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Organising for deal success

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The recent stock collapse of some high-profile deal-makers has led many executives to pull back from mergers and acquisitions (M&As). But a Bain & Company study has found that the companies most successful at creating long-term shareholder value tend to make acquisitions constantly through boom and bust. The most successful deal-makers are companies that shop frequently, use dollar-cost averaging to identify opportunities instead of trying to time the markets, and mainly buy companies a fraction of their size. They build experienced deal teams that get involved in all acquisitions, they commit line expertise, and they always set a walk-away price and prepare to leave the table if the deal's economics fail to make sense. The multinational food company Nestlé provides one example of how the best acquirers can create value.

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Fully seven out of 10 mergers fail. They fail to create any cost savings. They fail to create any significant merger synergies. Often, they fail to keep the jobs of the merging CEOs.

If successful mergers were all about luck, it might be better to head to a bookmaker and put your merger money down on the football team playing against Manchester United. Fortunately for merger chiefs, luck isn't the only thing involved.

In a Bain & Company study of deals made over 15 years by 1700 companies based in the Group of Seven industrialised nations, we found three practices tilted the odds in favour of the most successful deal-makers. Acquirers that consistently performed best were companies that shopped frequently, used dollar-cost averaging to identify opportunities instead of trying to time the markets, and mainly bought companies a small fraction of their size. (Mergers of equals are tougher bites to swallow.)

So, how do we reconcile our finding that frequent acquirers outperform wallflowers with the well-researched fact that most deals fail? Part of the answer has to do with the fact that we evaluated acquirers rather than individual deals. What we found was that certain kinds of companies, such as those that acquire frequently, beat the odds through discipline.

Our research reveals a central tenet of the deal world: dramatic M&A results are achieved from decidedly straightforward and intuitively logical practices. But the truth is, those practices — buying frequently, buying through good markets and bad, and focusing on doing the little deals that can slowly lead to bigger deals and bigger results — although not exactly the stuff of a Hollywood screenplay are hard work. When companies start doing deals without thinking, the results are grim.

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You can divide the world of deal-makers into those who discipline their deal-making process, and those who essentially roll the dice each time they acquire.

In fact, when enough companies suffer dire consequences as a result of bad deals, people become afraid of doing deals at all. Take the earnings debacles at frequent acquirers like Tyco and WorldCom, now reborn as MCI. The meltdown in shareholder value at these and other high-profile deal-makers has caused many a board to muzzle aggressive M&A strategies. At first blush, the reasoning is hard to fault. These fallen angels were the poster children for growth via acquisition. Their success was inextricably linked to their voracious appetite for deals. Therefore, the logic goes, their failures must discredit M&A.

We saw this kind of thinking at the end of the go-go 1960s and then again after the junk-bond-financed deal frenzy of the 1980s and the dot-com frenzy at the turn of the millennium. Investors and management teams beat a hasty retreat from M&A when the economy dipped following these eras.

Veteran acquirers know better than to head for the exits.

For such companies, acquisitions are an integral element of their growth strategy. They understand that acquisitions are critical to building scale and adding new competencies. They also understand that it is very difficult to meet investor expectations for growth organically: they need acquisitions to meet their targets.

Granted, M&A is a tool that requires practice to master. Acquirers should start with small, lower-risk deals, build an organisational capability, institutionalise the processes, and create a feedback loop to learn from their mistakes. Over time, as companies refine their organisation and processes, they can graduate to larger deals and move into opportunities adjacent to the core business. In that respect, committing the time and talent needed to *organise* for opportunities is the crucial decision that gives companies the ability to dispassionately discipline respective deal decisions.

There are three components that stand out in a disciplined deal-making process:

- *The people who make deals happen*. The winners build a standing, experienced deal team that gets in-volved in all acquisitions. This allows the company to create opportunities proactively or to strike rapidly when the right deal becomes available. The team is responsible for creating formal procedures for the process, with clear guidelines for the purchase and integration of acquisitions. The team updates its codified guidelines at the end of each deal through a post-mortem.
- *The people who evaluate opportunities*. Best-practice acquirers make sure that line management – the people who end up with the job of absorbing the new company – get involved early, and often, in all parts of the process, from the decision to buy, to the estimation of synergies, to the integration itself.
- *How the acquirer prepares to walk away*. The most successful acquirers always set a walk-away price and dispassionately prepare themselves to leave the negotiation, even at the last minute, if the deal's economics fail to bear out. They insist on high-level approval and put in place a decision-making process that clearly delineates who in the company recommends deals, whose input should be solicited and who decides yea or nay in the final instance. And they often use the compensation system to ward off ill-considered acquisitions.

We asked Joe Trustey, a managing partner of top-tier investor Summit Partners, why he thinks private-equity buyers have an edge in diligence. 'All we do is buy and sell companies,' he said. 'If you look at the corporate M&A departments at the Fortune 500, very rarely do you have an organisation that stays together for 20 years. People shuffle in and out.

