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MERGER/ACQUISITION

Acquirers Rush in Where Partners Fear to Tread


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In today's merger-minded climate, it's easy to forget that many mergers produce less than stellar results. For instance, in a McKinsey & Co. study of 115 acquisitions in the U.S. and the U.K., only 23 percent of the transactions earned returns greater than the annual cost of the capital required for the acquisitions. In contrast, a Booz Allen study of mergers and alliances found that over a five-year period, the average ROI for alliances – nearly 17 percent – was significantly higher than the average ROI of the individual corporations involved in the alliances. Furthermore, this study showed that alliances have a higher success rate than mergers.

Such figures suggest that when you are developing M&A strategies, you have an opportunity to improve the odds of success by examining some lessons to be learned from a tried-and-true alternative: corporate partnerships. Here is a look at five key differences between alliances and mergers that show attributes of partnerships that might be transferable to mergers.

Buddies From the Get-Go. Alliances are always friendly and generally have a strong focus on mutuality, with equal commitments and balanced risk-sharing by the partners. This win/win attitude is often missing in mergers, which can be one-sided and hostile from the very start. It's like the difference between a marriage based on love and a shotgun wedding. Which union would you bet on?

Consider what occurred in Wells Fargo's 1995 take-over of First Interstate. Not wishing to go to the altar with Wells Fargo, First Interstate gave golden parachutes with two years' salary to hundreds of executives and granted all other employees severance packages that were double the industry average. As a result, a mass exodus among First Interstate employees left branches understaffed and produced serious erosion of the customer base. Wells Fargo's staff was also spread too thin to implement a smooth integration. The hostility behind this debacle simply would not exist in an alliance.

Money Isn't Everything. The primary motivation behind a successful alliance is to complement and leverage each partner's resources, for example, to integrate two technologies. Although financial gain is the ultimate goal, it is frequently secondary or indirect. In contrast, with most mergers, the driving force on both sides is direct, short-term financial results. The acquiring firm desires visible revenue and earnings growth or tax advantages while the acquiree's leaders want to cash out or anticipate significant financial gain for themselves within the merged organization. Because the primary motivation is financial, the two parties often fail to leverage their resources, ironically making it unlikely that the financial objectives that originally drove the deal will be achieved.

Some mergers are winners because their motivation is more akin to that of alliances. In IBM's highly successful acquisition of Lotus Development Corp., the primary focus was not price or short-term gain but a true leveraging of resources. IBM got Notes, and Lotus got IBM's presence in corporate America. Interestingly, this merger began as an alliance, and the two organizations, in effect, lived together for a while before hooking up.

Focus! Focus! Focus! Most alliances are formed, at least initially, around narrow objectives, such as developing a new product, expanding into new markets or blocking a competitor. This focus on a few well-defined and attainable goals enables the partnership to focus and deliver clear value. As a result, many partnerships enjoy initial success and often go on to broaden their objectives. In comparison, when two entire companies are melded together in a merger, objective-setting may be done so broadly that no single goal receives enough attention to achieve the potential synergy.

Give Due Diligence Its Due. Lust plays a part in hampering due diligence in both mergers and alliances. After all, most deal-makers don't begin serious due diligence until they are pretty sure they want to do the deal! Nonetheless, in a partnership, where the motivation is to leverage specific resources and where the objectives are focused, you instantly know where to direct due diligence efforts. In many merger situations, however, due diligence is either done too broadly or becomes so focused on the financial and legal aspects of the deal that important specifics can get overlooked. Key business issues, such as current partnerships and target market niches that would be reviewed thoroughly in a partnership situation because they would ultimately determine the relationship's success or failure, may receive short shrift in a merger that is either totally focused on financials or overwhelmed by the big picture.

A Catch 22 further impedes the due diligence process with a merger. On the one hand, it is difficult to do too much due diligence before announcing the deal for confidentiality reasons and fear the news will leak prematurely; yet, after the announcement hype, it is easier to look the other way rather than uncover reasons to squash the merger.

It's the Culture, Stupid. The all-important issue of culture is treated differently in mergers and alliances. In an acquisition, cultural differences tend to be ignored, overlooked, or downplayed because either the buyer's natural instinct is to force the acquired company to adopt its culture or the deal is just so enticing that both parties may disregard warning signs of impending culture clashes. When Upjohn and Pharmacia merged in 1996, for instance, they saw the opportunity to significantly accelerate revenues and better position themselves against the giants of their industry. Instead, they became mired in endless policy differences, such as employee drug testing, vacations and management reporting methods, which quickly drained much of the vitality from the merger.

In contrast, potential partners can zero in on cultural issues that might impact the success of their narrower objectives. And, while they may, in fact, uncover serious cultural differences, potential partners often find ways to tolerate those differences because they aren't partnering permanently. With no one trying to force cultural change, the chances for success increase.

No Personal Angst Among the Personnel. Mass layoffs and executive infighting about who will stay and who will go are not part of the alliance model. Unhampered by such distractions, people at all levels of partnered organizations are free to focus on achieving the alliance's objectives.

With mergers, however, such issues often take on a life of their own and become paramount to the business purpose that initially prompted the relationship. For instance, just one day after Bell Atlantic and GTE announced their merger, The Wall Street Journal published an article about the anxiety being felt among the two organization's top execs about their future roles. Senior level distractions or defections that arise from such unease can create a leadership vacuum that imperils the merger's success. Combine this with layoffs or an exodus of people at other levels of the organization due to similar concerns about the future, and the merger is in big trouble.

A study of mergers earlier this decade by a professor at the University of Chicago and one at the University of Arizona found that about 44 percent of acquired companies were later sold off, many times at a loss. This high corporate divorce rate should prompt financial executives to look for ways to avoid the thorny issues that consistently trouble mergers. Where problems are apparent, a strategic alliance might make more sense than a full-fledged merger. And even when a merger is definitely the right way to go, the potential of an improved payoff makes it worthwhile to examine how that union can take on the best characteristics of alliances.

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