Beyond the Deal Newsletter

Mergers and Acquisitions that Achieve Breakthrough Gains

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January 2012

Dear Jay,

Quote of the Month

"*Courage is being scared to death but saddling up anyway*."

John Wayne

In the January Newsletter:

Warning: The "New Normal" Continues Shaking and Quaking - Are you ready for "Version 2012"?

Our New Year 2012 will carry over many of the characteristics of 2011, but of course with its own novel twists. The caution is not to even try to live in the past this year. If you do, you'll find yourself falling further off the mark than even in 2011. On the plus side, the US economy has begun, in a modest way, to come out of its doldrums and the financial markets are as little less volatile on a daily basis. At the same time, the Euro zone countries are under continuing stress, middle eastern oil producing countries and their neighbors are in a period of upheaval (throw in Nigeria as well), or feeling the repercussions of what is going on next door to them, Thailand is recovering from its partially natural/partially hyper-development caused flooding disaster and China is feeling its way through the wake of the western downturns - trying to determine how to continue the growth it needs without undermining its economy by inflation.

Cross-Border Acquisition Challenges

Consider the challenges Chinese firms have in carrying out cross-border acquisitions in the various regions of the world: low political trust, a Confucian based hierarchical decision-making model versus a more open, collaborative process one, unfamiliarity with the cultures they are trying to market to - as well as clashes on how to carry out that marketing. As these challenges grow both in extent and complexity Chinese firms will be hard pressed to continue operating in a business as usual mode in their acquisitions. Rather, Chinese acquirers will have to rework themselves, not once, but ongoingly if they are to work through ever growing complexities they will face. At the same time. The challenges Chinese acquirers face can also be seen as high relief examples of the types of challenges all companies, regardless of country, will contend with in 2012. This will be true both for integrating domestic acquisitions as well as for acquisitions that cross beyond national boundaries. This is enough to keep us up at nights if we already weren't there already.

High Cost of Not Examining Premises

Next, take a look at AT&T's move to acquire T-Mobile. Could AT&T have gone about this acquisition process differently enough to successfully move through its anti-trust challenges? Not only did its proposed acquisition get dropped after it faced massive resistance but this abortive attempt also is liable for a $4 billion breakup fee (plus many additional costs). A T-Mobile acquisition would have been a difficult acquisition in any case, but then we need to ask how many alternatives were examined and why was this course of action chosen? Do you think your company could afford this kind of scale of loss? Yet, many companies involved in acquisition planning and implementation continue to operate not too much differently than AT&T in their acquisitions this year and are learning nothing of significance from the AT&T debacle.

Transitioning to a New Business Model and Logic

One more factor that gets far too little attention is that many organizations seeking acquisitions and their targets organizations are in dynamically changing markets and rapidly shifting customer requirements. Acting as if your organization and the targets you are considering acquiring are in a static universe is a big mistake.

We use an intriguing article by Kevin Travis as a “lens” to look at how organizations can transition from a current and outdated business model and logic to an insightful business logic that enables it to meet its challenge both now and into the future. In this case the focus is on how the changing roles in multi-branch banks require reformulating the business logic to grasp the real value in such acquisitions and then guide the actions needed to integrate this newly shaping network for best outcomes. However, the underlying need to revisit your business logic and model is equally true across all sectors.

Key Lesson of 2011 and Moving into 2012

A key lesson from 2011 is that the quest for strategic position often trumps and tempers concerns over even extreme market conditions. The indications are this will be true for 2012 as well, although at a somewhat slower rate. A difference in 2012 is that regional variations will be more pronounced than in 2011. That also means that there is an even greater need to know how to perceive and manage integrations in this increasingly difficult and complex world.

Innovative Tools Are Coming Together in the "Integration 2.0" Model

Fortunately, a cluster of innovations (including community management, social media, and technological integration process tools) came onto the M&A stage in 2011 to enable even the toughest and most challenging acquisitions and integrations. All of these developments come together in what we call "Integration 2.0". A successful acquirer will customize its own set these approaches so that it can be fully geared to the challenges of 2012 and come out with quantum leap successes.

