Beyond the Deal Newsletter

Mergers and Acquisitions that Achieve Breakthrough Gains

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Quote of the Month:

There are intangible realities which float near us, formless and without words; realities which no one has thought out, and which are excluded for lack of interpreters.

Natalie Clifford Barney

In this Newsletter

Best wishes for a very good 2010! The new year looks to be a rebuilding year as well as one that equally opens up promising new opportunities.

This edition of the Newsletter takes on the issue of how acquisitions and their integration phases are conceived and what they encompass. It is more than worthwhile for any organization to make the extra effort to expand its strategic flexibility and imagination of how it thinks and acts on major acquisitions.

The first piece is a commentary on the ***Change By Design*** book by Tim Brown, CEO and President of IDEO, one of the most highly ranked innovation companies in the world. There are good reasons to go outside the box of M&A dedicated reading materials to open up to new views of the M&A integrations. This book is worthy evidence one of those reasons. Its strategic view is highly compatible with the Beyond the Deal approach. We can draw lessons from *Change by Design* to infuse the specific dimension of continuous innovation into all the stages of M&A thinking and acting.

We are also pleased to share with you the conversation with Jonathan Low, of Predictiv LLC, on Appreciating and Leveraging Intangibles in Mergers and Acquisitions. Intangibles are the majority of the value of most acquisitions but are only marginally accounted for in explicit acquisition strategy and implementation strategy.

While some kinds of intangibles, such as patents, trademarks and licenses, are commonly accepted as organizational assets and others are gaining more broad acknowledgment (including brand, reputation, alliances and networks, and leadership), there are still a number of fundamental intangibles that make a huge difference in the success of an acquisition but are rarely accounted for. These include workplace organization and culture, technology, human capital, and the abilities to assess risk, to innovate and to adapt.

This conversation explores what this range of intangibles are and the value of bringing them into appropriate consideration during M&A strategic planning and implementation.

Together these pieces link to keep M&A approach and practices fresh and open to effectively forging new opportunities and working through costly dilemmas.

In This Issue:

Bringing Design Thinking Innovation into

M&A Integration: *Change By Design*

Incorporating design thinking can make the opportunity of a major acquisition into a game changer. The strategic viewpoint to acquisitions and implementations advocated in Beyond the Deal can be significantly augmented by fusing it with the "design thinking", as mapped out in *Change by Design* by Tim Brown.

Design thinking is defined as "the collaborative process by which the designer's sensibilities and methods are employed to match people's needs with what is technically feasible and a viable business strategy. In short, design thinking converts need into demand." While *Change by Design* does not specifically address the acquisition process, it can be adapted in an intriguing and directly applicable way.

Design thinking is creative problem solving that is geared to continuous innovation. It is an approach that prompts rethinking of the acquisition project. It is not simply going forward with unquestioned assumptions in a more elegant fashion. Rather it is a distinct a way of approaching, thinking and acting. While it will produce products and outcomes, they are the result of participating in an active intelligible process, one with continuous experimentation, feedback and room for failure. Any major acquisition that is successful takes on the character of a complex problem solving process. In contrast to this approach is the more commonly found linear, "checking the boxes" procedures model. The extensive use of the latter can in good part explain the high failure rate of acquisitions in not meeting their strategic goals.

The process advocated in design thinking has three overlapping spaces:

- *Inspiration* - the problem or opportunity that motivates the search for a solution
- *Ideation* - the process of generating, developing and testing ideas, and
- *Implementation* - the path that leads from the board and project room to the fleshing out of the new organization

The context of operating is a "project", which is the integration itself and then the different components projects that make up the overall integration. For each project and sub-project there is a design brief, or set or framework for both the overall integration and its components. The design brief is carried out by interdisciplinary teams, and in an environment which is supportive of innovation. In fact, the whole of the integration can be seen as a large design portfolio, all infused with an attitude of experimentation.

A continuing dynamic of divergent and then convergent thinking generates and then provides for analysis of ideas, which are then quickly and inexpensively prototyped. Prototyping is done to give a rapid reality testing to ideas before they get too far along, in keeping with the notion that it is better to fail early, make course corrections and then move on to creating the next prototype. The final version of this series of prototypes is essentially the most realized and effectively successful prototype, one that successfully achieves the goals of the original design brief.

This kind of thinking and process leads to a departure from the status quo. At the same time it generates an innovative and systemic response to the whole set of acquisition/integration implementation requirements.

This approach can encompass all of the current actions that have become part of an integration. Yet, it is a different way of seeing them, composing them and working through them. Nothing in the current M&A integration practice is lost but rather it is rethought, reprocessed and reframed with a different spirit and involvement. This type of shift, with its emphasis on innovation, will achieve a different outcome.

