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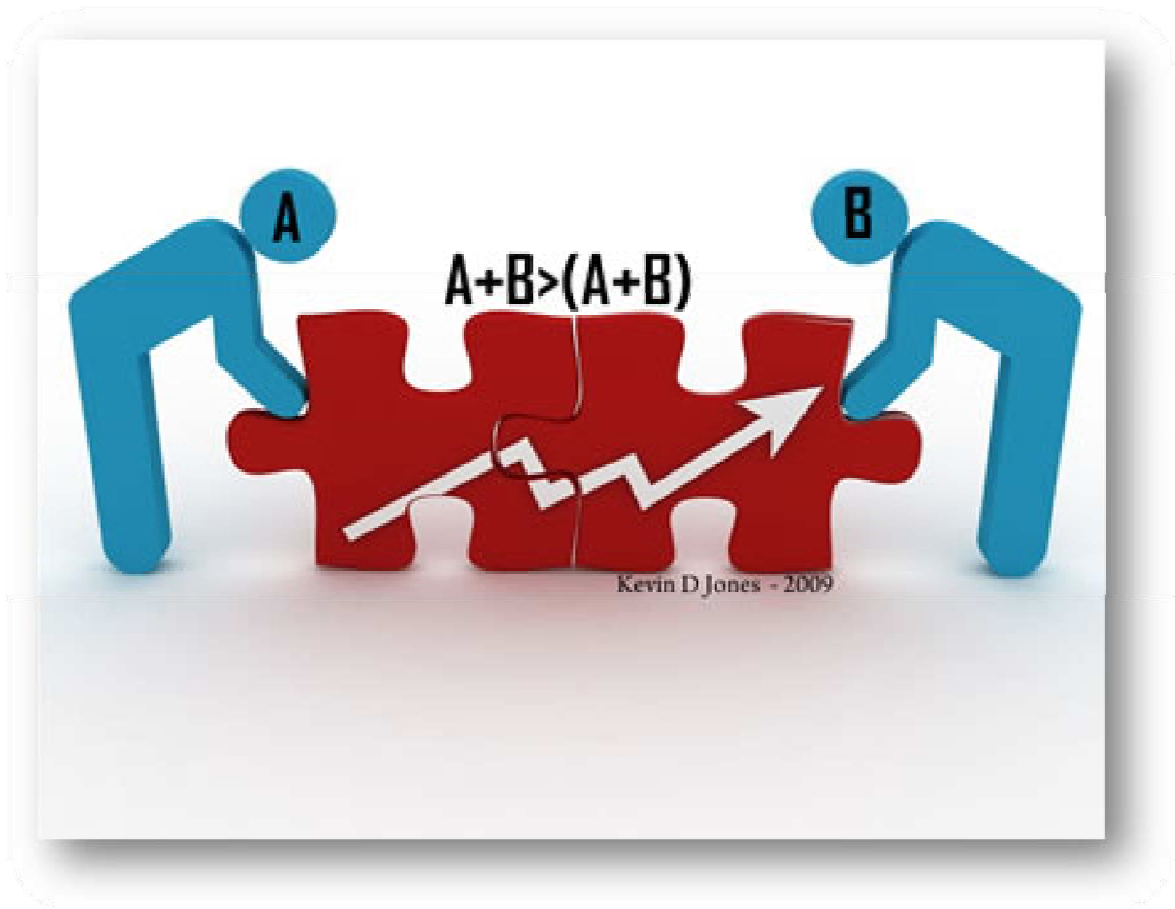
Jones, Kevin

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ABSTRACT

Imagine that you have reached the pinnacle of your career, and you are sitting in the driver's seat of a multi-billion dollar enterprise. Business is good, sales are up, and the stock market responds to your company's performance. In such circumstances, a chief executive officer (CEO) may sit back in his or her chair and ask, "So, what's next? Do I add more staff, buy more equipment, build more plants, or expand globally?"

This paper reviews the road map for a successful pre and post M&A team strategy. The writer attempts to develop a framework for a successful transaction. Every M&A transaction is different and requires special attention to detail and a contingency plan for unknown variables.

Keywords: mergers, acquisitions, M&A, SPECIAL, types of mergers, business

Mergers & Acquisitions: A snapshot of a SPECIAL pre and post M&A process.

