M&A Factories Drive Market Domination

by Dean McCauley

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Many observers regard the M&A tsunami crashing over Wall Street as the latest excess of out-of-control executives driven by ego, self dealing and inflated equity. After all, hasn't study after study has shown that the average business combination destroys shareholder value? Didn't our corporate leaders notice when AT&T obliterated $4 billion of shareholders' money with its purchase of NCR or when Quaker squandered $1.3 billion on Snapple? Doesn't anyone pay attention when Peter Drucker, the demi-God himself, proclaims that only 20% of mergers and acquisitions ever pay off?

Is NationsBank's Hugh McColl a slow learner? Is Travelers' Sandy Weill crazy? Is Bob Eaton smoking dope over there at Chrysler?

Perhaps not. I think instead the excessively analytic academics and consultants, who have been wringing their hands about the poor record of mergers and acquisitions, are the ones who have missed the deeper lessons that real world CEOs do not seem to have any problem grasping.

The first lesson is that if you want to be a player, you have no choice but to participate in today's M&A boom. In mature markets (and that describes about 80% of American business), acquisitions will continue to be the most efficient way to continue to grow. Companies that do not pursue acquisitions, or alternatively, develop an extraordinarily successful internal growth program, will be relegated to niche positions or gobbled up themselves.

The second lesson is that averages are irrelevant. Academics love to conduct studies that conclude that the typical merger destroys shareholder value. That may earn them tenure but it's about as instructive as reporting that the average elevation of the earth's surface is 3,000 feet below sea level. Understanding variation is far more meaningful to ongoing planning.

When we do hear about variation it is usually of the Marianas Trench variety, the great fissures of acquisition history such as Novell tossing $1.3 billion down a rathole named WordPerfect.

We have learned too little from the conquests of Everest. A large set of savvy companies is consistently successful at using M&A as a core tool of growth and market dominance. Our gaze should be upward, toward companies such as NationsBank, Cooper Industries and Cisco Systems. These companies have built standardized M&A processes that allow them to defy the averages by identifying, closing and integrating deals as predictably as they open checking accounts, build sparkplugs or design routers.

In fact, their "M&A factories" are so effective that, for these companies, continuing to pursue deals is not only not reckless, it is required. Their ability to reliably process deal after deal may be their single most valuable asset. Given this asset and the current life cycle of the banking industry, one could argue that Hugh McColl would be in violation of his fiduciary duty to maximize shareholder value if he did not pursue combinations with the likes of Barnett, Boatsmen's and BankAmerica.

How does a company less experienced than NationsBank build the capability to safely pursue deals? Not easily. My firm's research into merger and acquisition best practices found that every major deal that failed during the years of the study (1989-1994) was undertaken by an inexperienced acquirer. Those new to the game may want to start small, hire seasoned talent and use experienced advisors.

Novice acquirers should also take the time to build a M&A factory before doing a deal. Companies get into trouble when they try to execute on the fly without a disciplined M&A process. They tend to close deals, then build an integration plan, and then, some months after the close begin to integrate. This delay alone is often sufficient to allow the time value of the premium paid to destroy any hope of a profit on the deal. Compare the novices' timing to that of successful M&A veterans who make building an integration plan integral to both the selection of acquisition candidates and to the valuation of the attractive candidates. By the time of the close, not only is their integration planning completed, but often integration itself is well underway.

Setting the timing of the M&A process is only one element of designing a successful M&A factory. The architect must also design the entire M&A business model and designate who will play what roles during the various stages of the M&A process. The business model should define what skills the various M&A team members must have, how the M&A organization will be structured, what I/T support it requires, how team members will be measured and compensated, and what values and cultural norms must be nurtured.

Of course there is no best design for an M&A factory any more than there is a best design for a home. The blueprint depends greatly on the intent of a company's acquisitions. If they are primarily consolidation deals, the emphasis of the design must be on careful pricing of the deal based on identifiable cost savings. Those savings then must be quickly captured after the close through the aggressive elimination of redundancies. Many Consolidators pay little attention to the feelings of the acquired employees, knowing that success will come from getting rid of many of them, not from harnessing their skills. One mainframe computer software company used to go even further, purposely being offensive to acquirees in the hope of generating resignations that would save on severance costs.

Talent Scout acquisitions are at the other extreme. They are predicated on the belief that the unique skills of the acquired employees are the key reason for the deal. Talent Scouts, such as Cisco Systems, therefore have a quite different emphasis in their deal activities. No emphasis is placed on cost reduction. The focus is on ensuring that all newly acquired employees are better off financially and professionally with Cisco than they were before the deal and are given the resources to enhance their productivity immediately. When buying talent, high attrition is the ultimate failure.

A third type of deal maker is the Pioneer who looks to create through its deals something new that none of the predecessor companies could have created on their own. Ten years ago, Monsanto was primarily a bulk chemical company with questionable prospects. Since that time it has sold off its petrochemical operations and spent nearly $7 billion adding genetic engineering companies to its ag-chem lines. Together this set of companies has created a new type of agricultural genetics company with an intriguing enough future to entice a $35 billion bid from American Home Products. The challenge for Pioneers is to capture enough near term synergies to satisfy Wall Street in the short term, while nurturing the creativity of employees who must find and develop the interconnection points where 1+1=3. These interconnections seldom happen in less than 5 years.

An interesting statistic from our research is that companies that were clear about their intent, that is Consolidators, Talent Scouts, or Pioneers, were, on average, successful in their deal making. It was primarily companies chasing after revenue growth with no unifying discipline or process that failed.

Given the lessons of world class M&A practitioners, how should we handicap the chances for three of our current Godzilla-sized deals?

The NationsBank/BankAmerica deal is a slam dunk. It is the type of straightforward Consolidation deal that NationsBank has executed over 20 times in just the past 6 years. The scale of the deal may cause some unexpected troubles but Mr. McColl, no slow learner, is not going to make the kind of silly mistakes we have seen in other large banking deals such as losing key talent too soon or not having sufficiently robust systems. A clue that the deal is on track is that senior executives have already been named, some four months before the close.

The Travelers/Citicorp deal is an even bet once it gets through regulatory hurdles, although that is far from certain. On the plus side is Mr. Wiell's experience in pulling off many large deals. But his core value creation mechanism in the past has always been cost reduction, often humorously petty cost reductions. However, this deal cannot make it as a Consolidation as there is not sufficient overlap in functions and markets. It is Pioneering play that is already into the second act and still lacking the most rudimentary outline of the synergies to be showcased during the denouement. Succeeding with this deal will require the company's leadership to nurture the creativity and motivation of thousands of key employees around the world for a very long time. It be will be several years into the next century before we know if Mr. Weill is crazy like a fox or just plain crazy.

The Chrysler/Daimler-Benz deal is the most troubling. Neither company has completed any large acquisitions in the last decade, busying themselves instead with the discarding of past diversification disasters. In addition, they are insistent about performing the integration with minimal outside help, not what I would recommend for beginners. We can expect to see a slow capture of synergies and some expensive lessons being learned the hard way. One mistake already underway is that the companies are acting as if this is a Talent Scout deal, promising few layoffs. In fact, a huge part of the payoff should be in consolidation of redundant functions and excess capacity. Experienced acquirers know that these sorts of opportunities must be captured quickly and decisively, not sometime down the road. Given his buttoned down reputation, it is unlikely that Mr. Eaton is smoking anything illicit, but he does appear to be aiming to fill the Marianas Trench with shareholders' money nonetheless.

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