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Strategy & Business ...Booz, Allen & Hamilton

Lessons From Failed Corporate Marriages

Transactional Myopia and Organizational Overconfidence

By Allen J. Michel and Israel Shaked

The corporate divorce rate is distressingly high, nearly 50 percent. That is to say, almost one out of every two transactional marriages ends in failure. This is the case whether the transaction is a merger, an acquisition or a leveraged buyout.

It is not for lack of trying. The marriage process typically includes detailed plans, projections and analyses. Revenue enhancement schemes and cost-cutting programs are often meticulously laid out. Committees and task forces are formed to implement the transaction. Strategic thinking takes place at the most senior levels of the organization and resources are committed to increase the likelihood of success.

So where does the process go wrong? Why do so many transactions result in unmet expectations and sullied careers and, not infrequently, in bankruptcy?

Our experience providing financial expert testimony and consulting to the unhappy parties of corporate marriages that wind up in court suggests that the problems often result from transactional myopia and strategies based on optimism, rather than reality.

The focus becomes the nuts and bolts of the transaction, the minutiae of the combined company's operations. Forgotten are the sources of its profitability and cash flow, an understanding of its market and the need to maintain a close relationship with the customer. Instead, the company's control system becomes paramount. Spending levels are reduced and each outflow is carefully monitored.

All the while, the customer is wooed and attracted by the competition. These competitors use the opportunity to push their products, distribution system, ease of ordering and often better prices.

Do these acquiring companies ignore strategy in the midst of the acquisition? Usually not. But while strategic assessments are made, they are often based upon an unrealistic sense of the competitive environment and a "hoped-for cost structure" that does not resemble the combined entity's actual makeup.

Fourth Quarter, 1996

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Transactional Myopia

We recently participated in litigation resulting from the failed acquisition of one of the premier trucking companies in America. The company had a stellar history, going back more than 70 years. The acquirers were a management group with a sparkling track record and training at the best business schools in the country. They were intent on implementing the latest and most relevant management tools. But with that implementation came a dramatic loss of focus on the company's key business drivers.

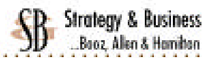
The new owners hired armies of organizational consultants to assist in all phases of the operation. In trooped TQM consultants, work-flow consultants and even consultants to help the acquirers select a long-distance phone carrier. The acquiring team had training videos describing the work-flow process and passed out relevant articles from management periodicals to managers on a regular basis.

The new owners also developed a detailed organization chart, which was always changing, and complicated procedures for all their trucking operations. They constantly updated their forecasts and even developed a recession plan. How many trucking companies had a perceptual map of the industry, showing their position relative to that of their competitors? Not only did the new owners have one, but they also commissioned an awareness study of the industry participants. The results showed them to have the highest awareness ranking among their competitors. And naturally, they had a mission statement describing the organization's goals in platitudinous terms. To insure their ability to cover interest payments resulting from the acquisition, they also had detailed cost-cutting plans and value-enhancement programs.

In short, the steps they took in implementing the acquisition looked like a classic "how to" example from business school. Yet soon after the acquisition, the company filed for bankruptcy protection. What went wrong?

To understand the company's demise, consider another study that the new owners had commissioned for themselves. This was a look at the effects of the bankruptcy of a key competitive trucking carrier. The study focused on the post-bankruptcy reallocation of market share among the remaining players in the industry.

Fourth Quarter, 1996



Lessons From Failed Corporate Marriages

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(Page 3 of 5)

The study failed, however, to address the issue of what caused the competitor to file for bankruptcy in the first place. Not surprisingly, the market forces driving the competitor out of business were virtually identical to those causing this group's own collapse only a short time later. As consolidators in the trucking industry, the new owners found much of their business eroded by Federal Express and UPS. Yet all of their myriad studies failed to address their changing marketplace.

