The Merger sting - and why mergers cannot succeed

(extract from "Conquest Management - a guide to the top". Whitepaper available from *www.davidparmenter.com*

By David Parmenter

I met an interesting investment banker on the plane from Melbourne to Sydney who told about the take-over and merger game that is being played by the large investment bankers around the world. It never made any sense to me when everybody knows only one in six mergers breaks even and many have lost billions off the balance sheet!

The game is all about the "transaction fees" and involves the study, by the investment bankers, in minuet detail of what are motivational factors of the key players. They end up knowing more about the private lives of the CFO, CEO, Board members, Fund managers than they would like their partner to know! Investment bankers go to the CEO and CFO with a proposed merger and acquisition deal and they often fail. The CFOs and CEOs know that these deals seldom work.

The investment bankers then go to the influential board members and the CFO and CEO have to fight it in the Board room, which they typically will win. The investment bank who has now spent $100,000s in research are not finished . They go to the fund managers, who are the major shareholders, and say "the board has lost the plot" they do not recognize the value in this deal" The Fund managers put the hard word on the Board who in turn say to the CEO and CFO. "If we do not do this deal the fund managers will change the board, but before that I will see that you go first". The CEO says "What the hell we will do it". The interesting part now starts. The CEO is offered a big sum to go quietly and this with the investment bankers fees are now amortized, through poorly thought out accounting principles, slowing killing combined company for years to come.
I believe the merger vehicle is totally flawed, it is set-up by those totally disinterested in its success or by those totally ignorant of the dynamics involved. In many cases the same executives, leading the charge, have often shown scant regard to understanding of their Human resources, their key asset.

The executives believe you can simply rationalise as if you were merging machinery together to form one production line. I dare say that has its complexities too. The reasons why a merger can never work include the following.

<u>Loss of focus on customers</u>
There is no better way to lose sight of the ball than a merger. Whilst meeting after meeting occurs at the office and sales staff focus on their future (either applying for positions elsewhere or joining in the ugly scramble for the new positions, the customer remain open for the taking. Researchers, sales staff , marketers, are all busy back at their desks busily trying to perform damage limitation exercises as they either jockey for the life boats or stay on board to try and keep the ship afloat. It would be an interesting Phd to assess the loss of customers due to merger activity.

<u>Culture clash</u>

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As someone said its like “herding wild cats”. Where have cultures merged successfully? In reality one culture takes over another. This is okay when one culture is fundamentally flawed. However in many mergers both entities have cultures that work. Now you have a problem. Many competent staff may chose to leave rather than work in a culture that does not suit their working style.

<u>There is no heart in a merged organisation</u>

How long does it take for a company to develop a “heart”. This is more than just the culture, this includes the living and pumping, life blood of the organisation. I think it takes years, and some consistency amongst the management and staff. The merged organisation cannot thus have a heart. The organisation can be kept alive by “dialysis” but just like an acute patient it is effectively bed ridden and in “intensive care” for some time.

Why is it then that senior management, and Boards rush like lemmings for this self annihilation? It is understandable why the investment community and shareholders make the mistake, they are simply naive. Try and find an analyst who has been a successful manager in business. Their skill is adding numbers up and the ability to write seemingly sensible evaluations based on little or no knowledge of why mergers cannot work. Shareholders on the most hand have little time for research or are just plain greedy, looking for supernormal returns and believing all the promotional material which does lift stock evaluations over the short term.

The only sensible shareholders in a TOM are the ones who cut and run.

<u>The loss of years of intangibles (passion, history, research, projects,</u>

An organisation is a collection of 000s of “years” of experience, networking, research, projects, experiences and pollution. If a major blue chip company said that it was going to de-establish all its staff and management, shareholders analysts would think management had simply lost it. The stock values would fall. This is exactly what a merger does.

Research and development is another victim. How do you keep on projects and maintain the level of momentum with unhappy research staff. At worse you will be moving one team to a new location, making redundant those who you believe are the making the least contribution and attending “leaving dos” of the talented. Research basically gets decimated. It would be interesting to look at the impact on research post the Welcome Glaxo merger.

<u>The wrong management rises to the top</u>

I have this theory that the main beneficiaries of a merger are the pararners, those management who relish the fight to the top. Burying a dagger in someone’s back needs to be a daily occurrence, it is the equivalent of our caffeine fix, they are addicted to it. The result is quite interesting, the mergered company becomes very soon disfunctional as more and more of these caustic management rise to the top. The senior management meetings make the feeding frenzy over a carcass, on the plains of Africa, look like an orderly thing. These management do not live and breathe the organisation, those managers have long since left as there is no heart in the new organisation.

If the merger has too go ahead then please look at the following list and get to it. I will not wish you good luck as that will not be adequate enough!

