# HOW TO MAKE YOUR MERGER UNSUCCESSFUL

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There are various statistics from around the world which indicate that approximately fifty percent of mergers fail to meet the objectives which were expected, planned or hoped for them. I must say, however, that I have seen corporate groups making acquisitions where I would suggest that their failure rate has been as high as ninety percent - that is in ninety percent of their acquisitions they haven't achieved what they thought they would achieve.

Speaking in rather general terms, if about fifty percent of your acquisitions fail, so that you have one successful acquisition and one not successful, you may not be very far wrong if you feel at the end of that particular set of exercises, that you are about square. As a result I counsel people to hasten very slowly in making acquisitions.

Now if I'm so smart in telling people that they will have trouble in making acquisitions, maybe I'm smart enough to give the reasons why. Let us not look at it in that personal way, however, because what I intend to do this afternoon is to give you my understanding of what other people have said on the matter.

I see three major reasons for difficulties arising in a merger or acquisition. The three major difficulties - and these are expanded by some writers into maybe eight, ten or twelve points - are quite separable matters.

The first one relates to <u>corporate planning</u>. Your acquisition is part of your corporate plan, not something unrelated to it or separate from it or ancillary to it: it's part of it. I'll deal with this more extensively in just a moment. But first of all let me say that if your acquisition is not in line with your corporate plan, then you are looking for trouble. The statistics indicate you will get trouble.

Having properly decided that a particular target company is within your corporate plan of development, you may nevertheless get into difficulties through an inadequate, incompetent or insufficient <u>investigation of the target company</u>. Even if the target company fits into your plan, in other words, an incorrect investigation of what it is will leave you with headaches.

Thirdly, assume that we have looked at our corporate planning and have investigated the target correctly, what is the third way of getting into difficulties? Simply put, you never acquire assets, you really acquire <u>people</u>. The cynics say that you acquire people-problems. They are what you hope not to acquire. So many people in the last three or four years of writing throughout the world have made "people" their number one consideration, as they say. I can tell you specifically that if you ignore people-considerations in your acquisitions, no matter how well you have corporately planned and how well you have investigated the target, you will certainly be heading for trouble.

There are thus three areas of difficulty: inadequate planning, insufficient investigation of the target company, and incompetent handling of people-problems.

Acquisition is one way of growing. There are two broad ways of growing. Of course you can expand internally; that is expand through your own resources. You may put on more people, have more stocks and more work in progress and you bring in more plant. You can grow internally. On the other hand, you can grow by making an acquisition. Acquisition has been described as indicating the concept of "planned approach to growth by acquisition". So what you hope to do by acquisition is to save time. You develop to the stage that you would like to be developed to, only more quickly than you otherwise would if you were expanding and through the infusion of resources. So in all cases you are contemplating the difference between buying and building.

Let me make it very clear to you that I have become less enamoured recently of the supposed benefit of acquisition and take-over. More and more I am going over to the type of approach which was very extent in the United States some years ago - the desire of corporations to expand internally rather than to acquire, where they had the alternative.

However, if we are determined to acquire, we look at our corporate plan to start with. To get away from the first of the above problems, we say "no acquisition is to be made unless it fits into our corporate plan". Ask a great number of company chairmen in this country if their companies have corporate plans. They will say "Yes, of course we have". You then say "What is your plan?" and that is the end of the conversation! That's one of the major problems - that you cannot make an acquisition and expect it to be successful unless it conforms with your long term corporate plan. The people who have recognised this, you will find, usually have their mergers and acquisitions division as part of their corporate planning division. It also appears that the people who don't have a corporate plan can only have a haphazard or accidental approach to selecting their acquisition targets.

Therefore, if you have no corporate plan I cannot see how you can make an acquisition and seriously expect it to fit in with your long-term programme. If you do have a corporate plan, no acquisition should be made unless it conforms with the requirements, with the boundaries and with the projections of that corporate plan. One article published in the Harvard Business Review refers to the difference between "reactors" versus "planners" - those people who "plan" their acquisitions as part of their corporate plan inevitably fare better than people who "merely react to opportunities to purchase".

Therefore, the major question that you consider in the first place is: what is your corporate plan? This is a question which you cannot answer until you have decided, as Willard Rockwell of North American-Rockwell has said: "What business are you in, what business do you want to be in?"

