Deal or No Deal?

By

Linda D. Henman, Ph.D.

When companies merge or acquire, stakeholders usually expect that the whole will be greater than the sum of its parts. Unfortunately, the facts tell a different story. One plus one does not equal three; too often it moves shareholder returns to the wrong side of zero. A once-exceptional organization can quickly take a turn toward mediocrity, or worse, demise if leaders don't plan meticulously, acquire intelligently, evaluate assiduously, and integrate attentively.

Study after study puts the failure rate of mergers and acquisitions between 70% and 90%. Many researchers have tried to explain those abysmal statistics, 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 them to fail or prevented them it. It doesn't truly get to the core of the cause/effect relationships among planning, evaluating, and integrating.

Traditionally leaders have lacked a more comprehensive approach, a way to determine how to merge for an exceptional advantage—a robust examination of the causes of both successes and failures. It all starts with a strategic purpose for the transaction and a commitment to distinguish between deals that might improve current operations and those that could dramatically transform the company's growth prospects. A clear strategic advantage for the acquisition should lead the way.

Both organic and acquisitive growth strategies often exist for a limited period, but sometimes an organization identifies expansion as a long-term objective and considers both forms of growth as part of their evolving strategy. Among all other influences, the desire to grow has one of the most dramatic, often hazardous effects on strategy. Limits and trade-offs take a back seat to the desire to escalate, increase, or expand. The low-hanging fruit of growth opportunity entices. Therefore, perceived opportunities for growth tempt leaders to go in new directions—paths that can blur uniqueness, trigger compromises, and undermine competitive advantage. Adding new products, features, services, or markets is both alluring and appealing, but doing so without screening these opportunities or adapting them to the company's existing strategy also invites trouble. Organic growth encourages its own kind of mischief, but acquisitive growth goes beyond—to an arena where true damage can occur. Caution should prevail.

Businesses make the decision to acquire for a number of reasons. On the one hand, companies will decide to acquire when they want to boost their current performance, to hold on to a premium position, or to cut costs. This kind of acquisition delivers bottom-line results but almost never changes the company's trajectory. The improvements stop the leaking of assets but don't truly put significant numbers of them in the coffers. For this kind of deal, CEOs often have unrealistic expectations about how much of a boost to assume; they pay too much; and they don't understand how to integrate after the fact. Many of these deals fail to delight, even when they don't truly fail.

Business leaders also make decisions to pursue acquisitions either to augment their organic growth efforts or to replace them when they have been exhausted—both decisions designed for top-line growth. Another less familiar reason to acquire a company is to reinvent the business model and fundamentally redirect the company. Almost nobody understands how to identify the best targets to achieve this goal, how much to pay for them, and how or whether to integrate them. Yet they are the ones most likely to confound investors and pay off spectacularly—when they work. Even more caution required in this scenario.

Whatever the reason for considering an acquisition, senior leaders and board members face the challenge of offering and demanding a disciplined approach—an intellectual framework to guide decisions and serve as a counterweight to the quick and easy fix of unfettered growth. This requires an examination of which industry changes and customer needs the organization will respond to and which ones it will reject. Penetrating existing markets and reinforcing the company's position help to maintain distinctiveness and competitive advantage, but a goal to squelch their enemies (competitors) usually provides only distraction and ill-advised compromise. Of course, major changes in the industry may require an organization to change its strategy, but taking a new position must be driven by the ability to find new trade-offs and leverage a new system of complementary activities.

When executives feel motivated to pursue a new strategy that includes an acquisition, almost always they want to acquire new resources and capabilities. Sometimes that means a true strategic direction change; at other times it involves changes to the tactics. At no time should the decision to acquire compromise the strategic principle and strategic advantage—at least not without a conscious awareness that you're gambling with the mortgage if you do so.

In any strategic initiative, the company should not concede its strategic principle—the power that exists at the intersection of distinction, passion, and profitability. This strategic principle explains why customers choose your products or service, why you make money at what you do, and why people want to work for your organization. It forms the foundation of your competitive advantage, the area that exerts the greatest influence on your business. Therefore, any deal that threatens your strategic principle is one you want to walk away from. But which deals should you walk toward?

It all starts with a well-thought-out strategic objective for growth—a decision that is rational and data-driven. It should *not* start with a directive from the board or a mandate from the owner or CEO to "double in five years." The day-to-day decisions that drive that sort of growth objective often serve as the sniper's bullets that take the company down. Leaders start making window-dressing hiring decisions they never have made before; they negotiate short-term pricing deals that can't sustain them; and they opt for the quick fix instead of steadfastly positioning themselves for future rewards.

Instead, decision-makers should carefully craft the criteria for an acquisition—the "must haves" of the deal. They should also list and prioritize the "wants" of the deal but carefully and astutely distinguish these from the "must haves." These criteria should have specific measures attached to them—ways by which everyone will agree success will be measured. Finally, everyone should evaluate the value each decisive factor will have.

What are we trying to do?

How will we agree we've done that?

What value will it provide?

The value of the deal merits the most discussion because that quite literally is where the money is. Beyond growing for the sake of growing, what good will this do in terms of actual dollars? What will the tangible payoffs be? Don't confuse value with opportunism.

Do you want to buy a business simply because it is available? That's what International Telephone and Telegraph did. From 1960 to 1977 ITT acquired more than 350 companies — at one time at the rate of one acquisition per week. They included well-known businesses such as Sheraton hotels, Avis Rent-a-Car, Hartford Insurance, and Continental Baking, the maker of Wonder Bread. During these seventeen years, ITT grew from a medium-sized business with $760 million in sales to a global corporation with $17 billion in sales.

In the ten years between the 1980s and 1990s, ITT continued on its buying spree, creating a broad group with interests ranging from hotels to pumps. In 1995, the company embarked on a continuous course of restructuring through strategic divestitures and acquisitions which culminated in 1995 when ITT split into three separate, independent companies. Ten years later the company was sold, and by 2011, it 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 acquisition rationale and solid strategy formulation.

Recent history has taught some hard lessons about M & A's—one of the most salient being that many, if not most acquisitions should never have happened. The second lesson indicates that the first lesson might be moot if the parent had done more and better positioning for the acquisition. Only after senior leaders have aggregated the relevant data should they begin the arduous journey of setting criteria, considering targets, evaluating these targets vis-à-vis the criteria, and negotiating deals. Only then can they accurately answer the question, "Deal or no deal?"