

Straight Talk Book No. 9

M&A Lies

(And why they're sometimes true)

**Everyone is entitled to their own opinion,
but not their own facts.**

Daniel Patrick Moynihan

M&A Lies

(And why they're sometimes true)



Truth. Or consequences.

Deals have always been an important part of business. Mergers. Stock swaps. Spin-offs. You name it. Acquisitions can be a fast way to expand. And divestitures can free up cash (and time) so you can focus on what matters most.

So why is it that so many deals—nearly half, according to some studies¹—fail to deliver the expected value?

It could be because too many companies still shoot from the hip, relying on conventional wisdom and back-of-the-envelope guesses

instead of hard-nosed analysis and discipline. Deal guys get carried away, expectations get over-hyped, and the next thing you know, you're caught up in something that has no chance of ending happily ever after.

M&A Lies takes a hard look at how companies approach transactions today. What you'll learn is that some things that sound totally outrageous can turn out to be true. And things that seem like sure bets can be dangerously wrong. The big trick is to understand which are which.

Tell the truth

Take this short quiz. "1" means strongly disagree, "5" means strongly agree.

	DISAGREE	AGREE
.....		
We never shoot from the hip.	(1) (2) (3) (4) (5)	
.....		
We know about all of the opportunities we should.	(1) (2) (3) (4) (5)	
.....		
Our deal pipeline is clear and well managed.	(1) (2) (3) (4) (5)	
.....		
Merger integration is not an afterthought for us.	(1) (2) (3) (4) (5)	
.....		
We're good at financial modeling—and we do it routinely in M&A.	(1) (2) (3) (4) (5)	
.....		
Our business leaders are hands-on when it comes to M&A.	(1) (2) (3) (4) (5)	
.....		
Tax is at the table when we're vetting opportunities.	(1) (2) (3) (4) (5)	
.....		
We keep most of the people we want to keep when we do a deal.	(1) (2) (3) (4) (5)	
.....		
We have businesses we should consider selling.	(1) (2) (3) (4) (5)	
.....		

Scoring

0–10 Good luck.

11–20 You're on the way, but deal-making isn't really on your radar.

21–36 You're positioned to win.

37+ We wouldn't want to be bidding against you.

Score:

Good enough is good enough

Mergers and acquisitions have become a common way for companies to meet their growth objectives. This is a fundamental shift, not a passing fad.

Achieving excellence in M&A starts with an honest self-appraisal of your current capabilities. And according to a recent global study, many companies are far more confident than they should be. In the study, companies that achieved their stated merger objectives more than 75% of the time were classified as "high achievers." Those that met their objectives less than 25% of the time were called "low achievers."²

Given their poor track record, you'd think low achievers would be gun-shy about doing more deals. But you'd be wrong. They're almost as likely as high achievers to do more acquisitions.

To beat the odds, companies need to improve their capabilities in every phase of the M&A process, from pipeline management and deal execution to integration and ongoing operations. The goal is to make M&A fast, efficient, and repeatable—and to manage risk effectively.

As deals become an increasingly important part of corporate strategy, a "good enough" approach to M&A probably isn't.

What to do

Take the quiz to see where you stand in terms of M&A discipline.

Smart companies don't do dumb deals

No one does a bad deal on purpose. Yet they happen all the time. Why is that?

Many companies start out with a clear rationale for any particular transaction. But somewhere along the way, the deal takes on a life of its own—and can keep moving forward even when it doesn't make sense.

There are plenty of excuses for this seemingly inexplicable behavior—and all of them can be true. Corporate development people who are rewarded for doing deals. Investment bankers

who get paid only if the deal closes. Company leadership that has painted itself into a corner by telling the board the deal is a strategic imperative.

Whatever the reason, it's easy for smart people to ignore the danger signs and get sucked into a bad deal.

Although nobody throws a big party when a deal is killed, in some cases it's absolutely the right thing to do. Sometimes the best deal is one that doesn't get done.

What to do

Write down the five most compelling reasons for doing your next deal. If the reasons change, pull the plug.



M&A matters only during a boom

Top-notch M&A capabilities are crucial at all times. According to a recent study, companies that pile onto the deal bandwagon when the economy is on a roll tend to do poorly at M&A. Early movers and other contrarians enjoy the lion's share of the rewards.³

Good deals are usually a function of strategy and execution—not the economy. But that's not to say companies should ignore broad economic conditions. Especially since there's less margin for error during lean times.

Typical deal analyses examine a wide range of details about operations and finances, but often take a fairly static view of the overall business environment. That's a mistake.

What to do

Use scenario planning to develop options. Include a range of economic assumptions.