Some time back I was asked to consult with a gentleman who had a large sum of money sitting in the short-term money market. I went out and he said to me: "We thought perhaps you could tell us what to do with this money. We'd like to make an acquisition." I said: "What sort of things would you like to acquire?" He said: "We don't really know; that's why we called you in." I said: "What is your corporate plan?" He said: "That's the trouble, we don't have one and we thought that you might be able to give us some ideas that will help to structure our corporate plan." I could help by consulting with him extensively and with his board, but this is something which that board should itself have done. Until you can define what business you want to be in, and also what business you are currently in, then it is not sensible even to contemplate acquisition.

I've referred to the Harvard Business Review and to the difference between reactors and planners. The author goes one stage further, in the article to which I referred by saying "Experienced acquirers have evolved valuable techniques for cool appraisal." Does the proposed acquisition fit into the corporate long-term plan or does it not? If it doesn't, you don't mould it, push it, shove it and do all sorts of other things with it. You discard that proposed acquisition. I've sat in at board meetings, in many cases as a legal advisor, when it was reasonably clear that the proposed acquisition didn't quite fit in with what everybody wanted. One member of the board says: "Well let's give it a try" and another one says: "Well, I suppose it will be alright". Another one says: "There could be some hidden advantages in this." They then vote to make the acquisition and expect success.

I therefore repeat: no acquisitions unless they fit in specifically with a defined part of your corporate long-term plan. No acquisitions at all if you have no corporate plan!

Let us assume that we've looked at the target company and are properly able to say that it is part of our long-term plan that we expand into the particular business activity of the target company. We must now investigate that target company.

On this aspect, I was impressed by the words said to me at the early part of the proceedings to-day by a new member of the Institute. He told me that he had adopted a most cynical attitude in looking at a proposed acquisition. His words were very well put, and in essence they indicated the attitude that if one is very cynical in his investigations then the chances are that he will be less disappointed! Now the only way to be effectively cynical is to know what to be cynical about; and therefore to be quite specific about what one is looking at. In short, having found the target company one begins properly to evaluate it.

Traditionally in this country, as in the United Kingdom, evaluations of targets have been made by chartered accountants. Recently in the Australian Society of Accountants monthly journal, one member wrote, stating that accountants were singularly well-placed to give advice on mergers and acquisitions and specifically to make the necessary investigations. My opinion is that generally they are singularly very badly placed! A book which I have written will be shortly available to the reading public. It is entitled "Appraisals of Companies" and deals with how to appraise companies whether it be for bank loan purposes, monopolies commission investigations, companies office investigations, merger and acquisition investigations and so on. There are thirty-five chapters in the book, yet only three of those deal with the usual finance aspects.

Because the finance aspects and the accountancy aspects are so small a part of the overall required investigation picture, the concept has arisen of the use of the investigation "team". No one individual is so smart that he can determine and evaluate the various ramifications of a business on his own. Accordingly, the use of the investigation team has become accepted. The investigation team can consist of a number of people. Subject to the problems of secrecy, and other similar considerations, it can be a fairly large size. Certainly it will contain finance people - financial analysts rather than accountants - and it will contain a lawyer. It will also have any number of other people who may be involved in understanding what is being investigated. Labour relations people, consulting engineers, consulting architects, consulting geologists are all possible members of the team. All sorts of people may be required to be part of that team - marketing men and people who are skilled managers. For example, if an acquirer is going to take over a producing organisation which employs thirty thousand people, then he must have at least one person in the team who can consider the management implications, the labour relations implications and other applicable personnel considerations.

Clearly, one of the biggest problems in an acquisition is to make an adequate examination of it beforehand. It stands to simple mathematical reasoning that if one is to spend twenty thousand dollars to make an investigation of something which is going to cost him two million dollars to purchase, then the twenty thousand dollar cost is a cheap insurance premium.

Much of the information required to complete an investigation is difficult to obtain and sometimes is obtainable only through some form of "industrial espionage." Industrial Espionage is best illustrated in the story of the gas company employee who was given a gold watch in return for twenty years faithful service. The watch was given to him at a dinner given in his honour by the

Electricity Trust! This sort of story is not too unusual nowadays and the recent mining boom has produced some rather fascinating stories.

It is interesting to note how many people look at acquisitions as if acquisitions or mergers are necessarily expected to be an advantage. I'd like also to talk about the problems of making an acquisition and about the disadvantages. Too many people consider only advantages of an acquisition and none of the prospective problems. Something that has developed from this critical type of approach may be of interest to you. I recommend, where there is an investigation team of any size, that one man in that team be given the job of "Devil's Advocate". I came across this concept by accident in that I was connected with one team, in which there was an ultra-cynic. Every time somebody else said something good about the prospective acquisition, he'd say: "How do you get that? Don't believe you. It doesn't sound right." In the end, his attitude forced the others in the team to prove their assertions, or at least to attempt to prove them. This resulted in a clearer understanding of the whole picture in everybody's mind.

