Deal *or* No Deal?

Essential Decisions for Successful Mergers and Acquisitions

When companies merge or acquire, stakeholders expect that the whole will be greater than the sum of its parts. Unfortunately, this happens less than half the time. Not only does one plus one not equal three; too often it results in losses. A once-exceptional organization can quickly take a turn toward mediocrity, or worse.

Study after study puts the failure rate of mergers and acquisitions between 70% and 90%. Many researchers have tried to explain these abysmal results, usually by analyzing the characteristics of deals that worked and those that didn't. That's a start, but that only informs decision-makers about the features of the deals that caused or prevented failure. It doesn't truly get to the core of the cause/effect relationships among planning, evaluating, and integrating: The Essential Traits for Successful M & A.

Vision

Successful deals start with a strategic purpose and rationale—a vision of what the future will hold. Does the acquiring company have a clear vision, or is the urge to buy born of opportunism? International Telephone and Telegraph had the wrong answer. From 1960 to 1977 ITT acquired more than 350 companies — at one time at the rate of one acquisition per week.

Between the 1980s and 1990s, ITT continued on its buying spree. By 2011, ITT had separated into three stand-alone publicly-traded independent companies but not before earning the dubious distinction of being the first major defense contractor convicted of criminal violations. In reality, the serial acquiring frenzy did not create value; the group became unwieldy; and stakeholders paid the price for the company's lack of vision and strategy. Absent the basic rationale and resulting rational planning, the financial synergy never materialized.

Financial Synergy

Sometimes an acquiring company will evaluate a target and determine that the products, services, or markets served align closely enough to take the plunge—a move forward that they hope will help them create more profit—only to discover that they have plummeted into a chasm. For example, in 2008 Nelson Peltz, the owner of Arby's roast beef sandwich restaurants, acquired Wendy's, the fast-food chain famous for its "square hamburgers" for approximately $2 billion. The deal transpired after two chaotic years during which Wendy's sold or spun off operations, reduced its corporate staff, and suffered a tarnishing blow to its image when a woman falsely claimed she found part of a finger in her chili.

The combined company not only failed to benefit from any financial synergy, it lost money in seven of ten quarters. Three years later the marriage of square burgers and roast beef sandwiches ended badly, complete with significant financial loss.

Financial performance—with a clear focus on revenue growth more than cost control—is the single most important grade in evaluating acquisitive success because even small changes in revenue can outweigh major changes in planned cost savings. A drop in sales immediately after an acquisition can be deadly as it fuels suspicion amongst customers, employees and suppliers alike. Regaining lost momentum is far more difficult than preventing it. Even with a good deal, the integration efforts can draw attention inward and off the customer.

Operations

Sometimes senior leaders find themselves in a game they never intended to play in the first place, as the leaders of ITT did. At other times, unexpected rewards come from playing a bigger, more rewarding game. That's what Enterprise did.

In 2007 Enterprise Rent-A-Car was the largest car rental company in the world. When Enterprise owners learned of a proposed merger of their two biggest airport rivals, Vanguard (which owned National and Alamo) and Dollar Thrifty Automotive Group, decision-makers took bold action.

Leaders at Enterprise had already realized that to grow at a rate they desired, they needed a larger share of airport rentals. They immediately recognized the threat of standing by idly as four rival brands combined into one competitor—a monolith that would have endangered their very existence. That didn't happen. Instead, CEO Andy Taylor agreed to buy Vanguard, less than six months after he learned of his rivals' plans. This deal paid for itself in less than three years, and total revenues for the combined Enterprise, National, and Alamo, now surpass $16 billion.

Enterprise's success holds no mystery, secret sauce, or unavailable formula. They did most things right—and quickly. Enterprise had little bureaucracy at the top, so senior leaders responded quickly to an industry threat with unprecedented speed. Because they were buttoned up operationally, they retained existing non-airport clients while acquiring the airport counterparts.

Talent

In 2002, Tyson Foods acquired International Beef Products, making Tyson the largest protein producer on the planet—a deal that stands as one of the largest successful acquisitions of the twenty-first century. Credit then-CEO John Tyson for creating a systematic approach for integrating talent.

After the acquisition, Tyson formed a senior executive task force including himself, his direct reports, and a small group of external succession-planning experts to solve the problem. The team ensured objectivity, high standards, and buy in. Task force members took nothing for granted as they mapped out their ideal leadership development system for Tyson.

The blueprint integrated succession planning and leadership development, made sure that promising leaders would be well versed in all aspects of the company's business, and put the accountability for succession planning and leadership development squarely on the shoulders of John Tyson's direct reports. Leaders couldn't waffle in their responsibility to ensure success; they couldn't "protect" favorites, hoard resources, or opt out of the process. They retained top talent and created what was ultimately a new culture.