Kevin D. Jones

**Ph.D. Candidate at the International School of Management Paris
President TEMAC Solutions, Inc.**

Address:

Email: kevin@kevindjones.net

Phone: +1 (713) 893-4949

14781 Memorial Dr. Suite 1051

Houston, Texas 77079

USA

Kevin D. Jones is in the Ph.D. Program of the International School of Management in Paris, France. Kevin is the President and founder of TEMAC Solutions, Inc. an international software and web design company headquartered in Houston, Texas. Kevin has served in leadership roles for several not-for-profit boards of directors. Jones worked for the Coca-Cola Company in the Information Technology Group from 1995 – 2000.

Introduction

Imagine that you have reached the pinnacle of your career, and you are sitting in the driver's seat of a multi-billion dollar enterprise. Business is good, sales are up, and the stock market responds to your company's performance. In such circumstances, a chief executive officer (CEO) may sit back in his or her chair and ask, "So, what's next? Do I add more staff, buy more equipment, build more plants, or expand globally?"

There are two predominant ways in which to grow a business exponentially. One is to grow it organically, that is, continue to increase the size of the business one dollar and one customer at a time. Another faster, but more disruptive way, is through mergers and acquisitions (M&A). Before they complete their first major M&A deal, the excitement of many executives is akin to that of the weekend warrior in the Home Depot do-it-yourself section. Many executives, when allowed to pursue the path of M&A, smell blood and cannot be stopped even if they risk a bad deal. The very nature of an entrepreneur includes the ability to take risk and laugh in the face of potential failure.

Corporations measure M&A success using different metrics. Merrill Lynch measures success or failure based on the retention of key employees, while WorldCom measures success by overall cost savings. The academic measurement for success is: Company A + Company B is greater than the sum of Company A and Company B, mathematically represented as $\text{Success} = \text{Company A} + \text{Company B} > (\text{Company A} + \text{Company B})$.

There is ample empirical evidence to suggest that most mergers are not successful within the first two years, and even more research suggests that approximately 65% to 85% of mergers fail (Sirower, 1997).

Failures are caused by various conditions, anticipated and unanticipated. Scholars and businesspeople have attempted to develop a road map for M&A transactions. However, it is easier to speculate and pinpoint why a merger failed than it is to predict with a substantial degree of certainty that another will succeed. One thing is certain in most M&A transactions: Problems integrating an acquisition into the acquiring business are inevitable. The real task at hand is not to be derailed by these problems. So, who are the real winners in mergers?

In this position paper, I will provide an analysis of the common characteristics of a successful merger. It is this researcher's belief that if an organization follows this SPECIAL process for a merger, its odds of success will increase substantially.

Mergers and Acquisitions: What's the Difference?

Mergers and acquisitions refers to the corporate strategy, finance, and management that deals with the buying, selling, and combining of companies; mergers and acquisitions can finance or help a growing company in a given industry expand rapidly without the necessity of creating another business entity (Wikipedia, 2009). The ultimate goal of a merger is to create value. Value can only be created when the value of Company A + Company B is greater than the value of Company A and Company B separately.

A well-known St. John's University business professor defined mergers as a combination of two corporations in which only one corporation survives. The surviving firm assumes all the assets and liabilities of the merged company. In an acquisition, the buyer purchases some or all of the assets or stock of the selling firm. If the stock of the selling firm is acquired, typically a controlling interest is obtained. The active firm is usually called the acquirer, and the passive one, the target. Usually, the

acquirer is larger than the target; and, usually, the acquirer survives, while the target ceases to exist upon completion of the merger (Wong, 2009).

Types of Mergers

Typically, there are three categories of mergers: horizontal, vertical, and conglomerate/diversification. Additional subcategories include product-extension merger, purchase merger, consolidation merger, accretive merger, and dilutive merger, but, for the purposes of this research, investigation will be limited to the three broad classifications. A horizontal merger is a merger of two companies in the same line of business. An example of a horizontal merger would be Walmart purchasing Target. Both companies are in the retail business with very similar product lines and strategies. There is no substantial deviation in the marketing or product lines. The problem with horizontal mergers is the potential of creating a monopoly or oligopoly, as would be the case if Walmart purchased Target. All mergers of publicly traded companies must be approved by the Securities and Exchange Commission (SEC), and due to government regulatory guidelines, a merger of Walmart and Target would not be approved. Horizontal mergers are represented mathematically as $\text{Company A} + \text{Company B} = \text{Company A}^B$, the best-case scenario. However, as this research reveals, the best-case scenario does not always occur.

