

Beyond the Deal Newsletter

*Mergers and Acquisitions that
Achieve Breakthrough Gains*

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September 2011

Dear Jay,

Quote of the Month

"Even if you're on the right track, you'll get run over if you just sit there."

Will Rogers

In the September Newsletter:

First, the world economy continues to churn and funding is tightening. Are we headed into a downturn or is the broader truth that we are in the midst of major change and reconfiguration of economic realities? We examine the changing M&A global landscape, looking into the dynamic trends and countertrends that shape the market and our opportunities. Step back from the day to day and think about where we have come from and where we are going.

Second, there are companies that continue to surprise in being successful, even more successful than incumbent companies in their own field or across borders in very different countries. What is their "secret sauce"? What is involved in coming up with your very own version of a "secret sauce"?

[The Changing M&A Landscape: Trends and Countertrends](#)

[Creating our Own Secret Sauce](#)

The Changing M&A Landscape: Trends and Countertrends

Let's take a look at three trends shaping and reshaping the M&A world.

Volatile Markets & Tighter Financing Leading to M&A Slowdown?

First, the most obvious dynamic is that the uncertainties and volatility of August continued into September due to global debt and unrest, and are all leading to a tightening of funds available. With a tightening of financial markets, a good part of sizable M&A's cannot be achieved since many are tied to debt financing. This is causing PwC and others to predict an M&A slowdown for the balance of the year. The overall economic slowdown is expected to put a downward pressure on valuations of companies in all sectors for the near term.

Enormous Cash Reserves Drive Selective M&A Activity

However, if we look at this from another perspective, which is that the world is in a dynamic change process, more than solely an economic downturn, we see other forces in play that will continue to redo the whole landscape of M&A's and global economies over the rest of this decade.

The bottom line is that there is an enormous amount of cash available. This is both true on individual companies balance sheets, and is also the case for entire countries.

On the company and sector level, IT is a dominant sector in which companies such as Intel, Marvell, Broadcom, Microsoft and Apple amongst others, are rich in cash and are, or may be considering significant acquisitions. Their cash reserves, coupled with cheaper acquisition prices for more financially pressed firms, will lead to a sizable amount of IT acquisition over the next several years.

Cross-Border M&A's Increasing - West to East & East to West

A second long-term dynamic is the continuing growth of cross-border acquisitions. On the one hand, some leading product suppliers in the West have recognized that to grow they need to establish a presence in developing countries, something that will be, in good part, accomplished through acquisitions.

But an even more powerful part of the cross-border dynamic is coming from Asian companies who are moving into European as well as North and South American markets through acquisitions. These acquisitions are driven both on the company level as in the case of India's Tata, and, in the case of China, by both individual companies and a by M&A's being named a top national governmental policy priority.

China: The Largest Driver

According to Ross James, manufacturing M&A partner with Deloitte, "Industrial intellectual property, manufacturing know-how and strong brand names will continue to be the main incentives for Chinese manufacturing companies pursuing overseas acquisitions." These companies are also cash rich and have sufficient capacity to finance M&A's. James continues to say that, "If the current trend continues, 2011 to 2016 will see greater Chinese investment into the EU, with deals exceeding \$1 billion becoming commonplace. Significant domestic demand fueled by China's burgeoning middle class, will play a key role in acquisition activity."

The Chinese government is a major player in this dynamic. In its 12th five-year plan, China's Central Committee set out four major tasks for the future, with accelerating M&A activity being one of them. This is something that Chinese "state capitalism" bring about. Just imagine the reaction to a push for that kind of industrial policy decision in the US or other Western countries.

While nationalism has some role here, there is much more to this decision by China. Duncan Innes-Ker of the Economist Intelligence Unit and based in Beijing says, "China would seek to diversify its investments after low returns from its US currency holdings and concerns about the greenback's future. China is likely to be increasing its appetite for risk, with mergers and acquisitions set to rise."

Tata: A Template for Cross Border Acquisition and Integration?

India-based Tata Group, whose motto is "Leadership with trust", provides an exciting glimpse of the future in the present. Tata saw it could not confine itself to India if it was to become the big and international concern it believed it needed to be if it was to thrive in its chosen businesses. Tata began acquiring an array of business in the UK, starting with Tetley Tea in 2000 that brought Tata immediately into being a global entity. Tata followed by acquiring Jaguar/Land Rover (JLR) where it gained valuable off road technology that it brought back to its auto operations in India. Much to the surprise of many, it has since turned JLR into a profitable venture. Tata then went onto the acquisition of Corus's steelworks, a transaction that brought Tata into the specialty steel business, something that would have been hard to build on its own. All of this put together has made Tata the largest manufacturer in the UK, with a payroll of 45,000 and is positioning Tata as possibly the UK's leading edge company in attitude and practice.

