests AOL TW should, “re-establish integrity with advertisers, re-establish financial reporting integrity, re-establish management integrity, and re-establish growth momentum” (Mermigas, 2002b, p. 24). The same advice also applies to Vivendi Universal. Re-establishing credibility, integrity and growth are not short-term efforts. The management teams of both companies continue to face challenges as they move forward from their disastrous mergers.
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As these two companies continue to rebuild confidence among investors, what further changes are likely? Some believe AOL could be spun off as a separate entity. The AOL Division negatively impacted the company’s bottom line following the merger, as the ISP experienced sluggish growth, a huge downturn in advertising revenues, and a loss of subscribers choosing high-speed access over dial-up modem access (Klein, 2003).

Yet another possibility is breaking up the entire company. The problem with this line of thought is the debt that AOL Time Warner has accumulated, in the range of $28.5 billion (Mermigas, 2002a). “Even if divisions were available, there are few qualified buyers…Putting a value on AOL Time Warner is challenging given all the questions: Uncertainty surrounding financial markets, the economy and the advertising recovery; investor skepticism; difficulty in valuing AOL; lack of logical buyers” (Mermigas, 2002b, p. 25).

Perhaps the capstone to the failed merger was the recent announcement from their Board of Directors that the company was returning to its original name, Time Warner, dropping AOL completely. Further, the company also is changing the stock symbol back to TWE (Time Warner Entertainment).

Vivendi Universal, with its recent partnership with GE/NBC, raises new hope for the company as it turns over the management and direction of its remaining media assets to a company well known and respected for many decades. In Europe, Vivendi will most likely return to its roots concentrating on its environmental assets and ownership of Cegetel.

Synergy was a frequently used concept in the late 1990s to signify a thought process that “putting together companies… [to] produce giants that could cut costs and create higher revenue. Instead, we now witness buyout teams busy unwinding those very deals. The pieces, Wall Street now says, are worth more than the whole. The only sure winners, says Jim Jubak, are the investment bankers” (Jubak, 2002, CNBC Program: Business Center).

What will the future hold for media mergers and acquisitions? “In this climate, a fashionable new buzzword is ‘de-merger.’ Convergence has given way to divergence. Mega-mergers are out and asset shedding is in” (Jubak, 2002, CNBC Program: Business Center). The skepticism following the mergers of AOL Time Warner and Vivendi Universal will keep many investors and media professionals searching for a model that appears sound, and most importantly, profitable.

References


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