For example, a tight credit market can significantly increase the cost of a highly leveraged deal, making it hard to achieve the expected ROI. Similarly, a drop-off in customer demand can make it harder to sustain revenues while wrestling with the challenges of merger integration.

No one can predict the future. But that doesn't mean you should ignore it. At a minimum, consider a full range of scenarios and how to manage risk in different situations. The principles of Strategic Flexibility can help you make choices that improve the likelihood of getting the desired results across multiple scenarios while reducing cost and risk.⁴

You're on top of all the deals that matter

Good deals are hard to come by. And the best are often ones you don't hear about until they show up in the news.

To make sure you're not missing good opportunities, you need a strong deal flow. That means spreading the word that you're in the market and prepared to act. It also means looking beyond traditional targets.

Conventional wisdom presumes your corporate development folks are plugged in with the investment banks, law firms, and other intermediaries. But it takes more than that. You need a position on the "A" list when

a deal arises—even when it's not an obvious target. To do that, you must cultivate influencers, just as you cultivate your very best customers.

A good pipeline has to match your business strategy. Your P&L owners—the people ultimately responsible for implementing strategy—should be involved every step of the way in assessing and building your pipeline.

If deals are central to your strategy, you need lots of irons in the fire. Building a healthy pipeline can take years, and maintaining it requires ongoing attention.

What to do

Take a look at the list of deals in your pipeline. You have a pipeline, right? What have you done this week to push the most important deals ahead?

Acquisitions are the only deals that create value

Acquisitions are the glamorous side of M&A. But divestitures can be just as important, especially in tough times. Unfortunately, too many CEOs want to sell as quickly as possible so they can focus on their core business. They want to dump underperformers quickly. After all, businesses that don't fit the strategy anymore are simply distractions.

But divestitures are not just acquisitions in reverse. They're actually much more difficult. To achieve high value:

- Develop a top-to-bottom view of how the business will operate the day the deal closes. By thinking about business continuity, you

signal to buyers that you're looking out for their best interests. This will help you get a premium price.

- Know what you're selling. What products are involved? Which people will be going with the business? What property and equipment will be handed over? Buyers will eventually ask these questions, so be prepared by making tough decisions early.

Handle a divestiture well, and you'll look smart. You'll speed up the process, you won't leave money on the table, and you'll avoid saddling yourself with new obligations such as transition services agreements and pensions.

What to do

Know exactly what you're selling.



Numbers don't lie

There's no question that numbers matter in every aspect of deal-making. Just be careful how you use them. They don't always tell the whole story—and they can be easily framed to justify almost any conclusion.

In the old days, companies would determine a target's value by slapping a standard multiple on EBITDA. But in today's ultra-competitive market, that traditional approach just isn't good enough.

Most companies are pretty good at assessing plain-vanilla deals involving mature companies with stable earnings. However, more and more deals don't fit that mold. In

some segments, such as life sciences, where targets often have yet to deliver even a penny of revenue, traditional approaches to valuation are nearly worthless. That's where advanced approaches for assessing value and risk come into play—things like Monte Carlo simulation, decision analysis, and real options.

A good model can add clarity to an investment decision and help you make a more compelling offer. It can also serve as the starting point for planning integration.

But remember, a financial model is only as useful as the insight it provides. Complexity for the sake of complexity is a waste of time.

What to do

Double-check the critical assumptions in your deal model—assumptions that could blow things up if they're wrong.

Don't worry about integration until the deal is done

Deal-making is hard, but integration is even harder. If you're not careful, it can drag on months after the transaction closes—making it tough to capture the expected value. That's because integration covers a huge range of areas: products, customers, compensation, sales, performance measurement, IT systems, facilities, branding, and more. If things can go wrong, they will.

To increase your chances of achieving desired results, make integration assessment a standard part of due diligence and build integration risk into your financial model. Find out what will happen if your expected benefits fall short by 20%.

What to do

Don't sign anything until you see a detailed integration plan and reconcile "cost to achieve" with ROI.

Before you sign a deal, have your integration team assess the due diligence estimates and commit to the costs and savings. When the deal closes, make sure everyone understands exactly where the benefits are supposed to come from. Hold your team accountable for delivering and tracking those benefits—and know how you'll communicate them on the Street.

While all of this might sound obvious, estimates of benefits are often purposely withheld from integration teams to force them to come up with an "unbiased" perspective. That's a formula for disaster.

This one looks clean. Just kick the tires.

Some companies subscribe to the idea that public companies don't require due diligence. Others cut so many corners that they end up with a bad deal. "Don't worry," they say, "we'll fix it on the back end."

