The SENIOR EXECUTIVE *Dedicated to the Financial Services Industry*

DCG Corporation DeHayes Consulting Group

Volume 101
Publication 3

Increasing The Odds For A Successful Merger And Acquisition Strategy

The process of blending two distinct companies challenges even the most progressive of companies, yet it can be a gratifying means to accelerate growth and success.

There were over 9,000 proposed mergers and acquisitions with US businesses last year, driving the deal value to reach $450 billion.[i] The total number of deals are expected to more than triple in 1996, bringing the amount of activity to record levels. In today's increasingly competitive financial services industry, merger and acquisition growth strategies provide a comparatively rapid, one-step method of creating and enhancing organizational strengths. However, recent studies suggest that more than 80% of mergers and acquisitions fail to achieve the expected financial return.

The odds of a merger and acquisition strategy achieving exceptional results can be increased dramatically when the organization:

1. *Realistically* defines goals and objectives.
2. Assembles the necessary expertise.
3. Utilizes an objective process for screening, analyzing, and valuing prospects.
4. Anticipates and prepares for an emotional environment.
5. Follows through with a workable integration plan.

The following discusses management methods which can be employed to significantly improve success in merger and acquisition activity.

Preparation

Clearly define objectives. Mergers and acquisitions can be an effective method for achieving one or more strategic objectives. Before implementing a merger and acquisition strategy, the CEO should have an established framework, such as the organization's verbal or written strategic business plan, to guide merger and acquisition activity. Conversely, if a company needs a quick fix for one or more long-standing problems, merger and acquisition activity could actually lead to exacerbation of these problems or even the failure of the organization. Examples of strategic objectives that can be realized by engaging in merger and acquisition activity are:

- Horizontal integration to:
  - Generate critical mass and enhance market position by entering a related vertical or geographic market or growth niche in the present market.
  - Fill voids in product or service lines.
  - Increase production capacity.
  - Improve market share.
- Upstream vertical integration to ensure supply of a critical component.
- Downstream vertical integration to position the company closer to customers in a growth market.
- Integration of another business as a counter-cyclical hedge (the other business is up while yours is down and vice versa).

Assemble the Necessary Expertise. A recent study published by the Kenan-Flagler Business School at the University of North Carolina found that (a) the initial contact and (b) the acquirer's own experience with mergers and acquisitions are two of the major factors pivotal to merger and acquisition success.

The CEO should assemble a team of expert advisors before the process is started. Drawing upon those who understand industry-related dynamics, people dynamics, and offer the advantage of top-level industry specific relationships can add significant value in making a deal work.

Today, more companies prefer to conduct product analysis, valuations, and negotiations internally. However, there is an increasing demand for specialist assistance to avoid the missed opportunity. For example, management may be hesitant to explore combinations that may involve a key competitor, a fairly new firm, or a related business. Employing external assistance can help avoid the possibility of an exceptional potential target left unrecognized or undeveloped.

Employing external assistance can help avoid the possibility of an exceptional potential target left unrecognized.

Utilizing experienced resources both internal and external, management has the opportunity to expand the possibilities that will be evaluated against the target profile, while keeping market expansion and high growth goals top priority. This knowledge can save valuable time and preserve confidentiality by focusing on the most probable targets for successful transactions.

Additionally, the benefits of assembling dedicated industry specific merger and acquisition experience increases the chances to have a smooth transaction process, including the post-acquisition period.

The following team members are important to the success of the endeavor:

- **Merger & Acquisition Advisor**: A dedicated, industry specific advisor will lend objectivity and continuity to the process, identify high potential opportunities not yet on the market, evaluate prospects for strategic fit and compatibility, inspire targets to respond privately, assist in minimizing disruptions to the company's operations, and be

particularly useful in planning and executing the integration of the companies.

• **Merger & Acquisition Attorney**: A merger and acquisition attorney with industry specific experience and an understanding of the regulatory environment can help protect the company and assist to structure the transaction, minimizing risks and maximizing value.

• **Financing Sources**: Additional debt or equity capital should be arranged ahead of time if required.

• **Accountant**: With industry experience in mergers and acquisitions and business valuation, accountants can add value in analysis of alternative deal structures, financial reporting issues, and tax strategies.

• **Internal Resources**: In-house resources can provide sophistication in valuing deals within the industry and can often judge the value of a transaction that some external to the organization may overlook. Senior staff dedicated to mergers and acquisitions can assist with in-depth research and strategic details for an informed merger situation.