Best wishes to all for a very good New Year and to joining with you for best outcome, *Jay Chatzkel*

Editor

- **Acquisitions as an Opportunity to Change Your Business Logic: The Case of Multi-channel Branch Banks**

Acquisitions as an Opportunity to Change Your Business Logic: The Case of Multi-channel Branch Banks

In the recent article "**Multi-channel M&A's: Where do Branches Fit?**" http://www.novantas.com/article.php?id=329, Kevin Travis, Partner in the Novantas management consultancy, looks at a fundamental error that acquirers too frequently make as they pursue acquisitions and then remake their newly organized firm. The fatal flaw lay in the mistaken belief that their market will fundamentally continue on the path it historically has taken. Regardless of the fact that this expectation may well no longer be the case, many acquirers continue to use an outdated business model or "logic" no longer relevant as the basis for carrying out their acquisitions and integrations.

While Travis specifically addresses multi-branch banking organizations that seek to grow by acquiring similar multi-branch banking organizations, the same basic need for revisiting the dominant business model or logic is equally applicable across all organizations.

What are the Real Challenges in an Acquisition?

Travis notes that, contrary to dominant beliefs in the industry, market demand is shifting away from uniform networks of full service branch operations model to one that provides a multi-channel network of options for customers. If an acquirer is going to best appraise both its own future and the actual value of a target organization, it first needs to be open to reassessing and revamping its own its business model where necessary in light of dynamically changing market conditions.

This changed perspective is then reflected in a no holds barred evaluation of how well the acquirer and target are able to remake themselves as needed. The new understanding becomes the basis for the new business model the acquirer uses as it moves along its pathway through target selection, due diligence, negotiation, planning and ultimately the integration processes that put the new business model into effect.

Consider how different valuations of a target would be if a prospective acquirer looked at it from the old business model versus the new business model. If an acquirer is captive of the old business model it would tend to over inflate the value of current branch operations as they shift from being profit centers to becoming marginal operations and possibly even loss centers. Many, if not most, current acquirers wind up fighting the last war, but in a better, more massive and perhaps more efficient ways. Sticking with an outdated business logic is at the root of a very sizable proportion of acquisition failures.

What does Travis say?

First that "market acquirers typically rely on back office and branch combinations for savings to off-set takeover premiums. They also look for pricing power as they bulk up in local markets. In other cases, acquirers seek geographic market expansion. These familiar merger concepts assume that branches are the core of franchise. But these former stars of the show are being relegated to more of a supportive role in retail banking."

Travis goes on to say that "Novantas research suggests that up to a fourth of all supposed branch customers actually transact the majority of their banking business through remote channels, including online, mobile, call centers and automated teller machines, and at least 20% are 'thin network ready,' (*with customers*) caring about branches but rarely using them. This profound customer migration is accelerating, and has serious implications for merger strategy in 2012 and beyond. Banks will need to reconsider the entire branch decision chain - including what they are worth."

He continues that "Traditional networks are in danger of becoming wasting. Familiar merger strategies are becoming obsolete as branch networks transition to a more supportive role in retail banking. As the retail banking revenue drought drags on, regional players face growing pressure for another round of merger-based consolidation. Based on a recent Novantas analysis of the U.S. branch system, roughly 16,000 outlets, or 18% of the current total, will either need to be closed or reworked within the next three years in order to remain efficient. Traditional merger models will prove insufficient to meet this challenge. It is not clear that acquirers and their investment bankers have factored this trend into valuation models."

Travis cites beyond the deal factors that pose critical questions about repositioning branches for a very different future. These factors include how location, configuration, staffing and relationship building through alternative channels affect outcomes.

What difference does all of this make?

If a typical multi-channel banking organization does not take these market shifts into account, a regional merger "could begin life with a serious competitive handicap if the predecessor companies had not already started transforming their networks. There still would be initial cost savings from capacity reduction, but the merged entity would be forced to spend heavily to catch up elsewhere, while facing an extended disadvantage in winning customers and building revenues."

As an alternative, Travis advocates three major steps for potential acquirers to take:

- Assess the growing base of "virtual" customers both in the current and target network
- Identify and actively address any competitive gaps in multichannel capabilities, and
- Incorporate these factors into decisions about what would be involved in formulating the new, post acquisition branch network.

Making These Insights Work for You

Think about Travis's comments on multi-branch banking organizations and then carry that critical thinking over to your organization and see how much you are applying this adjusted business logic view.
Turn conventional practice on its head. Instead, start looking at acquisitions as *an opportunity to redesign the dominant business logic* of the whole company and join together the capabilities required to implement a reformulated business strategy with renewed growth objectives.

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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).