The investigation team looks not only at the finance aspects, but at all sorts of other considerations relating to the investigated enterprise. For example, I saw one cartoon some years ago in which a man making an investigation of a target company for a merger asked the man on the other side "What is yourfastest moving item?" "Personnel", replied the prospective vendor. Last week, I was talking with a gentleman who had spent a sizeable amount of money in buying into a swimming-pool building corporation. It hadn't gone so well and we were just discussing the various approaches that could have been adopted. He said: "You know, all I should have done was to go out and have a look at some of their products and ask some of the people who already had them, were they satisfied. Half a dozen personal calls would have told me not to get involved, no matter how good the accountants said it looked." Similarly, if somebody says to you that the products of a target company are good but the after-sales service is poor, then you've got some real thinking to do as to the desirability of making the acquisition.

Examples of the importance of a full investigation are easy to give. One company acquired another company and then found that it had two incompatible computers on its hands. One company took over a company where the superannuation scheme for the employees generally called for seven and a half percent contribution by the employee and fifteen percent by the company. Just a little bit of investigation in each case would have exposed the above problems.

One company was acquired by an American corporation about three years ago. When the American corporation came in, it found that one executive had not had holidays for twenty eight years; another had not had holidays for twenty years. What does an acquirer do in such a case? Does it pay or not? In this case, it cost the acquirer twenty thousand dollars; that was a cheap alternative to having a large number of dissatisfied acquired executives to contend with.

If you are in a manufacturing industry and you are paying your process workers $1.40 an hour and you acquire another processing corporation which pays $1.25 an hour, then you as a manager will know that the first recalculation you'll have to make is for an immediate upgrading of the hourly labour rate cost in the acquired company to $1.40. Therefore your investigation will make an appropriate notation.

These are the sorts of considerations that often appear very small. The point is to amalgamate then, to collect them, to take notice of them in assessing what you expect you will obtain from your acquisition.

The examples I have just been taking about are intended to give you practical examples of the problems you can expect with a takeover or an acquisition. They are types of problems which you go looking for. Nobody tells you about these problems in advance, but if you don't calculate on them, then your return on investment is very likely to be less than you calculated. It certainly pays to make careful investigations; and by careful investigation I mean a wide one, not just the accountancy one - that often doesn't tell you very much at all.

There is one thing certain in making an acquisition: on the date of settlement of an acquisition, the acquired company will be different from what it was on the very moment before the settlement. It what way it is different is hard to judge initially - it may be better, it may be worse, but it will be something quite different. There's too much attention paid to the purely accountancy data in an acquisition and not enough to some of the other far more important considerations, all of which have had their individual effects on past accountancy results and which will have quite serious implications on the results in the future.

Yet it is these other considerations that you attempt specifically to determine by your wide investigation. I therefore stress again the importance of the investigation team.

Let us now assume that we have had a look at our acquisition. It conforms with our corporate plan. We have carefully investigated it. We have looked for "the strengths and weaknesses" as one writer has said, and not just for the strengths. And we have made the acquisition.

No matter how well we have prepared ourselves on the first two considerations, (i.e. in corporate planning and in investigating) our real problems start on actually making the acquisition. As has been said before, one does not acquire assets, one acquires people.

"Make people your number one consideration", says one writer. "People-problems" says another writer. Literally, a score of examples could easily be given to illustrate the variability and intensity of the personnel problems attendant on a merger or acquisition.

People-problems are related to both line and staff personnel. The trick in an acquisition is to have the organisation running better after the acquisition than it was before. Yet the organisation can only run on people. Your major problem is that if you do anything to demotivate the people you have acquired, then you must immediately break down the momentum of profit in the acquired structure.

On the other hand, as an example of calculated motivation, I quote the case of a New Zealand company where the acquirer called for an advance list of all personnel in the target company. The salary and wages figures were scaled according to size and the median figure was determined. On the date of acquisition, the person on the median figure was given five dollars a week increase in his salary, and everybody else got a proportionate increase, bigger or smaller than five dollars. The acquirer subsequently said to me "We've had to stand back out of the way ever since - we're being steam-rolled by profits". That is a wonderful example of motivation of personnel in an acquired enterprise, but it is not always so easy. In fact, motivating personnel in such a case calls for several ingredients, including luck.

To conclude, it is important that you assess your target in relation to your corporate plan, and that you properly investigate your target. In any case, if you ignore or do not adequately and carefully deal with the "people" element in your merger or acquisition, it may be hopeful or even fanciful to expect later success.