Vertical mergers involve companies that cater to different stages of production. The buyer expands back toward the source of raw materials or forward in the direction of the customer. An example is eBay's purchase of PayPal. Customers use PayPal's e-mail payment system as a secure way to pay for goods they purchase in eBay's online auctions (Brealy, 2008a, pp. 6-8). Another example of a vertical merger would be an ice cream business purchasing a milk company. The object would be to purchase

an integral part of the supply chain hoping to reduce costs for raw materials. This was the case in the 1950s and 1960s when General Motors (GM) was deemed to have a cost advantage over its main competitors, Ford and Chrysler, because a greater fraction of the parts used in GM's automobiles were produced in-house. By the 1990s, Ford and Chrysler had the advantage: They could buy parts cheaper from outside suppliers. This was partly because outside suppliers tended to use nonunion labor at lower wages. It also appears that in-house parts manufacturers have more leverage and bargaining power than those outside the company (Brealy, 2008b, pp. 885-886). An in-house parts manufacturer gain demand a higher price than one outside of the company. GM's legacy employee and union costs, coupled with the global economic crisis of 2008, inevitably caused the company to collapse and file for bankruptcy. The upside to a vertical merger is that it is more likely to be approved by regulatory agencies. The agencies will see the strong potential for consumers to benefit from the increased efficiencies that result in a supply chain integration.

A conglomerate or diversification merger is the union of two companies that are not competitors, not in the same industry, and not a part of the same supply chain. A conglomerate merger is the acquisition of a company in a totally separate line of business. Typically, the acquired company is operated as a separate business unit or a wholly owned subsidiary of the parent company. An example of a conglomerate/diversification merger would be Schlumberger (oil field services) purchasing GM; oilfield services have no relationship to the auto industry. The only possible link would involve Schlumberger and its employees purchasing GM vehicles at discounted rates.

Conglomerates were widely popular from the 1960s through the 1970s; in fact, one of the last M&A booms was the result of the decoupling of the conglomerate form during that time. Even though conglomerates are not as popular today, General Electric (GE) is one of the most recognized successful conglomerates. GE's success is due to its strong business principles and management team. Jack Welch,

the former CEO, has been recognized as one of the greatest CEOs of all time. GE managers consistently are pegged to head other corporations, and GE is a leader in creating effective managers. GE managers are evaluated every year and categorized into one of three groups. Group A (or the top 20%) consists of top performers who possess the potential to become a CEO. Group B (middle 70%) is not as effective as Group A and is not seen as being capable of managing a larger area; however, GE operates with 70% of its managers categorized as belonging to Group B. Group C (bottom 10%) is not seen as having any potential, and often managers in this category leave the company within a year of performance evaluation. GE managers are immersed in management training. Welch held group meetings with his top managers and dealt with key issues in their businesses one on one. Because of this personal interaction and the responses and performance of those involved, it was easy to determine the contenders for the top jobs.

Common Characteristics of Successful Mergers (SPECIAL)

Characteristics of a successful merger are most commonly seen in firms that are already well managed with strong core capabilities. The purpose of the merger is to round out or expand the current capabilities, not create entirely new capabilities unrelated to the current business. The rounding out or expansion should be in existing areas in which the business already has a strong presence. A good example of a successful merger involves CEMEX, the world's largest building materials supplier and its third largest cement producer. CEMEX is headquartered in San Pedro Garza Garcia, Nuevo Leon, Mexico (considered



a third world country) (CEMEX, 2009). The secret to its M&A success is known as “the CEMEX way” (Edition, 2008). CEMEX practices a unique and highly effective method of acquiring companies. The philosophy implemented invests time and effort in the acquired company’s employees and integrates them into the CEMEX culture, all while adopting the best practices of the acquired company (Kanter, 2009, p. 3).

The common characteristics of successful mergers are best articulated by using the acronym SPECIAL. Every M&A deal is unique, but there are many guidelines to executing a merger or acquisition. In an attempt to develop an easy-to-remember strategy, this researcher pegged the critical steps to the letters forming “SPECIAL.” In the following paragraphs, I detail what each letter stands for and identify the source that backs up my hypotheses.