Develop Objective Methods for Screening, Evaluating and Valuing targets. The greatest threat to a successful merger or acquisition is emotion. People naturally resist change, and the blending of two organizations often brings out personal, political, and territorial concerns. Based on defined strategic objectives, methods need to be developed to objectively evaluate and weigh the characteristics of the target as well as the potential resistance for people from both organizations to culturally integrate.

Areas to review include:

- Sales and earnings growth
- Management, cultural, and values compatibility
- Attitudes toward customers and employees
- Systems
- Procedures
- Controls and compensation compatibility
- Distribution and customer service quality
- Financial fit

From this list of criteria, perhaps the most crucial yet overlooked issue concerns the target company's culture and people. Often, not enough attention is paid to how the two companies will mesh culturally. Statistics reveal that it is the people in the company that determine if the goals of a merger and acquisition fail or succeed. Special consideration should be taken to study how the infrastructure of each company will support the acquirer's strategic goals.

Negotiating The Deal

The value which is placed on an acquisition target should be based on its specific worth to the acquiring company, not what it may be worth to others. The total value will be composed of a financial or economic estimate, a transaction premium, plus a factor for synergy (where 1 + 1 = more than 2). Sometimes a negative adjustment is applied (e.g., in cases of vertical integration when the prospect may initially lose sales and profits with new ownership).

Often, not enough attention is paid to how the two companies will mesh culturally.

The calculation of synergy value is an uncertain science, and emotions again can affect the process.

It requires making assumptions about the outcome of the deal which the company must anticipate in the planning and implementation of the integration. Invalid assumptions, emotion, poor planning, and weak implementation are the primary reasons why a large majority of mergers and acquisitions are not as successful as expected.

The structure of the deal, such as purchase of assets, stock swap, combinations of stock and cash and owner financing, consulting contracts, and non-compete agreements, should naturally emerge during evaluation and valuation. The price to be paid, structure, and terms are interrelated and are best viewed as a balanced package. The value of a strategic fit is ultimately more important than price.

Integration Planning And Implementation

Quality and thoroughness during the integration planning and implementation stage is critical to the outcome of the transaction. The cornerstones of a successful integration are organization, speed, and communication.

Once the deal is consummated, the integration must take place in a rapid and orderly manner. Contrary to traditional thinking, instead of easing into the new situation, the time to combine and harmonize the two entities should be compressed.

Immediate and consistent post-merger involvement with the new business is the most proven method to generate long-term success.

The acquirer should be in constant contact with the acquired company's key suppliers, agents and agencies, customers, and employees. This will help to keep key players involved and motivated. Immediate and consistent post-merger involvement with the new business is the most proven method to generate long-term success. Activities should include face-to-face information exchange, testing of assumptions, and a commitment to focusing on common goals.

The issue of the acquired company's identity after the transaction is often a major marketing concern. There are various options to consider, such as whether or not to continue operating with the same name, take on the acquirer's name, or have the merged entity take on new name altogether, possibly with elements of both names.

If the acquirer entered the transaction to achieve strategic objectives for horizontal integration in the same or related markets, the acquired company often melts into the acquirer and may take on its name as quickly as possible. If the transaction was executed to meet objectives for vertical integration or horizontal integration into unrelated markets, the acquired business may benefit by retaining its own identity. If the transaction is a merger between equals, a new name with elements of both of the merging company prior names is frequently created.

The value of a strategic fit is ultimately more important than price.

Finally, it is prudent to remember that even though the deal looks good on paper, it may translate to a less than ideal reality. A merger inevitably challenges every facet of an organization, and how the post-merger integration is handled within the first 100 days is significant.[ii]

Summary

An organization carrying out a successful merger and acquisition strategy must go through the entire process to create a successful outcome. Exciting new mergers and acquisitions continue to be achieved and rewarded with a winning marriage, if planned carefully in an orchestrated and coordinated effort, while remaining realistic throughout the entire process.

The decision to pursue a merger and acquisition should be based on long term benefits and value. This requires management to take a sound assessment of needs and motivations. Consistent communication between management and employees, merger and acquisition advisors, and the target company is vital to the success of blending two companies to form a stronger, more competitive entity. ■

i Barr, Stephen, "Meet The New M&A Masters: CFOs Are Taking On The Role Of Investment Banker," CFO, June 1996, p29.

ii RHR International, "Ready, Set, Merge!" For CEOs Only, Volume 13, Number 2, 1996.

DCG Corporation
3300 Douglas Boulevard, Roseville, California 95661
916.782.8321 • Fax 916.782.8325