Indeed, all of the detailed planning and extensive cost controls could not have saved them. To have remained a viable competitor, they would have had to see the forest for the trees. That meant they would have had to understand their ever-evolving marketplace. Yet, amazingly, just weeks prior to filing for bankruptcy, they were still revising their organization charts and submitting management reports with no mention of their deteriorating fiscal condition. To the end, they were convinced that their worsening cash-flow position was temporary.

The acquirers also had little comprehension that a company such as theirs, which had highly volatile profits and cash flow and a net margin of only 5 cents per sales dollar when times were healthy, would have to watch its cash position on a continuous basis. When the company entered a recession, the new owners' well-developed recession plan served them not at all since they never implemented it.

As a result of their focus on the mainstays of modern-day management -- forecasts, organization charts, employee training, productivity improvement, management reports, etc. -- the acquirers simply lost sight of what really counted: the competitive inroads being made into their deteriorating business and their steadily worsening cash position.

Fourth Quarter, 1996

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Organizational Overconfidence

While some buyers are obsessed with the details of an acquisition, others limit their scope of analysis to the organizational "big picture." Unfortunately, business schools fail to provide a recipe for the appropriate balance between the big picture and operational detail. From our experience, neither one alone will result in a successful implementation of even a well-crafted acquisition plan. The problem of unevenly allocating too many resources to one mode of management style is a common thread in a large number of unsuccessful corporate marriages.

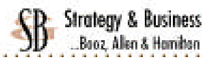
Consider the case of a large department store chain in the Midwest. The acquirer was a holding company that also owned a major fleet rental firm. Both the planning and implementation stages were predicated on the acquisition's success. Even though the retailer failed to earn profits in the three years prior to the deal, the acquirer assumed with certainty that the target would be turned around. Indeed, there were several obvious opportunities for profit improvement.

But as in many acquisitions, the actual time needed to implement organizational changes dramatically exceeded the plans on paper. For example, to discontinue several departments and open new ones took months, not weeks. But when we analyzed the financial projections, we were shocked to learn that it was assumed that such planned changes would be implemented immediately upon consummation of the transaction.

Moreover, the impact of virtually all other planned operating changes was also assumed to take place immediately. The new owner, like many others in failed transactions, ignored the details of carrying out the planned changes. It was almost taken as a given that with a wave of a wand, revenues would increase, expenses would fall and profitability would be reestablished. The acquiring company was so confident of success that it focused almost exclusively on ancillary issues rather than insuring that the ownership transition was smooth.

For example, the acquisition was to be managed by an experienced retailer with a distinguished track record. However, the senior operating executive of the holding company's other unit, the fleet operator, recognized the large profit potential of the retail unit relative to his fleet operation. As a result, he pushed to run the unit even though he had no retailing background. The acquiring group had so little appreciation of the importance of the customer, the market and the details of the acquisition's implementation plan that it decided on who would run the fleet rental business and the retail unit by a flip of a coin! The coin toss resulted in the unit being run by the fleet executive and the fleet being managed by the retailer.

Fourth Quarter, 1996



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Not surprisingly, soon after the executive won the toss, he drove the company into bankruptcy. While the new management had expertise in implementing cost-cutting programs, the ailing retail unit required leadership focusing on customer and market needs.

Though such organizational overconfidence is extreme, numerous corporate decisions are made by executives who focus on grand visions and mission statements. Many of these executives consider detailed implementation plans not worthy of their attention. Yet during periods of sudden and significant changes, executive attention should be carefully balanced between broad strategic decisions and detailed programs that can be implemented.

As long-time students of corporate transactions, we have analyzed and tracked an extensive set of business combinations resulting in financial distress. Numerous transactions consummated each year by senior executives and their high-powered investment bankers have characteristics in common with the examples described above.

The lesson should be clear. If corporate America wants to reduce the failure rate of its marriages, it must come to understand the implications of transactional myopia and organizational overconfidence. When it does, it will finally be able to see both the forest and the trees.