Beyond the Deal Newsletter

Mergers and Acquisitions that Achieve Breakthrough Gains

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Dear Jay,

Quote of the Month:

"Any dope with a checkbook can buy a company. It's what you do afterward that matters."

Henry Silverman, CEO of Realogy Group, 2006

In the May Newsletter:

In this edition we first look at several acquisitions that illustrate broad reaching issues and trends in current acquisition practice. Each demonstrates that there is more to acquisitions and integrations than a simple plan that can be neatly carry out an in isolation. Rather, each shows that acquisitions take place in a context and most often the integrations that follow do not play out on the straight, logical line we would like them to.

We then examine the importance of adopting an authentic partnering approach in acquisitions. Making the choice to cultivate a partnering relationship is key to engaging the acquirer and the acquired firms from top to bottom and across the board. A partnering capability is usually given lip service, if that. Overcoming the tendency to say "We bought you, we own you...It is our way or the highway" requires a major shift but that is exactly what is necessary to enable the access and flow of capabilities that become the basis of the newly combining firm.

Three Recent Integration Issue Indicators

Let's take a look at three recent developments that indicate core issues in integrations.

Microsoft Acquires Skype

The first development is the Microsoft's acquisition of Skype for $8.5 billion in cash and assumed debt. As Dan Mitchell of CNN Money put it, "Given the premium price Microsoft is paying for Skype, its striking that the Internet phone company has spent so much of its short life being passed around like a cheap bottle of holiday wine."

The bottom line question is whether Microsoft will capitalize on its acquisition or whether it will be throwing $8.5 billion in to a bonfire. There have been many opinions. One is that Microsoft can take the capabilities that Skype has and weave them into a number of its existing programs. In a growing market, with any success, Microsoft would get a good return on its investment. Another view is that Microsoft acquired Skype in a defensive move so that Google or another competitor would not obtain what could easily become a disruptive force for Microsoft. A third perspective argues that Microsoft has a track record of not doing anything with its acquisitions.

The key question has Microsoft that is the rightful owner Skype. That is, does Microsoft have or can it create the capabilities to carry off the acquisition and integration so that it can create substantial value. It has shown that it has the financial resources to acquire Skype, but it has not provided satisfactory evidence that indicates it is reinventing its business model and redirecting itself in a fundamental way, one that would allow it to leverage its acquisition to yield exceptional value.

Are Acquisitions Cost Free?

Apparently not. As good as Wells Fargo is in moving systematically through its integration with Wachovia, it has generated real integration costs that it probably did not anticipate.
"Wells Fargo's annual non-interest expenses have risen historically from $19 billion in 2005 to over $50 billion in 2010, and more than doubled in 2009 due to its acquisition of Wachovia.

As a percentage of revenues, they have increased from a low of 53.7% in 2008 to around of 59% in 2010. The increase has been driven primarily by high merger integration costs ($1.9 billion in 2010 and $1.1 billion in 2009, leading to increases in outside professional and contract services in 2009-10." (Source: Daily Finance, http://www.dailyfinance.com/2011/05/11/wells-fargos-rising-expenses-take-a-bite-out-of-its-outlook)

Anyone contemplating an acquisition of similar scope and scale needs to realize that there are cost generating activities as well as the much more touted cost savings synergies.

Cross Border Acquisitions Rise

In our global market world, cross border acquisitions may become more attractive than domestic ones where opportunities may be more limited. Such is the case in the acquisition by Japanese based Takeda Pharmaceuticals of the Swiss drug maker Nycomed for approximately $14 billion. In seeking to compensate for some of its more profitable drugs going off patent, it seeks to solve that problem by acquiring Nycomed, a firm with certain late stage development drugs that can bolster its offerings. Both companies, like most large scale pharmas, are global enterprises. They live or die on the global stage.

Takeda gained experience with cross border acquisitions when it acquired US based Millenium Pharmaceuticals in 2008 for $9 billion. Nycomed bought a majority stake in a Chinese pharmaceutical firm in 2010. The challenge of maintaining a worldwide pharmaceutical enterprise are massive. Acquisitions are one option for achieving corporate goals, but are not a guarantee for building a strategic position, as seen by the less than stellar performance of Pfizer after its acquisition of King Pharmaceuticals and Wyeth in 2010. It will be instructive to see what approach Takeda takes to satisfy the strategic, managerial and cultural requirements, where it succeeds and where it falls short of its goals.

Partnering: A Capability to be Cultivated

What do all of the transactions discussed above have in common? To be optimally successful they all require healthy partnering between the acquiring and the acquired companies.

With partnering the resources of the acquired company become open and accessible; knowledge and experience flows between parties, and both problems and opportunities can be more fully explored. Without partnering, decisions are made on partial knowledge at best, and chances of implementation are significantly handicapped. When there is no partnering the result is sub-optimization and a weaker return on the significant investment.

Partnering does not a financial cost but does involved upfront time and a significant level of effort. In the longer run, that investment of time and effort can have far richer payoffs than implementing the more conventional "conquistador" approach.

If partnering is embraced early on the basis of integration business plan is strengthened by the development of trust between the two management teams. Trust is the basis for partnering. Trust building can start as early as due diligence, but it especially needs to be incorporated during the integration planning stage and it bears the greatest fruit during integration implementation. Partnering can intentionally be embedded within the business plan in the course of discussions with both management teams.

To have real effects, partnering requires:

- the capacity for self-initiation, trust and interdependence. Partnering can take place only between people who are not interacting in a dependent mode. Partners are able to move forward only when the people involved are self initiating and open to how they can complement one another. Without this partnering there is a high chance of failure because partners will eventually reach a point of distrust that will damage the partnership.
- a sense of collective ownership, with the individuals involved taking joint responsibility for co-creating the new company's future and recognizing that by doing so, they are creating their own futures.

When trust-based partnering exists, the integration leadership can create a team composed of both management groups to work through any remaining issues that need to be resolved. Other major benefits of engaging with the acquired company's managers are that the integration leadership gets a better idea of the acquired company's strengths and weaknesses and is able to obtain the manager's advice on the items that mattered the most and how to manage them effectively.

If the governance restrictions of a particular country allow it, the two companies can begin sharing the details of the business plan during the negotiations stage. They can participate in discussions, although they cannot take actions or bring any change to the company being acquired. These conversations with the partners in the acquired company corroborate the different resources, viability, and potentials of the acquired company. The leaders of the acquiring company can say, "This has been our thinking--can you validate that?" Some of the issues to bring up may include the physical location of various groups, the extent to which the new company might downsize here, upsize there or recalibrate in this or that area, and the types of customers the new company can sensibly go after. Openness at this stage sets the tone for the new company.

In a partnering approach, the acquiring company's opposite numbers are not regarded as antagonists in an "us-vs.-them" stance, but rather as potential collaborators who can be brought into a win-win negotiating and operating framework. Sound partnering tends to start at the more senior levels, but over time, it will be cultivated throughout the entire company. Partnering skills already exist in most companies to one extent or another. The point is to bring them knowingly into play during the acquisition and integration implementation.

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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).