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Mergers: Back to "Happily Ever After"

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Mergers: Back to "Happily Ever After"

Mergers are often considered risky, but when they're executed correctly, there's no better way to grow a company. Booz Allen Hamilton identifies three crucial factors for merger success.

by Gerald Adolph

Most mergers fail. It's an assumption repeated so often that few would dare question it. But is it true?

During the 1990s, it was indeed true — confirmed by a 2001 Booz Allen Hamilton study that found that two-thirds of all mergers fell short of expectations. In the intervening years, however, much has changed. The Internet boom and bust made their mark. New regulations brought far greater scrutiny — and accountability — to senior management and boards of directors. Merger activity has come and gone and come once again.

Today, in an altered business landscape, a close look at current merger activity suggests a different point of view. Companies no longer should expect or accept the probability of merger failure. Although our observation is, admittedly, anecdotal, we examined dozens of transactions completed since our last study, and there is no doubt that the success rate of mergers has increased significantly. Instead of the troubled marriages of Quaker Oats and Snapple, or Matsushita Electronics and the entertainment giant MCA Inc. in the 1990s, more recent couplings, such as those of Bank of America and FleetBoston or Verizon and Bell Atlantic/GTE, are on the path to "happily ever after."

Our analysis shows that at least one of three critical factors is usually evident in mergers that pay off:

1. Consolidation. Many companies are shifting away from big, strategic deals that are intended to add capabilities or create new business models, but that often instead fall flat when companies prove ill-equipped to realize the synergies that they sought. In place of such deals, consolidation-oriented transactions, designed to add scale or grow existing business lines within an existing business model, are gaining favor. Think Wachovia Bank and First Union or Quest Diagnostics and SmithKline Beecham Clinical Laboratories. (See "Making Acquisitions Work," by Kenneth W. Freeman, *s+b,* Fall 2005.) Because these types of mergers essentially involve an enhancement of the company's core business without the need for a fresh set of operational and strategic skills, they carry far lower execution risks and, therefore, have a higher success rate. In the first 10 months of 2005, 42 percent of the 50 largest deals involved companies within the same industry group. This compares with fewer than 30 percent in 1999.

2. Stakeholder Oversight. Boards of directors and stakeholders have become more active in vetting the "how" of potential transactions, rather than considering only the

"why." They are getting involved earlier and are moving beyond traditional board-level issues, such as the purchase price and strategy, to such fundamental concerns as the roadblocks to successful implementation. Witness Dutch publisher VNU's proposed $6.3 billion merger with IMS Health Inc., a U.S.-based health-care data firm, announced in July 2005. Two large shareholders holding a combined 25 percent of the stock publicly opposed this merger even before the proxy was filed with the SEC. They argued that VNU should focus on improving the performance of its current businesses and questioned management's ability to execute a difficult integration. By the end of November, the deal was off and VNU's chairman and CEO, Rob van den Bergh, resigned.

3. Premerger Planning. In our original research, we found that more than two-thirds of mergers failed because the companies did not integrate their operations quickly and effectively to leverage the anticipated gains from the transaction. To avoid this type of failure, companies now initiate integration planning or ongoing examinations of the acquisition anywhere from two to five months before a transaction is actually closed and increasingly even before the agreement is finalized. During this time, managers from both companies may meet to assess short- and long-term performance targets; design a framework for the merged organization, including use of resources and staff allocation; draw up blueprints for integrating corporate networks; and create benchmarks for tracking the planning process. The advantage is obvious: The economics of the merger will improve because synergy realization will be accelerated.

The economic rewards of planning early were aptly demonstrated recently by a global telecommunication services company's $1 billion acquisition of a U.K. fixed-line operator. Shortly after the initial due diligence was completed, a management team analyzed the deal more closely and identified three to five times more potential gains than the companies had initially found. By balancing these newly discovered opportunities with existing cost-reduction goals, the companies were able to more effectively determine the resources and integration requirements needed to capture the most substantial benefits from the acquisition.

The fact that the track record for mergers is improving suggests not only that these deals will continue to play a major role in the growth strategies of many companies, but that they should. After companies reach a significant size and level of maturity, they need to consider acquisitions if they want to continue to deliver shareholder value. Indeed, multiple studies confirm that acquisitive companies outperform their less aggressive peers.

Some of these acquisitions are going to have to go beyond mere consolidation to tap new strategic possibilities. However, that needn't be cause for alarm. As recent mergers increasingly have shown, if the transaction makes business sense for both companies, has the backing of stakeholders, and is diligently planned-for well before it is finalized, it is reasonable, for the first time in many years, to expect success. +

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Resources

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