



The Right Way – and Some Wrong Ways – to Make an Acquisition

Some mergers, like marriages, are made in heaven. The union of two companies augments revenues, boosts profits, generates shareholder value – and wins applause on Wall Street. Other mergers – also like marriages – are made in hell. Turf battles break out, management deadlock ensues, revenues fall, the stock plummets, and inevitably a slew of shareholder lawsuits challenges the ill-matched combination. The hard part, of course, is being able to predict ahead of time which scenario will play out after an acquisition.

The challenge in making an acquisition work – which determines whether the future will be heavenly or hellish – is managing the process correctly. This involves paying close attention to factors ranging from setting clear-sighted goals and knowing what to look for during due diligence to recognizing the circumstances in which it makes sense to walk away. While there is no golden nostrum that suits all situations, experts at GE Capital and the University of Pennsylvania's Wharton School explain that focusing on a few basic principles could greatly improve the chances of making a merger succeed.

Choosing a Target

Assuming that a company has decided to embark on an acquisition strategy, how should it identify a target? That question can cover a range of possibilities from cutting-edge opportunities to distress situations and everything in between.

In selecting a target, companies should consider whether the acquisition would let them extract value in three ways. First, the takeover should make it possible to lower costs through economies of scale and better cost management. Second, the acquisition should be able increase the combined company's market power by spreading the stronger brand name over a wider product or service base. And third, the takeover should help the acquiring company change the competitive game. Harbir Singh, a professor of management at Wharton, explains that Cisco Systems has pursued the last strategy with considerable success. "Cisco recognized that it could not be innovative in every technology, so it built its technological base through acquisitions," he notes. Cisco reportedly has acquired some 40 companies in six years.

From Due Diligence to Integration

Once a target has been identified and a deal has been initiated, the critical phase of due diligence begins. A crucial objective at this stage is to spot potential deal-breakers, or issues that are so serious that the proposed acquisition would have to be abandoned. According to Singh, one reason why



many acquisitions flop – or fail to deliver on the promises envisioned by their architects – is that “executives fall in love with the acquisition and want it to work at any cost.” That mindset is often a recipe for disaster.

John Lanier, a Quality master black belt in the Access GE group of GE Capital’s Commercial Finance unit, points out that errors during the due diligence phase are rarely technical. In fact, most people who manage takeovers for a living do a competent job of technical analysis. “The reason why the prognosticated value fails to appear in many cases is that people fail to pay enough attention to cultural factors,” Lanier says. “That is why many acquisitions flounder – because of the people side, the soft side. That is the reason for failure in three out of five cases.”

GE’s discipline for managing acquisitions is rigorous in this respect. “We platoon a large cadre of due diligence professionals, and we try to cover all bases,” Lanier says. “We consummate about two acquisitions a week at GE, so acquisitions are a compelling part of our growth model.” As a result, GE has refined its acquisition tactics over time and ensured that it looks at more than numbers when it takes over a target company.

What factors does GE examine when it acquires a company? Among them: The target company’s market position; its products or services; the degree of customer satisfaction with these products/services; the uniqueness of the product/service line; and potential threats to or weaknesses in the product/service line. “In short, we look at how viable the company is,” Lanier says. Since the goal is also to integrate the acquired company into GE, a lot of time is devoted to examining how to ensure a smooth integration of cultures. This means paying close attention to people issues. “If people are not united around a common vision, and they don’t understand their individual roles, responsibilities, measurement systems and reward systems, the confusion that results can be both demoralizing and inefficient,” Lanier notes.

In practice, this means that when GE targets a company for acquisition, it names an acquisition integration manager whose full-time responsibility is to integrate both organizations. This executive acts as the liaison between the acquired company and the business leader at GE who is responsible for the acquisition. So vital does GE consider the integration manager’s function that the individual is identified well before an offer letter is sent to the target company. This lets the integration manager become familiar with the target company, while also ensuring that if an offer is made and accepted, GE can hit the ground running. For example, the integration manager can be prepared with a communications plan that announces the takeover to employees and answer their questions. “We have learned over time that it is best to be proactive,” Lanier says.