S

S is the first letter, but it by no means represents the start of the process; nor is it the most important part of a successful merger. All parts of the SPECIAL indicators are important. However, one common characteristic of successful mergers is a solid strategy, a strategy that focuses on saving time, money, resources, and execution time.

Although every business must have a well thought out strategy, more often than not, entrepreneurs and CEOs succumb to their egos before or after an acquisition or merger. Some would liken this reaction to a wild animal smelling blood in a duel to the death, and the tenacity with which a determined manager works toward an M&A to a wild animal’s instinct to survive.

Post global economic crisis and global recession, many executives might think it shrewd to move in and acquire firms on the cheap—buy low, cut costs, and defy the unusual prediction that most mergers will fail to produce economic value in their first two years (Kanter, p. 2). In any merger, it is important to set clear objectives and priorities for all parties involved. Prior to the merger, a company should ensure that

the potential target is in line with its M&A strategy. Merrill Lynch was considered to be one of the master acquirers in 2000. Then Chairman and CEO David Komansky commented that “you don’t want to fall into the trap of making acquisitions just for the sake of it. [...] We started out with a well-forged, highly tuned strategy and decided between acquisitions and green-field investments depending on the approach we felt would more quickly fulfill our ambitions” (Carey, 2000, p. 146). Merrill Lynch completed more than 20 acquisitions from 1990 through 2000, roughly two per year. Speed is also critical in pre- and post-merger situations. If a company moves too slowly in pre-merger situations, it stands to lose money by allowing competitors to bid up the price or a reluctant acquiree to evoke some form of protection to block the deal altogether. In a post-merger situation, a company wants to be prudent and to move as expeditiously as possible. Disruption equals time wasted, and wasted time means lost money. Dennis Kozlowski, the former CEO of Tyco, has observed that in normal circumstances a person is productive for 5.7 hours of each day. If there is an interruption (i.e., merger or other significant event), productivity drops to 1 hour a day. In merger situations, people immediately begin thinking about themselves. The faster a company moves to execute and communicate a plan, the better (Carey, 2000, p. 147). Finally, an organization must remain focused on saving time, money, and resources. In most cases, a merger is approved by boards of directors based on a predetermined cost savings or tangible synergies that will be created. Often, this is forgotten in mergers that have severe hiccups and issues that cause a CEO or team to take focus off the original goal. Dennis Kozlowski commented that “[...] the key thing I’ve learned is that acquisitions work best when the main rationale is cost reduction. You can nearly always achieve them because you can see up front what they are. You can define, measure, and capture them” (Carey, 2000, p. 4).

P

Pre- and post-integration merger teams are crucial to a successful merger. A dedicated team must focus on the strategy and integration of the two companies and systems. This task should not be taken lightly,

and the effort required is monumental. People, processes, and technology are involved in any acquisition or merger, all of which are delicate and should be handled delicately. The integration team should be led by someone who is a champion of the merger with enough seniority, tenacity, and business savvy to make things happen on both sides of the merger team (Bourgeois, 2009, p. 1). It is critical to ensure that the team is dedicated to this specific mission. If the needed internal resources are not available, a company is obligated to hire outside consultants.

A merger is an ambitious task in and of itself, without any undo roadblocks from obstructionists to slow down progress. If personnel and responsibility shifts are involved in a merger/acquisition, a leader must recognize those who are on board with the merger and those who are not in favor of the change. Pharmaceutical giant GlaxoSmithKline learned the value of promoting pro-integration leadership after a failed merger attempt in 1998. The lessons had been learned by the second attempt, and the leadership structure was included in the pre-negotiations and not the post-negotiations (Bourgeois, 2009, p. 6). It goes without saying that an organization must plan for contingencies. Often, however, acquirers fail to anticipate the dictionary definition of disruption: something that threatens to unravel their deal after the papers are signed. Acquisitions inevitably run into difficulties. Key people leave, processes break down, information systems get tangled, and customers grouse. Many company leaders are blindsided by these impediments because they are so focused on nailing down the terms of the deal and hashing out a broad integration plan that they give short shrift to spotting specific problems. The most successful acquirers, however, don't ignore any of these details. Recently, I interviewed a score of top acquirers that I'd come to know through my own experience and through a Bain study of 1,700 large companies in the United States, Japan, and Europe. I learned that they all have something in common: They expect the unexpected, and they proactively plan for contingencies (Harding, 2004, pp. 4-5).

