STRATEGY

Bad Deals

Eight warning signs that an acquisition may not pay off

By Freek Vermeulen

STUDIES SHOW THAT the majority of acquisitions fail to create any value. That is, the premium paid for the target is higher than the value that the transaction subsequently created for the acquirer.

Most executives know this. But they figure things can't be that bad. And besides, *they* can do better.

What's more, the complexity and uncertainty of aquisitions and mergers is so great that even insiders find it difficult to determine whether a deal will create value.

Still, there are several strong warning signs that a transaction is unlikely to create any value—and which should trigger insiders and outsiders to question their support for the deal:

■ **A PREOCCUPATION WITH SIZE:** Many managers see acquisitions as a relatively easy and quick way to increase a company's size, compared with the painstaking process of organic growth.

Yet while success will likely make a company bigger, striving for size per se is not necessarily going to make a company more successful. In fact, a strategy in which acquisitions are undertaken as a substitute for organic growth has a bad track record in terms of adding value.

By contrast, successful companies often have a high level of coordination between the various activities and parts of the organization, including technology and systems as well as intangible characteristics such as a shared culture. This is difficult to achieve, however, if your company is the result of a large number of hastily acquired firms.

Thus, acquisitions undertaken as a substitute for organic growth often fail to add value.

■ **DEAL-EAGER EXECUTIVES:** Some executives can become preoccupied with making deals—and the thrill of selecting, chasing and seizing a target.

It's easy to understand why. In the short run, analysts, investors and the media often lay praise on "successful acquirers," and the company making the highest bid for a target is usually proclaimed "the winner."

But such focus has consequences. Executives who are constantly involved in the all-consuming process—assessing numerous acquisition candidates, negotiating with their counterparts and investment bankers and so on—are left with little time to focus on the internal workings of their companies. A corporation also often becomes not much more than a loosely connected portfolio of businesses.

■ **LACK OF ACQUISITION EXPERIENCE:** The reverse approach also may be problematic. When a company with little acquisition experience does undertake an acquisition, employees of the acquired business often find that the company is intolerant of different ways of doing things, which can lead to serious integration problems and employee turnover, among other things.

What's more, companies that focus solely on internal development are known, in the long run, to become simplistic, narrow and rigid in terms of their portfolio, processes and culture—which may result in a lack of innovation.

It is the reluctant acquirers that aim to cultivate and stimulate organic growth as a result of transactions that have the best chance of creating value. They certainly don't shun acquisitions altogether, but they don't get seduced into an overly large number of them.

■ **ALL-OR-NOTHING INTEGRATION:** Acquirers often seem to develop a preference to either completely and quickly assimilate a target (to avoid a lengthy integration disturbance) or to leave the acquired unit autonomous (to avoid disrupting existing systems and processes).

While both strategies usually manage to avoid severe integration tension, they also hamper value creation. Some form of blending has to take place that creates a new entity.

■ **AD-HOC RATIONALE:** A strategic rationale to combine two companies should explicitly state how the merged enterprise will be able to accomplish something in the marketplace that neither company could have achieved alone.

Yet often a strategic rationale is being drawn up after it has been decided by management that the deal is desirable. Usually, such logic will appear overly complex or contrived.

■ **A FOCUS ON WHO WILL BE IN CHARGE:** Sometimes the single biggest hurdle in a deal is the question of who will be in charge after the merger. Such negotiations indicate that the logic for a deal may have more to do with advancing the careers of executives, rather than advancing the value of the combined companies.

■ **SURPRISE SYNERGIES:** Overexcited executives have a tendency to not walk away from a deal when they should. Sometimes, a company mysteriously uncovers extra value in a transaction when the potential seller's rivals are starting to outbid. That's a sign to company directors and investors that executives might be at risk of commiting value to a deal which the company won't be able to recover.

■ **INVESTMENT-BANK INITIATION:** In itself, it's not relevant who comes up with the idea for an acquisition. When the deal is initiated by an intermediary, however, extra care should be taken to analyze the strategic rationale. Investment bankers, for instance, may attempt to initiate deals where the benefits to the acquirer are unclear. This is especially true when M&A activity is relatively slow. ▪

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