What is Tata's "secret sauce"? Tata was a challenger conglomerate from a formerly peripheral area that went international in order to access resources. According to Andrea Goldstein, Senior Economist at the Organization for Economic Co-operation and Development (OECD) and the Center for the Advanced Study of India, "Tata was driven by multiple factors, including the need to access new markets, the opportunity to integrate the value chain (e.g., in steel), and the

quest for brand control (e.g., in tea, autos, etc.). This strategy proved feasible because Tata possesses strong leadership combined with vision; can exploit the possibility of leveraging increasingly developed financial markets in India, a large domestic market, and global liquidity; and reacted fast to the opening of specific opportunities at given times."

Will One Size Fit All?

Is the Tata way the only way for all challengers? No firm, or even a nationally backed venture, can copycat the core capabilities that were uniquely cultivated and have come together to enable Tata over time to be the broadly effective enterprise it is in both India and in its extensions across the globe. It turns out that its secret sauce is really not that secret: but one that involves strong values, vision, and leadership, coupled with risk taking, healthy discipline and excellent execution skills. Secret sauce or not, this is its competitive advantage and it works.

The reality is that any company, conglomerate or even national initiative can only succeed over time if it builds up a similar cluster of capabilities. Leveraging financial strength is the usual focus. It is a necessary ingredient in the sauce but it is not sufficient. All of these other capabilities need to be in play as well. The look and feel of each of these initiatives will differ from one to the next, but the underlying sets of capabilities will have much in common.

To 2016 and Back

Where will these initiatives come from? Entities from China, India and Brazil are the most frequently mentioned emerging players, but don't be surprised if other challengers such as Turkey or countries in Eastern Europe and beyond come onto the stage as well. And, with enough competitive stimulus, the next generation of recast existing firms (e.g., possibly Ford and others) and new firms in North America and Europe will join into the mix.

With this as our starting point, let's take a step back and note how the world of 2011 differs from the world of 2006, just five years ago. From there, go forward to visualize the world of 2016 and detect in what critical and key ways it will differ as well. Going back and forth will help identify the dynamic trends that are reshaping our markets, both for now and into the future. An awareness of these dynamic trends gives a handle on how to reconsider how companies can move through all the pre-deal phases and post-deal integration phases to set themselves up for achieving unprecedented gains.

Create Your Own "Secret Sauce"

What will drive success in acquisitions and integrations going into the future is the kind of leadership that shapes and guides an operating context. It sets the direction and tone for the organization through its work in shaping the vision, values and strategies for the new entity that

emerges from the integration. It is the leadership's role to see that the organization is developing the capability to create opportunities for acquisitions and other growth combinations and to take advantage of those that are brought to the organization. To do this, the leader's strategic vision has to be shared by everyone who is involved with the organization in its supporting or partnering network. This type of leadership cannot be passively delegated or assumed to exist at other layers or areas of a company. However, it can be cultivated and manifested at all levels of the organization. This is of great importance because every level has to take a leadership role in its area of responsibility.

If the leadership does not keep the organization nimble and responsive as it goes through acquisitions and integrations, the organization is likely to grow in *size* more than in *capability*, *value* and *profitability*. It is important to note that in some cases, even companies with the best integration capabilities have made only marginal gains in financial and general performance when growth synergies have not been fully pursued. The challenge that must be overcome is to integrate acquisitions in a manner that will continually renew the organization and its capability to perform and grow in a fast-changing business context.

For example, a new CEO set a stretch goal of doubling the company's revenue in a three-year period. To achieve this goal, business unit leaders had to reconsider everything they knew. Standard operating procedures would no longer work. The leaders had to consider options that they had never seriously considered, including an aggressive acquisition model. They had to see new possibilities, learn new skills, work with people inside and outside the organization in new ways, and achieve tangible success. At the corporate level an infrastructure was created to engage with them to develop the acquisition capabilities to accomplish that audacious goal. In this way, an acquisition/integration approach became an outgrowth of the overall strategy and, at the same time, created the opportunity for the organization to renew itself.

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All the best,

Jay Chatzkel
Progressive Practices

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