E

Establishing metrics sound easy enough; however, they are often forgotten when a melee or confusion begins in a merger transaction. Setting metrics is necessary to establish whether a company is doing well against its plan. For example, in the case of a merger plan intended to reduce operational cost by 50% by year-end, progress is easy to track against the goal. The problems come in when the metrics are forgotten or ignored during the process. Metrics are used to measure the current status versus the target goal. A company will not know if it is doing well or poorly if it doesn't establish metrics to measure its outcome. Metrics can be defined as dollars saved, in terms of headcount, or in terms of planned steps to be completed by certain deadlines (Bourgeois, 2009, p. 5).

C

Communication, cultures, and customers rank at the top of the list for merger activities and areas that deserve significant focus. Most research articles agree that the correct communication is critical in reducing any tension or anxiety and helping the entire organization understand the plan. Change is difficult. All stakeholders will have questions and concerns that need to be addressed as the merger unfolds. They will be phrasing their questions and evaluating responses they hear through the WIFM, or the "what's in it for me," filter. Therefore, it is critical that the team identify all stakeholders whose concerns must be addressed and do its best to craft responses with stakeholders' various needs in mind (Bourgeois, 2009, p. 6). Culture is a valuable asset that is not easily transferred or adopted. Culture is a prevalent concern in both international and domestic mergers. Internationally, CEMEX overcame cultural issues by training its own employees on the merging culture and employees from both companies on the importance of merging into a single team. Investors did not initially approve of CEMEX's decision to buy the British cement maker RMC, and some CEMEX leaders sensed negative perceptions among RMC employees that a company from the third world was reversing history by taking

over a major business operating in developed markets. RMC employees were sent to CEMEX plants in Mexico, the United States, and Germany to experience the CEMEX way—the company’s system of ethics, management practices, and technology platforms—and to become change champions upon their return. In addition, a new variable compensation bonus plan based on plant performance was introduced to spread the fruits of success to workers (Kanter, 2009, p. 3).

Another important subject in mergers is the customer. During a chaotic and sometimes frantic merger, it is easy to lose sight of the concerns of the customer. Tig Krekel, president and CEO of Hughes Space and Communications, said that “it is important to understand what the customer likes and dislikes about the deal as well as who will control the relationships after the deal with the customer” (Carey, 2000, p. 153). If a company ignores the customer, it can lose clients and business. For example, consider the merger of food giant Kellogg with Keebler in 2001. Keebler was the target because it had a superior delivery system and an SAP technology platform that Kellogg hoped to incorporate into its business. A problem arose during conversion of Kellogg distribution centers to the new systems. The order fill rates dropped from near 100% to 70%. This was a serious problem, and orders were not getting to customers. The post integration merger team (PIM) team was directed to slow down and make personal phone calls and visits to the affected customers until the situation was resolved. Kellogg was able to avert a potentially serious loss of business by not only listening to its customers, but also reaching out repeatedly to those whose orders were delayed (Carey, 2000, p. 147).

I

Integrating best practices and best cultures is also key to a successful merger. A merger is a time-consuming, emotional exercise in convincing an organization to combine with another business. There is often a sense of us versus them that complicates the post-merger process. Employee and customer problems tend to occur shortly after the completion of the merger; however, operational problems can

