Beyond the Deal Newsletter

Mergers and Acquisitions that Achieve Breakthrough Gains

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Dear Jay,

Quote of the Month:

Retrospective comments on Adidas' 2006 acquisition of Reebok:

"...there were surprises. We had to do much more cleanup work than we thought... There was also jealousy left and right. When you've been competitors for 20 years, it's hard to suddenly become friends...If I could do it again, I would have managed expectations better. We didn't give a time frame for how long this would take, and I didn't replace people fast enough."

Herbert Hainer, CEO of Adidas, in April 11, 2011 Bloomberg BusinessWeek

In the April Newsletter:

More frequently than not, however well intentioned, most acquisitions do not shape up in the way acquirers expect. This month's newsletter draws on the recent Harvard Business Review article by Clayton Christensen and his colleagues that argues that our dominant thinking on M&A's is both confused and wrong. When our premises are that off base, our outcomes will also be skewed in ways we did not plan for or find desirable.

Christensen broke valuable ground in his work on disruptive innovations. His findings gave him a very different strategic perspective which he uses to form a contrarian view of what matters for M&A's to be successful. Get ready to let go of your conventional ideas and try this fresh understanding. It may well open up way of staging acquisitions that is a significantly better match with reality and on target with our strategic goals.

- **Could Your Approach to M&A's be Both Confused and**

Wrong?

Could Your Approach to M&A's be Both Confused and Wrong?

Trying to figure out if your proposed acquisition will be worth it? Clayton Christensen and his colleagues, Richard Alton, Curtis Rising and Andrew Waldeck offer a framework for sorting out what they see is complete confusion on what works in M&A's and what does not in "The Big Idea: The New M&A Playbook" "(*Harvard Business Review*). They say there is a good chance that much of what we understand about M&A strategy and integration is not only confused but wrong as well --- and then offer some basic ways to look at things a different way to get the successful outcome you always wanted. This is a significantly different take on M&A strategy and is a natural outgrowth Christensen's previous work on disruptive innovations.

The authors give us a strategic perspective that enables differentiating which acquisitions will be worth pursuing and which will not. A set of reference points is included indicating the particular forms of integrations that need to be implemented so that each of the different types of acquisition can be successful.

Christensen et al's take on M&A's gives us both the opportunity to cast off the strategic lenses we have become accustomed to wearing and a chance to try out this alternative way to approach what matters in M&A deal making and follow through. The dust has not yet completely settled but they may be providing us a paradigm shift in how to consider and act on acquisitions, both large and small. This is no small accomplishment.

Despite this achievement, there remains an important consideration to take into account: like most M&A strategy-based viewpoints this framework does not sufficiently include attention to the practices for carrying out a successful integration - and this is the half of the battle where most acquisitions falter. Our advice is take advantage of Christensen's breakthrough understanding to get on the right track strategically. Then make sure to link it to the *Beyond the Deal* approach to integrations so that you can have the kind of follow through to complete the process for achieving unprecedented value creation.

What are Christensen et al saying?

Christensen et al say that acquisitions "fall short of expectations because executives incorrectly match candidates to the strategic purpose of the deal, failing to distinguish between deals that might improve current operations and those that could dramatically transform the company's growth prospects. As a result, companies too often pay the wrong price and integrate the acquisition in the wrong way."

The authors see there are two reasons to acquire a company. The most common one is to stage acquisitions that seek to boost a company's current performance - either by improving its "premium" position or to cut costs. They state that this kind of deal "almost never changes the company's trajectory...and CEO's are often unrealistic about how much of a boost to expect, pay too much for the acquisition, and don't understand how to integrate it." Why is this? These are mostly "resource acquisitions" where the acquiring company keeps certain resources that it incorporates into the acquiring company and jettisons the rest. This type of acquisition succeeds in those scenarios where the acquiring company has high fixed costs and which allow it to scale up profitably.

Equally important is that the target company's resources are compatible with the acquirer's. In those cases the acquirer dissolves the business model of the acquired company and folds in the specific resources that improve performance. Cisco and Apple have been fairly adept at that and those types of acquisitions have paid off for them. But very often in practice there are fewer opportunities for the kinds of scale increases that the acquirer expected. The result is that actual cost synergies do not live up to what the acquirer anticipated going into the acquisition. Other types of synergies also, such as cross-selling synergies also turn out to be considerably tougher to capitalize upon than what appeared on paper.