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I'm 100% focused on what I do. I won't be going off to run a plastics division.'

On effective corporate deal teams, decision-making roles and responsibilities are crystal clear. An organisational design tool we frequently use to achieve such clarity is called RAID. 'Recommend, Agree, Input, Decide' codifies individuals' roles in contributing to or making decisions. RAID makes sure that only one person is on the hook for any given decision but that the right parties have a voice at the right time in making recommendations (Recommend), agreeing on the course of action (Agree), providing the input to vet a decision (Input) and before the decision (Decide) is made.

Nestlé is a great example of a multinational company that successfully creates value with deals, using those four principles. The largest food company in the world, with about 500 factories in more than 80 countries, Nestlé has made over 50 acquisitions since 1985. Initially, Nestlé's growth strategy used acquisitions to diversify the company's product offering. Then, in the early 1990s, it used acquisitions to expand geographically. More recently, Nestlé has used acquisitions to grow a select number of very attractive businesses in markets where it can achieve leadership positions.

Like most successful acquirers, Nestlé has a core deal team that is in charge of all acquisitions. This team works with groups in the legal and tax departments that have accumulated considerable M&A experience.

Every year, Nestlé's senior management team sets targets and strategies for its strategic business segments. The M&A team begins its work here by evaluating how M&A can help each business unit achieve its objectives.

Nestlé not only pulls operations people into the acquisition process but, in fact, requires it. James Singh, Nestlé's head of acquisitions and business development, describes how the process works:

> The people in the geographic zones and the strategic business units become part of an M&A team that we put together. We try to get the requisite competencies. More importantly, we make sure that the people who are going to be running the business are an important part of the team that acquires the business. On large transactions, Nestlé requires the business unit heads to participate in the whole due diligence process, attending the management presentations, visiting the data room and understanding the synergies.

Because it has a small M&A team, Nestlé also pulls finance people from the strategic business units and different regions into the process to assist on the financial evaluation. On international transactions, Nestlé requires the local-market CEOs and CFOs to be involved in the process. 'If they are not, it would be difficult to achieve the commitment to the business plans necessary for success,' emphasises Singh.

Ultimately, the line managers, operators and finance people are responsible for assessing potential business synergies, with guidance from the M&A team. 'We work hand in hand with the line managers to make sure there is clarity with respect to the objectives, for example which factories are going to be closed, what capital investments will be made, etc.,' says Singh.

Nestlé bases its definition of success not only on how well it delivers on specific targets, but also on how much it learns from the acquisition

The relevant executives are not only involved; they ultimately have to sign off on the acquisition proposal, including the valuation. Says Singh: 'As a matter of fact, we would not necessarily recommend buying a business, no matter how attractive it might be, if the operational management was not prepared to support it.'

Once a deal is complete, Nestlé evaluates the achievement of a deal's objectives through its post-audit review process. The company used to do post-mortems on an ad hoc basis, but experience has persuaded it to implement a more formal post-audit review process as an operating norm. Nestlé now conducts reviews of all of its major deals, including acquisitions and divestitures, two to three years after it makes them. These reviews compare the results achieved with the objectives around synergies, growth rates, management structure, etc. that the company had set during due diligence and at closing. As Singh explains, 'That adds a different discipline to the process, because it requires active involvement and real commitment. As soon as the acquisition is done and announced, it becomes part of the long-term strategic plan.' And if the deal goes off track, it is Nestlé's collective responsibility, including the operators',

to find ways to create the value that the company promised at the time of the acquisition.

'The important thing is that we understand what we are doing and don't by chance find out that the deal has gone astray,' says Singh. Nestlé bases its definition of success not only on how well it delivers on specific targets but also on how much it learns from the acquisition. Says Singh, 'Capitalising on the technologies, brands and management skills that you have acquired in the process is a critical success factor in achieving high-quality, sustainable growth.'

Careful attention to the deal process by senior leadership serves as the final check. Nestlé CEO Peter Brabeck keeps deal fever from overheating by remaining closely involved. Nothing gets bought or sold unless he knows about it and approves it. Singh believes that senior-management leadership and support are key success factors in M&A. 'The CEO and the key executives in the business units provide leadership for the entire acquisition-and-integration process. And they provide me with the support and clarity to get the job done,' says Singh. 'That creates an obligation for com-munication with the executives to be frequent and relevant, so that direction can be given before you get too far down the process.'

Like Nestlé, if you organise strategically for deal-making, you will move quickly up the learning curve and master the decisions that make or break deals. Your standing deal team will hone the science of investing with a thesis and by asking and answering the big questions in due diligence. Your organisation will embrace the art of integrating quickly where it really matters, planning contingencies and correcting course quickly when the deal strays. Then, as you unleash your most powerful tool for growth, deal-making, you will notice something remarkable. By bringing rigour to a handful of decisions, you will control your own fate. In short, you will have disciplined the deal.