Culture

When a deal fails, too often culture takes the blame. Many view culture as some sort of complicated, abstract, nebulous force. While culture plays a role in any major transaction, the cultural differences that derail M & A deals have more to do with beliefs about the ways the companies make money and less to do with customs and interactions.

Bart Becht, CEO of Benckiser, which became Reckitt-Benckiser via a merger, took control of this early on. He had a clear vision and strategy and a team of senior leaders who had no doubts about where Becht intended to go. The senior leaders and external consultants evaluated the top three layers in both companies to determine how well each person fit in the culture that would define the company. This thoughtful, thorough, and unwavering process created their mantra, "If you fit, you're in. If not, you're out." The share price of the newly merged company doubled in the two years following the deal.

One of the biggest impediments involves the uncertainty brought about by the change in ownership and structure. These changes bring both excitement and fear, but the speed at which things happen can also raise anxiety, even in normally confident people. Trepidation worsens when people don't understand what those changes will be or when they will occur.

During these critical times, indecision will be your enemy, especially if covered up with platitudes such as "Don't worry." The tough calls about priorities should happen quickly. Failing to make them allows a what-shoe-will-fall-next phobia that compromises morale and productivity and takes the corporate eye off the customer.

You'll need a plan to communicate about the change. Be fast and honest, and avoid empty promises. Don't soothe people falsely to lower the heat. People can take some uncertainty if it doesn't go on too long.

Deal or No Deal Survey

Rank each on a scale of 1 to 4

1=Totally Disagree 2=Disagree 3=Agree 4= Totally Agree

Vision

1 We have a clear strategic objective for doing this.

2 Our desire to grow goes beyond cost-savings and defensive moves.

3 We clearly understand what is achievable in light of market and industry trends.

4 We have widespread agreement about our goals.

5 We have tied our short-term goals to our long-term vision.

Financial Synergy

1 We know how they make money.

2 We know how our investors will measure success.

3 We have a plan to make money quickly.

4 We have a clear picture of their financial situation.

5 We have a plan for integrating our financial systems.

Operations

1 We know what to do to retain their key customers.

2 Our business models are compatible.

3 We understand their competitive advantage and driving forces.

4 We agree about how to integrate products and services.

5 We understand what our key customers will want.

Talent

1 We have set criteria for choosing the people for the new organization.

2 We have a commitment from key players that they will stay.

3 We agree about who will run the new company.

4 We have clear lines of accountability for each function.

5 We have developed a succession plan for key positions.

Culture

1 We agree about how each step of the deal will be communicated to employees and stakeholders.

2 We have decided how fast things will happen.

3 We have made a strong commitment to change.

4 We know that we have compatible risk tolerance.

5 We see evidence that key decision-makers share core values.

90 – 100 Deal
Congratulations! It's a deal. Obviously you have done your due diligence and carefully analyzed both the pros and cons of going forward.

80 – 89 Maybe Deal
You probably feel pretty good about the opportunity and may be tempted to think you should go ahead. Before you take the plunge, however, think about the tendency of people to be over-confident. If you are over-confident by even 5%, what will that mean? You are far better off challenging yourself now than wishing you had done so later.

70 – 79 Risky Deal
At these levels you need a very good price to ensure you can address issues you aren't seeing now. If you do a deal you know is risky and pay a "fair" price, it could be a disaster. Meanwhile, you're tying up money that could have been used elsewhere.

Below 70 No Deal
No explanation needed here. It is tempting when you're "close" to start rationalizing away concerns. Some shores are reserved for shipwrecks. Don't let it be yours.

Conclusion

Recent history has taught some hard lessons about M & A's—one of the most salient being that many deals should never have happened. The second lesson indicates that the parent companies should have done more and better positioning for the acquisition. That doesn't mean more of the same due diligence conscientious companies do anyway. It means a different formulation approach, starting with an in-depth understanding of the parent's and the target's five essential traits. Only after senior leaders have aggregated these data should they begin the arduous journey of setting criteria, considering targets, evaluating these targets vis-à-vis the criteria, and negotiating deals.

Client Results

- Merger of two finance companies produced dramatic growth in revenue and profit
- Acquisition and integration proceeded while maintaining sales growth
- Acquisition fueled upgrade in top talent, resulting in no loss of revenue post deal
- Selection of an outstanding new CEO for a NYSE organization impacted market capitalization while positioning the global enterprise for enhanced levels of growth and profitability
- Merger of two global, publically-traded companies returned 50% growth in two years, post deal
- Another merger of global companies achieved 100% growth in share price after two years
- Acquisition led to revenue growth and enhanced reputation of the firm, the board, and the Chief Executive Officer
- Firm successfully acquired poorly performing licensee of its trademark and restored brand integrity
- Acquisition succeeded in adding R&D capability and market share while reducing SG&A

Dr. Linda Henman, the author of *Challenge the Ordinary*, works with leaders who want to think strategically, grow dramatically, promote intelligently, and compete successfully after a merger or acquisition.

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