Another non-trivial aspect of managing the human side of acquisitions is coping with executive egos. These are generally dealt with during the



negotiation process. Unless this is done, an acquisition can fall apart for as seemingly trivial a matter as whose name is on a certain parking space. Such horror stories abound in Corporate America.

Some Common Errors

Wharton's Singh points out that one of the most common mistakes companies make in planning and executing an acquisition is poor due diligence. Another common error is overestimating – and over-valuing – the potential synergies that the combination will bring about. "When an acquisition is made in an auction-like atmosphere, where several potential acquirers are bidding for the same target, it is easy to make this mistake," Singh notes. Among the examples he offers of a merger that is widely believed to have gone awry is the one between Chrysler and Daimler-Benz. Although it was once hailed as the union of two world-class auto makers, the Chrysler operation has been hemorrhaging cash, many former Chrysler executives have quit or been fired, and the company has announced massive layoffs. "The company simply did not have a well-developed post-integration strategy," Singh adds.

GE's Lanier identifies several potential pitfalls. Among them:

1. **Lack of a compelling strategic rationale.**

This tends to happen if a company is caught up in a hot M&A market. Its leaders may begin to feel that since they aren't involved in a merger, they don't measure up – and embark on a merger largely to gratify their egos. They may end up buying a company that makes no sense at all. This happened during the 1970s when "diversification" was the buzzword du jour. Some heavy manufacturing companies got into services that had little or nothing to do with their core operations. A farm implement company, for example, entered the office furniture business –eventually with disastrous results. The first question to ask, in order to avoid making this mistake, is: "Why am I doing this?"

2. **Inadequate due diligence.**

This means that some significant aspect of the business did not get disclosed or understood during the due diligence phase.

3. **Unrealistic expectations or excessive price.**

The leveraged buyouts of the 1980s offer a good example of such acquisitions, especially in the retail sector. Several of these companies, which went private at high levels of debt, had to go through bankruptcy before they could find viable operating models.

4. **Failure to integrate expeditiously.**

One reason why GE appoints a full-time manager to oversee integration each time it acquires a company is to speed up the process. Depending on the size of the target company, the integration process could be as short as a month, or as long as a couple of years. Still, it is important to



prioritize things that are most important – and to lay out milestones of who will do what by when. The point is to do this as rapidly as possible, and with a sense of urgency and “without ever, ever, ever losing customer focus,” says Lanier. “The customer couldn’t care less how long it’s taking you to integrate. What they want to know is if they can rely on you as a vendor. Anything that threatens that relationship threatens your enterprise value.”

5. Lack of shared vision.

It is common for acquiring companies to have a different vision and philosophy than the companies they have bought. This is often overlooked. “Assumption is the mother of all disaster,” says Lanier. When people aren’t on the same page, it gets in the way of achieving common goals.

6. Conflicting corporate or national cultures.

Americans, for example, are regarded as aggressive, cut-to-the-chase kind of business people, and some national cultures may regard such a style as being offensive. Every culture has its own mores, and it is easy to offend people out of ignorance. On a corporate level, companies may have autocratic environments or empowered environments. A company with an empowered environment will probably be more successful buying one with an autocratic environment rather than the other way around.

7. Not investing adequate resources to consummate the transaction.

Acquisitions don’t just happen. Enough resources must be provided to those trying to integrate the organizations of two companies to do their jobs effectively. While this is more easily done in large organizations than in small ones, it is a critical issue that must be addressed.

Some Ground Rules

Lanier offers some concluding rules of thumb for executives responsible for overseeing acquisitions. “Integration is a process, not an event – in much the same way as personal development is a journey, not a destination,” he says. “Integration begins with due diligence, though many companies don’t do it that way. Some organizations wait to buy a company before they address how to integrate it into their existing operations. That is an error. It is crucial to anticipate, and to get integration managers involved as early as possible. The choice of the integration manager is critical, because that person must have the trust and confidence of both the acquirer and acquiree. Roles and responsibilities must be established early. Get the buy-in of the CEOs of both acquirer and acquiree organizations. If you have to make tough decisions – such as letting go some senior managers – make them early and handle them professionally. Don’t let them fester. And finally, recognize that the soft, people issues will always be more challenging than the hard, operational ones.”