And then there are companies that do just the opposite. They get so bogged down in the details that they lose out to competitors with a higher tolerance for risk, or a different approach for managing it.

To find a happy medium, let value be your guide. Focus on areas that have the greatest impact on value (your financial model can show you where). Also, look for deal-

breakers—hidden risks that are likely to have a material impact on your decision. Dig deep, yes, but don't get lost in the weeds.

The traditional approach to due diligence revolves around finance and taxes. However, operational due diligence—looking into areas such as supply chain, technology, and people—is also important, especially for companies with a broad footprint.

Some say that operational issues are just details that will work themselves out. But more often than not, these details represent the difference between realizing and not realizing targeted results after a deal closes.

What to do

If you haven't found at least one significant problem, you haven't looked hard enough. Focus on the deal-breakers.



It's all about price

In theory, an acquisition is an auction that should be awarded to the highest bidder. But in reality, deals rarely come down to price unless you're lousy at making deals. And while it's true that many deal-makers understand what it takes to get a good deal done, it's also worth reviewing the basics—those principles that most executives already know, but sometimes ignore.

- Build good relationships with important decision-makers and influencers, including owners, managers, and investment bankers. You have a right to ask tough questions, but trying to come across as a hard-nosed negotiator often backfires.
- Understand each party's real needs instead of assuming that money is all that matters. Sellers may be more interested in closing a deal quickly than in securing top dollar. Create a compelling offer instead of just throwing money at the problem.

- Think carefully about your own needs too, and structure the deal accordingly. If you're looking to grow your brand or expand into a new region, make sure those specific goals are reflected in the terms.
- Creative deal-making can help close the gap when buyers and sellers don't see eye to eye. Keep in mind, however, that these creative trade-offs may complicate matters after the deal closes.
- It's okay to pay a premium on a specific opportunity, as long as you know exactly how it contributes to your overall strategy and have a realistic financial plan to make up the difference downstream.

I'll pay any price as long as you agree to my terms.

What to do

Create a list of "must haves" so you know where to hold the line in negotiations.

Customers will love it

Companies always talk about the big benefits customers will get from a planned merger. And sometimes they actually believe their own hype. But in the heat of battle, things don't always work out as planned. All too often, customers are put on the back burner as merging organizations wrestle with operational issues that seem more pressing.

One study shows that neglecting customer issues can reduce revenue by as much as 50% in the four years following a merger.⁵ But it doesn't have to be that way. The same study shows that a customer-oriented approach to merger integration can yield double-digit improvements in revenue and margin growth.

Some things to consider:

- Put customers at the center of your planning. Rationalize products and processes around customer requirements, not internal considerations. Establish a "virtual war room" as the central point for resolving customer issues.
- Keep in touch. Talk to customers early and often, even if you don't have all the answers. Use online surveys, focus groups, suggestion boxes, and more—whatever it takes to stay connected.
- Establish consistent prices. Savvy customers will take advantage of pricing inconsistencies resulting from a merger, cutting into revenue and margins. Others will get frustrated and leave.
- Minimize operational changes. Focus on activities that will ensure your customers a smooth Day One. After that, you can make all the improvements you want.

What to do

Keep your people informed about deals whenever possible. If they don't know what's happening, neither will your customers.

It'll be great for our people, too

Yeah, right.

When employees hear about a merger or divestiture, they naturally assume the worst. Instead of working, they spend their time spreading rumors and wondering whether the company is going to lay them off—or double their workload.

One problem is the sense of secrecy that surrounds many deals. Executives don't want to make a premature announcement that could derail things or create a distraction. Another problem is pace. People involved in

deals feel as if they don't have time to communicate. Before you know it, this silent treatment becomes a bad habit.

The only way to stop the rumor mill and get people on board with a deal is to replace gossip with a compelling vision and hard facts. Although things might make perfect sense to you, don't assume that everyone else in the company shares your vision. Know who counts—both inside the company and out—and help critical talent understand what the deal means for them.

What to do

Don't forget to listen as much as you talk.

Tax? We'll figure it out later

When a deal is in play, most companies treat tax as an afterthought.

Big mistake. There is no such thing as a pre-tax dollar, especially when it comes to mergers and acquisitions.

Most opportunities for creating value through a merger or divestiture involve taxes. And as you know, tax can take a big cut out of every dollar. If you're not focused on those numbers, you're missing an important piece of the puzzle.

How much overhead will a deal really eliminate? How will additional production capacity drive opportunities in new jurisdictions? What will you gain from a combined sales force? How will you drive new revenues and reduce costs?

