

When TOMs (takeovers or mergers) go bad

By David Parmenter

The Economist¹ ran a very interesting series on six major TOMs and this article looks at some of the lessons learnt, which are very relevant to the NZ environment, and provides a scorecard for your next TOM.

It is often quoted, and even great leaders seem to forget, that “history has a habit of repeating itself”. Company executives, New Zealand directors and the major institutional investors (whose support is often a prerequisite) need to learn the lessons, from both overseas and at home, and think more carefully before they commit to a take-over.

NZ is too small to suffer the losses arising when large TOMs fail. The recent impact to the New Zealand economy on the near collapse of our national air carrier should be a lesson to all. Whilst there are examples of failed TOMs in NZ I have deliberately excluded them to avoid any disputes.

The lessons learnt from the 6 mergers featured in The Economist articles

1. Over half of TOMs had destroyed shareholder value, and a further third had made no discernible difference. In other words, a one in 6 chance of increasing shareholder value (per KPMG report as stated in the economist 22nd July 2000).
2. Defensive TOMs are not a great idea, companies escaping a threat often import its problems into the marriage.
3. During the starry days of courtship, do not limit due diligence in the haste to close the deal as you tend to know less about each other than you think (Vereinsbank - Hypobank).
4. Have a clear strategy for after the merger including who is getting what job thus avoiding the cancerous uncertainty (Citicorp and Travelers).
5. Murphy's law is at work, the time you are the weakest, post merger the industry is likely to have a major crisis (Boeing – McDonnell Douglas, Compaq – Digital Equipment) thus it is best undertaken during time of stable growth.
6. As The Economist stated trying to merger two distinct cultures is “like herding cats”. Arranged marriages need similar backgrounds, culture, and complementary styles to work (read “the kite and other stories” by Somerset Maugham).
7. Acquisition and merger companies may not have many staff who have worked in senior positions in companies who have managed successful mergers, it would be a good idea to look at the last 10 TOM's they were involved with and assess how accurate their forecasts were.
8. Severance packages can create further wastage as staff leave before generous severance terms disappear.
9. The dirty washing may take years to find and clean (Vereinsbank - Hypobank).
10. Appearances count, joint CEOs need to be able to work together although eventually only one CEO and one company will survive (Citicorp and Travelers).
11. Beware of share options being the incentives for a merger (the executives can cash up and leave the shareholders with the infant with soiled nappies).
12. Do not take employees loyalty for granted (Daimler-Benz Chrysler).
13. Have all integration projects report through every 4 to 6 weeks to a “council” (Daimler-Benz Chrysler).
14. Merging the operations will distract management from the basic task of making money (Boeing – McDonnell Douglas).

¹ The Economist Journal 22nd July 2000 through to 26th August 2000

15. Set up an in-house think tank whose task is to speed up integration and to suck out knowledge from the different parts of the joint company and use it in the new organisation (Boeing – McDonnell Douglas).

Set out below is a scorecard based on the lessons from which executives need to complete before boldly going where others have mistakenly gone before, (5 out of 6 TOMs fail to achieve the synergism planned).

TOM scorecard	tick if you can answer yes
Has your company got the ability to turn away from a deal if it does not stack up?	
Have you done an evaluation of the potential downside?	
Are all the following team players experienced in accurately assessing the full costs of the TOM and accurately estimating synergistic savings?	
Advising Brokers	
TOM advisors	
Board	
Executive	
Note: TOM advisors and hungry executives are as accurate with potential cost savings estimates as they are with assessing the cost of their own home renovations (in other words pretty hopeless)	
Have all other alternatives to the TOM been fully explored?	
Have safeguards been put in place to ensure that the benefits from this TOM accrue to shareholders, staff, local community as well as the executive “share option holders”?	
Has your company got experience in doing a proper due diligence process?	
Has your company enough time to do a proper due diligence process?	
Has an impact assessment been undertaken on the New Zealand economy if the TOM fails?	
Has the company got enough cash reserves to “weather any eventual storm” arising from the TOM?	
Have you performed a culture audit - a TOM is like merging two families and many problems are overlooked in the frenzied courtship?	
Have you locked-in a portion of your advisors’ fees to a successful realisation of the proposed TOM benefits? - remember many of your advisors have never worked in an organisation which has had a successful TOM.	
Have you performed an assessment of asset fit - quality, condition and usage?	
Is your target company a “CAMEL”? - a company with adequate capital, good asset quality, good management, record of sound earnings growth and with good liquidity.	
Has an assessment been done on the locked-in employment terms and conditions (especially relevant if acquiring an Australian company)?	
Has an evaluation been performed of the current pressure on the environment in which the organisation is trading?	
Has an assessment been performed on the IT systems integration? - few understand the implications of a TOM and the timeframes involved. The IT team may not have the skills to cope with the now larger environment.	

Has the TOM been initiated through sound reasoning? (Many mergers based on a defensive or cost cutting strategy fail).	
Have you carefully selected the target? Or if you have been approached, have you really ascertained why they want to sell?	
Have you checked the adequacy of provisioning for potential bad debts and under performing loans?	
Is the business tied to contractual conditions which enable customers to pull out of profitable contracts? (a lesson that NAB learnt)	
Have you established a integration plan which would include the setting up of a "council" which would oversee the key integration projects?	
Current relationship between the companies is favourable (in other words have not been fierce rivals in the past).	
Do you have the resources to select the new management structure ASAP?	
Have you got a contingency plan for the potential loss of key staff? - uncertainty and very generous severance clauses may force executives, who you want to keep, to activate the severance clause for fear of losing the generous terms.	
Are you prepared to go through the potential pain of lower revenue as management and staff are diverted by the merger?	
Are you prepared to be made surplus to requirements when all the dust has settled and the blood letting finished?	

less than 15	Stop now, - take a break, and think of another strategy for growth or protection
15-20	High risk TOM - you may be able to increase your score through further evaluation and planning
20-25	Well done, look out for the areas where you do not feel inclined to cover, they could be your Achilles heel.
over 25	Congratulations, you are in a unique position - worth having your assessment checked by a third party

Remember there are other options to a TOM

- Remain being a boutique operator that has strategic alliances, this may be better than the fate of many failed TOMs
- Paying back shareholders the surplus fat and letting them reinvest elsewhere
- Improve performance by focusing on under performing assets (that's often the reason why the other company is interested in you in the first place)
- Look to grow the old fashioned way by expanding from within
- Invest as silent partner in small but fast growing companies with complementary services and extract value by internationalising their innovation

Survival guide for a shareholder

1. If you have shares in the amalgamated company monitor progress carefully. Share price rises, a common feature of the early days of a TOM, are largely due to the investors, equally unskilled at evaluating TOM's, getting swept away with potential cost savings and synergistic benefits.
2. The first sign of TOM savings not eventuating will mean you are only seeing 'the tip of the iceberg' that may sink the company - get out.

3. The first sign of write-offs of goodwill or debts is a warning that worse is to follow, seldom are all the write-offs made the first time.
4. Remember that the executives in most mergers gain both through their share options holdings and remuneration increases/golden handshakes. Monitor their share holdings as any decrease may signal that they now realise that the merger is one of the 5 in every 6 that does not produce the goods.

Last words

- Cost savings from TOMs seldom eventuate as planned
- Tie your advisors fees to realisation of merger benefits - this may focus their mind a bit
- If you are trying to be the one “defensive merger” that works remember many have failed
- Talk to a director or fellow executive from a failed TOM and assess the downside and pain
- Expanding from within maybe the best option in the long run
- The first sign of write-offs of goodwill or debts is a warning that worse is to follow

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