A second, but less frequent, reason to acquire a company is to "reinvent the business" model and redirect the company in a fundamental way. The central dilemma with this model, according to the authors, is that "almost nobody understands how to identify the best targets to achieve that goal, how much to pay for them and how or whether to integrate them. Yet they are the ones most likely to confound investors and pay off spectacularly."

One Pill Makes You Larger and One Pill Makes You Small

For Christensen et al, the premise is simply this:

"A company can't, however, routinely plug other elements of an acquisition's business model into its own, or vice versa. Profit formulas and processes don't exist apart from the organization, and they rarely survive its dissolution. But a company can buy another firm's business model, operate it separately, and use it as a platform for transformative growth. We call that a "reinvent my business model" (RBM) acquisition. As we shall see, there is far more growth potential in purchasing other companies' business models than in purchasing their resources."

This less traveled path requires a different type of thinking and acting. Instead of going towards the expected and increasing commodizing a company's resources and products, the successful acquirer seeks to decommodicize. It locates where the value resides in the acquiring organization and finds the unique arrangement for integrating the processes, offerings and resources of that entity. It may find it worth paying a significant premium for a target that can be utilized to reinvent its business model. This is the case when it understands that the target firm's business model may be a unique input for the trajectory it seeks to put in place.

Making the best strategic choice can be very rewarding. EMC acquired VMware and recognized that its business model was quite distinct from own storage model. EMC choose not to closely integrate VMware, kept both business models and has reaped extraordinary rewards from VMware's disruptive practices in its market.

On the other hand, if an acquirer confuses the two approaches the result can be disaster. When Daimler-Benz acquired Chrysler it did not perceive that there was value in the business model that Chrysler had been developing and focused on eliminating "redundancies". As it folded Chrysler's resources (brands, dealers, factories and technology) into Daimler, "the real basis for Chrysler's success (Chrysler's speedy processes and lean profit formula) disappeared. Daimler would have served itself far more to preserve Chrysler and its business model as a separate entity".

Christensen et al's approach gives us a way to distinguish exactly what can be accomplished with each acquisition using each business model - and that, in itself, is their great contribution.

Acquisitions: Look at Them as Three Legged Stools

Try this thought exercise: Take a look at several acquisitions, either inside or outside your organization. See if the acquiring company gave sufficient consideration as to where the real value lies and structured the integration to capitalize on that reality?

Also do not lose sight of the fact that even when making the best strategic choices an acquirer must also forge a strong link to an adequately comprehensive, deep and effective integration practice. Look at the model as being a stool with three legs. This is the third leg on the stool. The first leg is to strategize for your desired outcome. The second leg is to sort through to optimally structure and leverage for the value that is possible. And, the third leg is to have in place the integration process that you can mobilize to create unprecedented value for the new organization.

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and Outcomes of Your Integration Processes

Is social media a fad or is it a viable set of tools for advantage in an integration? Social media is now mature enough to be a major accelerator of speed and quality in integration outcomes. Click on this link to the Social Media Strategy to Transform Integrations PowerPoint presentation to see how you can start developing this capability in your organization now. See how you can develop and implement an effective social media strategy in your firm. Contact Jay Chatzkel or Euan Semple to make arrangements and for further information.

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Please send in your comments, contributions and suggestions to Jay Chatzkel, editor. They are important to making the newsletter as relevant to you as possible.

You are welcome to forward this newsletter on to a colleague or friend.

All the best,

Jay Chatzkel
Progressive Practices

Jay L. Chatzkel is coauthor of the *Beyond the Deal,* and editor of the Newsletter. He is Principal of Progressive Practices where he assists organizations in transforming themselves into knowledge-based, intelligent enterprises. This includes working with organizations to develop skills and practices in the areas of merger and acquisition integration, intellectual capital, knowledge management, leadership and collaboration, business process management and performance measurement.

He is also author of *Knowledge Capital: How Knowledge-Based Enterprises Really Get Built* (Oxford University Press, 2003) and *Intellectual Capital* (John Wiley & Sons, 2002).