Where should new people be located? Where should headcount be cut?

Without a clear understanding of tax, you can't accurately answer any of these questions. You won't know how to create the combined structure to achieve the benefits you want. And you won't be able to move money and deploy cash the way you need to—including covering the debt service associated with the deal. The workability of cross-border deals, in particular, can hinge on international tax, especially when the transaction requires deploying or repatriating cash.

All that said, if tax considerations are the only motivation for a particular deal, you probably shouldn't do it.

What to do

Drop the term "pre-tax dollars" from your vocabulary. Pre-tax dollars don't count.



International deals are like domestic deals, except you have to fly more

Virtually every major transaction these days has an international dimension—customers, suppliers, investors, operations, or some other key component. Adding foreign operations into the mix can create extra layers of complexity around governance, risk, and compliance. Here's just a sampling of the new wrinkles you have to watch out for:

- The Foreign Corrupt Practices Act often conflicts with local business practices, making it hard to get things done.
- Information in some markets may be of questionable quality, which means you might have to get creative in finding facts and conducting primary research.

- People issues such as labor practices, pensions, and culture can upend integration plans if you're not careful.
- Some contracts may not be enforceable in other jurisdictions.
- You may need a phased closing because of special requirements in different jurisdictions.

Tackling these types of issues requires local experience and knowledge, not frequent flyer miles. You'll need knowledgeable people on the ground in all jurisdictions—people who know your business, your industry, your goals, and your objectives.

What to do

Cancel your team's international flight reservations—unless they're going to meet with local specialists living in the country you'll be operating in.



It's not personal

One way or another, every major transaction will end up on the CEO's desk. But that doesn't mean the CEO should carry the whole burden of the deal alone.

Work together. Keep in touch with your board. They share your risk, and they may even have insight to offer. Make sure you—and they—understand the reasons for doing every deal (see M&A Lie No. 2).

Engage your entire leadership team. That's how you get control of all the parts and pieces. Leave the wrong person out—and you'll leave a stone unturned. It might not be an important stone. But then again, it might.

Effective acquirers have deal-making down to a science—with a touch of art thrown in for good measure. That's where it gets personal.

What to do

Read this book again.

What to do

We've given you a lot to think about—and plenty of areas where you can take specific actions. Here's a summary of the "What to do's."

- 1 Take the M&A readiness quiz on page 4.
- 2 Write down the five most compelling reasons for doing your next deal. If the reasons change, pull the plug.
- 3 Use scenario planning to develop options. Include a range of economic assumptions.
- 4 Take a look at the list of deals in your pipeline. What have you done this week to push the most important ones ahead?
- 5 If divesting, know exactly what you're selling.
- 6 Double-check the critical assumptions in your deal model—assumptions that could blow things up if they're wrong.
- 7 Don't sign anything until you see a detailed integration plan and reconcile "cost to achieve" with ROI.
- 8 If you haven't found at least one significant problem, you haven't looked hard enough. Focus on the deal-breakers.
- 9 Create a list of "must haves" so you know where to hold the line in negotiations.
- 10 Keep your people informed about deals whenever possible. If they don't know what's happening, neither will your customers.
- 11 Listen as much as you talk.
- 12 Drop the term "pre-tax dollars" from your vocabulary. Pre-tax dollars don't count.
- 13 Cancel your team's international flight reservations—unless they're going to meet with local specialists living in the country you'll be operating in.
- 14 Read this book again.

The truth?

Whether your goal is to conquer your industry, diversify your business, or just get back to basics, you're likely to be involved in deals. M&A is here to stay. You might as well get good at it.

- 1 "The Big Deals: Promises Unfulfilled," *Chicago Tribune*, March 2001.
 - 2 Deloitte Research and EIU study. "Strategic Acquisitions Amid Business Uncertainty: Charting a Course for Your Company's M&A," November 2007.
 - 3 Gerry McNamara, Jerayr Haleblian, and Bernadine Johnson Dykes. "The Performance Implications of Participating in an Acquisition Wave," *Academy of Management Journal* Vol. 51, No. 1 (2008).
 - 4 Michael E. Raynor. *The Strategy Paradox* (New York: Currency Doubleday, 2007).
 - 5 Deloitte Consulting study. "M&A—Sales and Marketing Effectiveness Evaluation," April 2006.
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About this book

M&A Lies (And why they're sometimes true) is the ninth in a series of books dedicated to helping companies improve performance. To request additional copies of this book or to order previous editions, go to deloitte.com/straighttalk.

Talk to us

We look forward to hearing from you and learning what you think about the ideas presented in this book. Please contact us at M&ALies@deloitte.com.

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