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The synergy calculations are totally flawed

Now let's look at the savings. Press clippings are easily gathered with CEOs stating the anticipated savings have taken longer to eventuate. The reason is as follows:

It can take up to 4 years to merger the IT platforms together, and even when this is achieved many future efficiency and effectiveness initiatives have been put on the back burner.

They never allow enough for the termination, and recruitment costs involved in merging entities

Many such companies are making paper money like Enron did

The "Enron documentary" should be compulsory watching for all investors and employees with pensions invested in their companies.

The lessons from Enron and other collapses I believe lead to the opinion that all company collapses as predictable. This is my checklist for you. Score more than five an you had better disinvest, before your funds are de-invested from you, by others.

Checklist	Is it covered?
Stock market loves the share for over a 2-3 year period	❏ Yes ❏ No
CEO has become a media loved person	❏ Yes ❏ No
The company has adopted some bizarre HR practices	❏ Yes ❏ No
There is an over hyped culture within the company	❏ Yes ❏ No
The Key positions in the top are head hunted visionaries	❏ Yes ❏ No
The investment bankers are earning large transactions fees	❏ Yes ❏ No
There are no questioning articles in the press	❏ Yes ❏ No
Excessive company executive remuneration	❏ Yes ❏ No
Senior management team consists of many rags to riches stories	❏ Yes ❏ No
Outside superstars are recruited in with media fan fare	❏ Yes ❏ No
There is no muck (high proportion of the income comes from "invisibles")	❏ Yes ❏ No
The organisation has created a new market, service that the market does not yet understand	❏ Yes ❏ No
Take-overs are becoming a regular occurrence in the company	❏ Yes ❏ No
There are signs that business ethics are questionable	❏ Yes ❏ No

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Very innovative company	❑ Yes ❑ No
Taxi drivers are talking about the share	❑ Yes ❑ No
The company has changed its executive jet twice in the last three years!	❑ Yes ❑ No
Excessive media interest borne from media spin	❑ Yes ❑ No
Executives are charismatic in front of analysts and the press	❑ Yes ❑ No

Human beings find it hard to conceptualise the intangibles

For many of us conceptualising the abstract is very difficult. A company is most definitely the abstract. It is not a balance sheet, it is much more, and much less. Executives in major corporates can write-off the annual gross national product of a small country on a failed merger and still not loose sleep at night. The numbers are so large that it is passed off as just a poor management decision and not the catastrophe it really is for the investor who is really on it for their pension.

It is impossible for the average Board and SMT to fully appreciate the full implications of a merger.

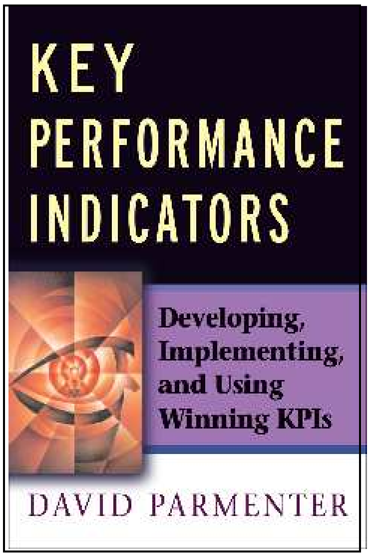
Mergers are seldom done in a position of strength

Most mergers are defensive. management on the back foot trying to make something happen. Alternatively they occur because management consider themselves invincible. They talk to the general public through the press revelling in their moment in the lime light. There short track record of stellar growth is now extrapolated out of all proportions.

There is never enough time to fully evaluate the target

A merger is like an action. The buyer rarely has more than a cursory look at the goods before bidding. Management often do not want to find the dirty washing as they would mean going back to square one again.

Writer's **biography**



David Parmenter is the CEO of waymark solutions. Besides helping organisations implement their winning KPIs David also helps organisations to: streamline their month-end reporting and annual planning processes, implement quarterly rolling forecasts, adopt the principles of beyond budgeting, and develop decision based reports. His 2007 speaking engagements included Scotland, Ireland, England, South Africa, Malaysia, Singapore, Johannesburg, Australia and New Zealand.

John Wiley & Sons Inc. published two of his books in 2007: *Key Performance Indicators – developing, implementing and using winning KPIs* and *Pareto's 80/20 Rule for the Corporate Accountant – better practices from winning finance teams*. He has written over 30 articles for the accounting and management Journals in Australia, Malaysia, Ireland, England and New Zealand. His articles published include: "quarterly rolling planning - removing the barriers to success", "Throw away the annual budget", "Maybe its time to look at your KPIs", "seven time wasters", and "quick month end reporting", "Beware corporate mergers", "Implementing a Balanced Scorecard in 16 weeks not 16 months", "Convert your monthly reporting to a management tool", "Smash through the performance barrier", "Is your board reporting process out of control?"

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