

Why Do They Do it : The Strategic Motivations

The tribulations of some merger or another provide a constant source of material for newspapers and business magazines. The ups and downs, the mind-blowing figures, the breathtaking flops. There is no shortage of action on the M&A stage. To better understand some of these real-time dramas, it may help to step back and observe the dynamics that drive mergers. Indeed, no two mergers are alike: each involves its own set of issues, challenges and motivations.

Over the past decade, Bain's analysis of M&A's that lived profitably ever after -and those that met with less happy endings- has yielded some interesting findings. Among them, the conclusion that all merger transactions, large or small, unions of equals or outright take-overs, can be clustered into six distinct strategic categories.

1. ACTIVE INVESTING

Leveraged buyout companies and private equity firms acquire a company and run it more efficiently and profitably as a stand-alone firm. Typically, these transactions improve performance through financial engineering, incentive compensation, management changes, and stripping out costs.

The purchase and restructuring of GartnerGroup by private equity player Bain Capital (a company independent of Bain & Company) illustrates the power of active investing or "squeezing the lemon." By narrowing its scope from an array of media and consulting services to a tight focus on valuable technology data, Gartner became a premier broker of computer information, its margins expanding from 10% to 30%.

However, active investing is truly the domain of leveraged buyout and private equity firms. Corporations need a more strategic rationale.

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2. GROWING SCALE

Mergers most often aim to grow scale, which doesn't mean simply getting larger. Rather, success requires gaining scale in specific elements of a business and using those elements to become more competitive. For instance, if the cost of materials drives profit, then the scale of purchasing activities will be key.

If customer acquisition is more important, then channel scale will be critical. Getting scale-based initiatives right requires the correct business definition and the correct market definition. That is rarely easy because, over time, the definition of scale in an industry can change dramatically, especially during recessionary times when demand shrinks.

In acquisitions seeking to gain scale, pre-merger planning can be done "by the numbers." One can, in advance, calculate goals for combined market share and cost reduction, plan steps to achieve them, and create measures of performance. That type of merger places great demands on a chief executive's ability to cope with complexity. The task may not be easy but at least the leader can craft a plan before the transaction and execute it after the merger.

LEADERS CAN MAKE OR BREAK A MERGER

Beyond the motivation behind a merger, or the approach chosen to tackle it, its success ultimately depends on sound leadership. Here are a few core characteristics of top-notch merger leaders:



A leader must establish and communicate the strategic vision for the merger and must convincingly answer the central questions: "why are we doing this" and "what do we plan to achieve" for both the company's external and internal audiences.



Successful leaders must cheer on the troops to generate enthusiasm for the merger or acquisition and to confront fear and uncertainty in their various forms.



Leaders must close the deal. That seems obvious but it is not a given. One in five deals falls through after it is announced, sometimes because of regulatory issues, other times because leaders fail to resolve outstanding disagreements.



Successful leaders must captain change by managing the integration of the two entities. The CEO owns the action plan that outlines milestones and deliverables for the teams who are responsible for integration. What's more, the captain defines the "rules of engagement" i.e. the basis on which the two companies will start to work together.



Leaders must crusade for the new entity. Crusading roots itself in the second task -building enthusiasm- and develops momentum as the deal closes and the integration progresses. This means dispelling inertia and encouraging people into actions consistent with the overall strategic vision. The crusader must provide guidance on how to behave and set both hard and soft targets for performance. When crusading for changes in behaviour, he or she must lead by example.

ration behind Today's Mergers

3. BUILDING ADJACENCIES

The next most common impetus for mergers and acquisitions is to expand into highly related or adjacent businesses, as Viacom did by buying broadcaster CBS. That can mean expanding business to new locations, or into new products, higher growth markets, or new customers. But most importantly, the additions

Examples also abound in Internet hardware, where equipment maker Cisco Systems made 18 purchases in 1999 and 22 in 2000. At those firms, growth strategies include major ongoing investment to scan for new product concepts or technologies. For most, organic development would be too expensive, too slow and/or would diffuse the focus on their existing businesses.

Despite being hit hard in 2001 by the downturn in the telecom sector, Nortel has become a contender in Internet equipment sectors.

6. REDEFINING AN INDUSTRY

Sometimes a bold strategic acquisition can redefine an entire industry, changing the boundaries of competition and forcing rivals to re-evaluate their business models -the AOL Time Warner mega-merger was set up to do just that. But in those bold mergers, the numbers may not be as precise. The companies involved will have a post-merger model for operations. However, the model will change as industry rules change and as competitors react.

In such a profoundly uncertain environment, vision is critical and must come from the top of the organisation. A strong leader must cope with flux by confidently and effectively communicating the strategy and the vision. The post-merger integration plan will have to be much less detailed and much more flexible than that of a scale transaction, leaving room for leadership to adapt its message to a rapidly evolving competitive environment. ✨

The above was extracted from an article entitled "The Leadership Testing Ground" published in the Journal of Business Strategy, April 2002, by Orit Gadiesh, Chairman of Bain & Company, Robin Buchanan, Senior Partner in Bain's London office, Mark Daniell, Bain Director based in Singapore and Charles Ormiston, Managing Director of Bain's Southeast Asia operations.

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should be closely related to a company's existing business. Chris Zook, in 'Profit From the Core', provides empirical evidence that expanding into closely related businesses through acquisitions drove some of the most impressive success stories of sustained, profitable growth in the 1990s: GE, Charles Schwab, and Reuters, to name a few.

4. BROADENING SCOPE

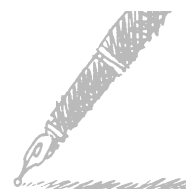
In mergers geared to broaden the scope of products or technologies, a "serial acquirer" systematically buys expertise to accelerate or substitute for a traditional new-business development or technology R&D function. That acquisition model -successive deals to broaden scope- has been used successfully in industries such as financial services. For example by GE, where new chief executive Jeff Immelt recently reaffirmed his desire to make acquisitions in Europe.

5. REDEFINING THE BUSINESS

Deployed strategically, mergers and acquisitions can redefine a business. That's an appropriate strategic rationale when an organisation's capabilities and resources grow stale very suddenly due to, for example, a major technological change. In such cases, a firm cannot quickly refresh its technology or knowledge by making internal investments and incremental adjustments.

When telecom equipment provider Nortel Networks embarked on a strategic shift towards Internet-based infrastructure, it relied on a series of acquisitions to make it happen. Nortel made a string of purchases from the late 1990's onward, migrating from supplying switches for traditional voice networks to supplying technology for the Internet. John Roth, then Nortel's chief executive, called it the company's "right-angle turn."

WATCH
THIS SPACE



Telecom Upstarts Can't Act Like the Big Boys

Why did WorldCom and other challengers to the telecom industry's status quo fall off the growth curve? The answer is tied to a fundamental difference between the cost structures of newer challengers and the big incumbents. The old telecom giants find their costs evenly split between fixed and variable costs, which means revenue growth tends to buy margin improvement. Newcomers like WorldCom tip more steeply toward the variable cost side -roughly two thirds of their spending. Here, undisciplined growth can lead to a sea of red ink.

Rather than assume that any growth is good, telecom players need to treat growth selectively: what's the real cost of the next dollar of revenue? What's the right price?

In a changed industry, young telecoms cannot assume that growth will automatically drive margin improvement. They must be realistic about the cash-flow outlook and they shouldn't benchmark their performance against the financial ratios of industry behemoths.

Excerpt from The Wall Street Journal, July 2002, by Chris Harrop, Vice President Bain & Company Sydney and Vernon Altman, Director of Bain's Telecom and Technology Practice.