Incorporating design thinking may not be as efficient at first as current procedural practices, but it may soon become more effective, less costly and definitely worth your consideration. Think about a trying the design thinking approach out on a pilot project or two to see what is involved and what differences you could make. Contact Jay Chatzkel for a further conversation about introducing this approach to your organization M&A practices.

A Conversation with Jonathan Low of Predictiv LLC on Appreciating and Leveraging Intangibles in Mergers and Acquisitions

by Jay Chatzkel, Progressive Practices

Valuing Intangibles

JC: *What company intellectual assets are typically undervalued and what difference does that make in an M&A setting*?

JL: Overall what is undervalued in M&A is anything that is not strictly defined by traditional GAAP (Generally Accepted Accounting Principles) accounting. Since we have moved decidedly in the last fifty years towards a service based economy that gives both acquirers and acquirees a lot of wiggle room and lot of potential difficulty. This is one of the reasons why when a merger and acquisition is announced the acquiring company's stock price declines almost immediately.

Price Waterhouse Cooper's (PWC's) research showed that 65% of acquisitions fail to achieve their published goals is because there so little understanding of these so-called intangibles. Most of these intangibles should be better understood than they are at this point of our development as an economy.

Intangibles that tend to be underreported or undervalued include:

- Workplace organization and culture
- Technology (particularly processes around technology)
- Human capital (which is kind of a bloodless description for workforce and its skill and knowledge),
- The ability to assess risk
- The ability to innovate, and
- The ability to adapt

There is an additionally a whole range of other intangibles that are better understood and are, at least, defined in the US. Those include brand, reputation, alliances and networks, and leadership. Because of the stasis involved in the evolution of our accounting and financial management systems, these intangible assets are not routinely or comparatively assessed across the economy. The companies that have a great reputation doing acquisitions, such as Oracle and GE, are better at accounting for this range of intangibles. They have developed templates and teams that focus on M&A's. A lot of other companies say "We see some synergies!", but it turns out that those synergies are not as readily achievable as was first thought nor are these companies very well set up to capture them.

JC: *What enables better acquiring companies to be more adept at* *grasping the value of intellectual and similar assets?*

JL: Some companies inherently understand that their intellectual assets can be leveraged and doing so does affect performance, whether that performance be productivity, financial value added or whatever. The difference gets back to another intangible, which has to do with organization and processes. If you focus beforehand on what goals you want to achieve and then try to figure out what elements, particularly in the post merger integration process need to be brought to bear to achieve those goals, you are more likely to achieve those goals.

Strategic Perspective

JC: *Does a more strategic perspective yield better outcomes?*

JL: Yes. In terms of tools and methodologies to evaluate the impact, it is not even so much that you need specialized tools and methodologies. It is that you need to be thinking strategically about every element of your business, how they link to each other and how all of the elements in an M&A situation, particularly in the M&A integration phase, leverage each other so that you can optimize value. A company needs to know, from a leadership standpoint, to what degree people are working together. Equally it needs to know to what degree the organization is broken into silos and where different elements of the organization jealously guard their information and prerogatives. The optimal situation is instead to think holistically of an expanding pie, and seek out how "I contribute to it I get to take part in that expansion."

JC: *How do you get people to think in the more positive way?*

JL: It is a cultural issue that gets back to what kind of atmosphere you create. Point number one is: Is it an atmosphere of fear and retribution or is it an atmosphere of "we are all in this together and we are going to build value for the long term." Point number two is: Do you walk the walk by designing compensation systems that reflect that overarching point of view? Or do you say one thing ("Our most important assets walk out the door every evening 5 PM) but in times of distress behave otherwise." People's attitudes and knowledge - their antenna for hypocrisy and disinformation have become very finely attuned. People are more confident about their ability to find their own way and perhaps not be as fearful, particularly in an M&A situation of concerns of "Am I going to lose my job" or "Is my pension in serious jeopardy?"

We found in our work on employee engagement that one of the biggest mistakes that companies make is that they have a monolithic approach to employee attitudes. In fact, that factor is very finely and idiosyncratically defined depending on things like what subsidiary you work in, whether you are management or not management, and if you are union or non-union. The good news about technology is that you can now get a handle on this. You can design messages that will have the greatest impact on the subset of the people you are trying to influence.

