

With two-thirds of mergers and acquisitions creating no value for shareholders, acquisitive companies need to pay greater attention to planning and implementing their deals

Hitting the takeover trail

SPRING IS TRADITIONALLY the time when a young man's fancy turns to love. This year, after a long period of enforced hibernation, the rising sap is fuelling large numbers of company bosses to embark on the takeover trail again.

The value of global mergers and acquisitions during the first three months of 2004 was higher than at any time since October 2000. Yet given the failure of most mergers and acquisitions in the 1990s to create shareholder value, acquisitive companies must be careful not to get swept along in the stampede and plan their moves very carefully to improve their chances of success this time round. Deals fuelled by ego and the pursuit of size for its own sake rather than the creation of long-term shareholder value are likely to fail.

However, research by KPMG suggests that managers' record on creating shareholder value from M & A is improving. Two years ago, the firm's Transaction Services division showed that just 17% of global mergers and acquisitions in 1999 succeeded, with 83% either not increasing or actually reducing shareholder value. The main reasons were that the mergers and acquisitions weren't fully integrated and failed to exploit the combined human potential of the merged enterprise.

But in 2003 the firm's biennial Beating the Bears survey showed that double that figure – 34% – had enhanced shareholder value for the acquirer's shareholders.

The most common reasons for companies doing deals are to protect or increase market share or to diversify into new markets or products – both largely expansive motives with a strong focus on revenue. The report concluded that companies with clear, expansive M & A strategy and efficient execution outperform their competitors.

The successful deals demonstrated common characteristics. For example:

- Of the deals that enhanced value, 67% came about as a result of management identifying a suitable target in advance, compared with 28% that were opportunistic or where the strategy was not clear.
- 37% of all respondents described due diligence as the most important pre-deal activity, up from 25% in the first survey.
- The gap between KPMG's objective assessment of the deals and respondents' perception of success had narrowed: 65% believed their deal had been successful, compared with 75% in the previous survey.
- According a higher priority to synergies and integration planning appeared to have a favourable impact on the outcome.
- Only 16% of respondents said that their own M & A teams were most closely involved in assessing the value of the deal, half the number cited in the previous survey. Conversely, the influence of the board and some professionals appeared to have increased.

However, the KPMG survey did raise some questions about the degree of rigour applied to the post-deal implementation and integration. Phil Probert, managing consultant in the People and Organisational Change Practice at PA Consulting, points out that failing to deal adequately with the people elements in any change situation can threaten its success.

However, he says, the problem becomes particularly acute with M & A because of the heavy focus on the numbers. He explains: "In M & A lots of the rational and factual analysis is based on the numbers and the business case.

HOW TO DO AN MBO

If you've always fancied running your own show, are tired of someone else reaping the rewards of your hard work and can see opportunities for your company that its present owners can't, then doing a management buyout might be your next logical career move.

But while doing it well could make you master of your own destiny, handling it badly could put you out of a job. It's a fine line to tread, and taking advice from a venture capitalist such as 3i, Alchemy or Apax Partners is a vital preliminary step.

Ask yourself:

- Does the company – or your division, have growth prospects?
- Are you ambitious to grow the business?
- Do you have a product or service with a competitive edge or unique selling point?
- Does your management team have complementary areas of expertise, such as marketing and finance?
- Is there a clear team leader?

You then need to discuss the opportunity with the venture capitalist in more detail. They will give you an indication of the terms on which they are prepared to invest in your business.

You then need to make an initial approach to the vendor, and prepare a business plan.

This should include:

- An analysis of the markets you serve, the potential and your competitors
- Historical financial information
- The current year's budget and management accounts to date
- Your profit and cash flow forecasts
- Detailed CVs for the buyout team

After reviewing and checking this information with other parties, the venture capitalist will agree with you how best to finance the acquisition, before putting forward the offer to the vendor. Once this is accepted, agreed and made legally binding, you can uncork the Champagne. The business is yours to run according to your business plan.

M & A SUCCESS BASED ON KPMG RESEARCH

	Enhance value	Neutral	Reduce value
1999	17%	30%	53%
2001	30%	39%	31%
2003	34%	34%	32%

The more difficult issues like culture and whether the management team can be truly objective are much harder to get right – and may even be overlooked completely.

Human factors are always difficult, and they can throw highly rational people.”

Probert often has to explain to very senior people “the very basics of human nature,” he says. “They will ask, ‘why are our staff reacting this way?’. The deals that are successful are invariably led by people at the top who haven’t lost touch with what people further down the organisation think and feel.”

And with well-educated, empowered and sceptical employees making up a bigger proportion of the workforce these days, companies will only keep their best people if they involve and communicate with them, warns Probert. The modern emphasis on employability and personal development means that individuals are less concerned with a job for life and more prepared to up-sticks to the competition if they become disaffected or scent a better deal.

While this is true generally, during periods of uncertainty or upheaval, particularly as a result of M & A activity, it becomes even more critical that companies manage their people effectively.

With transition and flux being increasingly the norm in business life, companies and their staff should be flexible and adaptable and in a perpetual state of preparedness for change. To this end, they should put in place mechanisms and guidelines and communications strategies that allow them to respond quickly to sudden and unexpected change, such as a hostile takeover.

You need to work out exactly what the change will involve, how it will affect organisational structure and jobs, how long it will take to happen, and then develop action plans and communicate the facts honestly and directly, advises Probert. “Even the most junior staff can handle the truth and react positively to it. You only get negative responses when people aren’t given the facts, and they fill in the gaps with negative assumptions. Worrying that you might lose your job is a lot more corrosive than knowing you will but that you will be helped to find a new one.”

The most senior people in the organisation should be involved in communicating any change. “Too often HR, PR and so on synthesise the information so that by the time it reaches front-line staff it sounds like a party political broadcast rather than plain dealing,” says Probert. “Those organisations that manage change well work very hard to deploy people from the most senior levels to talk to the people further down the organisation.”

Mergers and acquisitions invariably involve redundancies, and, as Probert points out, “casualties going off down the road have your reputation in their hands more firmly than those who stay. The destruction of shareholder value through loss of reputation is well-researched.”

While fair severance packages should be a given, “the help you give over and above that – outplacement consultancy or just coaching people in how to engage with the job market, for example – is very powerful and makes a very positive impression on both the workforce and the outside community.”

A key factor in securing the commitment of staff you want to keep is having the systems and processes in place to help them do their jobs effectively and head off feelings of disorientation and demotivation. “Change affects people’s work routines at all levels and unless you tackle that it has a direct effect on productivity,” says Probert.

What’s more, he adds, companies should quickly allocate new jobs and roles and establish a new ‘emotional contract’ with a clear set of values for people to subscribe to.

Interim executives can play a key role in M & A, particularly at the critical implementation and integration stages where, as the KPMG research indicates, there remains considerable room for improvement. As Probert points out, the value of an interim lies in their combination of high emotional intelligence and objectivity.

He says: “Interim executives can see what is going on, yet are outside it and have no vested interests. They can make a difference by being objective, and being seen as objective means people will listen to them because they have no self-interest or personal axe to grind. People react in a very powerful way to those they see as ‘honest brokers’ who are there to get a solution rather than personal gain.”

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