develop more slowly. They may not be evident until a year or two after the merger. This is especially true when two companies join operations with the intent of making significant gains in joint sales transactions. For example, when CitiGroup purchased Travelers Group, the success of the transaction was predicated on cross-selling. The projected additional profits were estimated to grow by \$1 billion (US). In actuality, a year into the merger, cross-selling had yet to come to fruition and had fallen far short of projections. Fortunately, CitiGroup had in place an internal system to regularly track the status of acquisitions and the targets specified in the original merger terms. The numbers are built into the budget of the companies, allowing the management team to see where the company is versus projections. The CEO reported the actual results monthly for 12 months to the board of directors and management teams. The difficulty was traced back to an integration problem with Travelers' investment bank, Salomon Smith Barney. It turned out that the overall difficulty was caused by personality clashes and historical allegiances that were preventing the team from addressing important integration issues. The end result was the termination of a popular executive and additional personnel changes. Within a year, CitiGroup's stock began to rebound and its cross-selling objectives began to gain serious traction (Harding, 2004, p. 3). Integrating best practices and best cultures from both organizations is smart policy. Often, just because an acquiring company is larger than the acquired company does not mean that it has the best practices and systems. In the case of Kellogg's merger with Keebler in 2001, one of the significant factors in the merger was that Keebler had superior technology and advanced SAP systems. As for CEMEX, after a series of international acquisitions beginning in Spain in 1992, followed by others in Latin America, Asia, the Middle East, and the U.S., it had learned how to quickly identify cost savings and transfer best practices to and from the acquired company, formalizing its integration capability into a methodology (Kanter, 2009, p. 4).

A

After a merger is announced, it is important for an organization and CEO to take action. The action must be focused on setting the plan in motion and developing the right core teams to execute the plan. The CEO or PIM team must be prepared for a plan to change. After a deal is announced, the CEO of the acquiring company must explain the transaction to employees, investors, and the public at large. For example, Rick Wolford, CEO of Del Monte, not only solicited feedback, he paid attention to it and then acted on it—visibly—when an idea was promising. “If you have a good argument and the data to back it up, I’ll go with you,” he said. Though that sounds simple, it’s a juncture where all too many acquirers stumble. In this researcher’s experience, companies are better at soliciting feedback than hearing and acting on that feedback (Harding, 2004, p. 3).

L

Looking out, looking in, and listening are signs of a prudent leader and leadership team. When participating in pre- and post-merger activities, it is critical that the CEO and pre- and post-merger integration (PPMI) team look at all areas of the business and listen to internal and external clients. For example, after signing the papers for the Del Monte merger with companies spun off by H. J. Heinz (Pittsburgh), Rick Wolford knew he faced the challenge of bringing together similar sized organizations with distinctive cultures and proud histories. In a sense, the companies were cultural polar opposites. “If DelMonte said ‘tomato,’ H.J. Heinz would say ‘tomahto,’” Woolford recalled. “Whether it was organizational philosophy, distribution mechanics, sales strategy, or operating practices, if we did it one way, it seemed that Heinz did it the other.” Instead of waiting for something to go wrong, Wolford set up employee forums and divisional teams to gather unfiltered feedback from every corner of the company. For six months, he visited Heinz and met with the executives who were coming with the deal, eliciting their thoughts about the best way to manage the merger. Wolford made a point of drawing out

different—even contradictory—ideas. “I knew there was no inherently right or wrong way to run the business. Both companies had systems that worked for them,” he explained. “What we had to do was to find one way to get things done for both businesses. We needed to listen, think through both sides, and then make a decision.” By opening lines of communication early on, Woldford empowered line managers to identify problems and quickly fix them (Harding, 2004, pp. 3-4). He listened to his team and all parties involved and, with effort and diligence, he was able to book a successful merger.

Even though one company is the acquirer in the transaction, this is not always an indication that the acquirer’s business practices and/or personnel are the best for the new company. The integration team should spend time looking at the other organization. This is also an ideal time to look inward to identify shortcomings and deficiencies. It is the perfect time to realign strategies, if necessary. One approach is to write down both firms’ top 10 decision rules. Most firms have some ingrained ways of doing business that may not always be obvious or readily articulated. Taking the time to clarify the firms’ implicit decision rules can help determine whether the buying firm’s values are compatible with those of the target. Also, understanding a company’s own decision-making rules can help an integration team create a strategy that is customized for its stakeholders (Patel & Bourgeois, 2009).

Conclusion

Although a merger is the fastest way to grow an organization and its capabilities, it should be approached with extreme caution. As in any business undertaking, there must be a sound strategy to execute properly. Arguably, it is hard to define the areas from which a company truly extracts value from a merger. In the end, it is believed that only the investment bankers, consultants, accountants, and acquired company profit from a merger. Statistically, the deck is stacked against merging; however, the largest companies in the world, namely Walmart and Microsoft, would not be the behemoths they

are today without many successful mergers and acquisitions. It is this researcher's belief that if a company follows the SPECIAL process, it increases its chances of ending up in the winner's circle.

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