For example, our research has shown that over a number of industries people, even though they may work for the same company and have the same type of positions and skill sets, can have very different attitudes. Two individuals who may have the same educational background and the same job technically but have been with the company for different periods of time (say, less than two years or more than fifteen years), are going to have totally different attitudes in an M&A situation. Some may view it as an opportunity and some may view it as a threat. Some may view it as a disruption and some may view it as an adventure. Companies have to put more work into determining the value to be derived from the workforce they are acquiring as well as the impact an acquisition is going to have on workforce they are already managing

JC: *How can we manage this degree of complexity?*

JL: Technology has given us the ability to quantify these impacts and measure them against outcomes that matter to the company. We can look at it at a corporate, subsidiary, business unit, or work group level and it all can be measured. We no longer have to be focused on the longer, broad scale return on investment type metrics, which are relatively meaningless from an operational level. We can be more focused on "impacts taking place on my programs and on specific outcomes that I care about as a corporate manager."

We have learned that while few corporate managers are managing day to day against stock price because they have so little influence on it, these managers also know that there are many things that they do ultimately contribute to stock price performance. Again, it is making the effort to understand your organization, to filter this information and then to apply it internally.

Strategy Execution as an Intangible

JC: *What do we really need to be focused on as far as intangibles?*

JL: When we are asked questions about how intellectual capital affects merger and acquisitions scenarios, as far as we are concerned, the valuation exercise is almost irrelevant. Valuation is going to be a negotiation. It will be based on GAAP accounting or international accounting standards. The real impact is going to be on evaluating and measuring the impact on these various intangibles, performance management systems, organizational design and so forth. That can all be done. It is about will. It is not about ability.

One of the greatest intangibles is strategy execution, i.e., what does it take to execute strategy. In an early study we did, *Measures That Matter*, executives ranked strategy execution ahead of quality of strategy. When we asked these executives about this, they said. "Ninety percent of the world uses the Window/Intel technology platform. Hardware is become interchangeable and fungible. We all have access to the same information. The only strategic differentiator is ability to actually make it happen. Even if you have a weak strategy, if you can execute it, you are much better off than your competitor that may have a brilliant strategy but has no way of achieving it. "

That gets back to the M&A conundrum. We believe in the economic tumult in the creation and destruction of economic value as being essential to the ongoing health of the capitalist system but we have become sort of lazy at doing the hard work necessary to understand the building blocks of that creation and destruction process.

Who Will Carry Out the Changes?

JC: *Who ultimately has to do the heavy lifting here?*

JL: The good news is that as a society we have gotten smarter about management and we are less freighted with judgment about who is up and who is down in an organization. One of the quiet revolutions of the last twenty years is that organizationally we are much more inclined to work as teams who contribute to a solution, rather than as siloed individuals who have their responsibility, and when they are done they throw it over the transom for the next person.

When we are talking to people, we are talking to groups of people. These are people from financial units, from marketing backgrounds, from corporate communications responsibilities, etc. We almost never have a single client anymore.

The real challenge is that the meetings get so big because there are so many people that have a stake in this kind of decision making. It is a conundrum because on the one hand we have a meeting with twenty people in the room, which is unwieldy, but on the other hand, that is reality. There should be twenty people who should be contributing to these sorts of decisions. Then the question is: "Do you have a framework for that sort of discussion and for eliciting actionable wisdom?"

Everyone is faced with the same issue, which is they are making bigger decisions in a shorter length of time, with less information. In that scenario, you almost have to have more people because there are so many pieces of the puzzle that are missing and where there is great pressure to take into account more points of view in order to get a better outcome.

JC: *How does an understanding of intellectual assets affect the redesign of the new organization, structure and processes?*

JL: The redesigners have to be aware of the influence these intangible assets influences have on the organization's ability to create value. These are not necessarily the people defined by the management information system or by GAAP accounting. You have to have a team of people aware of and interested in optimizing those variables.

JC: Thank you for participating Jon.

For the full conversation with Jon Low, click: www.beyondthedeal.net/Newsletter.html.

Jonathan Low Bio:

Jonathan Low is a Partner in Predictiv LLC, a consulting firm specializing in the valuation of intangibles such as intellectual capital, brand, reputation, leadership and alliances. Jonathan has recently created PredictivAsia with partners in China.

He is the co-author of *Invisible Advantage*, was co-editor of *Enterprise Value in the Knowledge Economy* and was a contributor to *Business Power: Creating New Wealth from IP Assets*. His work has appeared in The Wall Street Journal, The New York Times, Forbes, Business Week and other publications. He has been a featured speaker at numerous conferences on intellectual asset-based management hosted by academic and business groups.

He is a graduate of Dartmouth College and Yale University's School of Management.

In addition to having the Newsletter sent to you directly, you can access the Newsletter and article library at:
http://www.beyondthedeal.net/Newsletter.html

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).