DO YOU MERGE OR ACQUIRE?

> "Generally in warfare, keeping a nation intact is best, destroying a nation second best; keeping an army intact is best, destroying an army second best; keeping a battalion intact is best, destroying a battalion second best; keeping a company intact is best, destroying a company second best; keeping a squad intact is best, destroying a squad second best.
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> **(Sun Tzu (544 – 496BC), Chinese Warlord and strategist. The Art of War)**

Surely, when applied to real conflict as opposed to perceived conflict in business and in commerce, this is common sense. Whilst the objective must be to overcome opposition and to destroy the weapons and the ability of an enemy to continue to wage war the less you destroy, in terms of infrastructure and utility services such as water and electricity but not radio and telecommunications because you need to destroy his ability to communicate and marshal forces, the more you have available to use as part of the strategic and tactical process to overcome opposition by winning 'hearts and minds'.

In the commercial world this fundamental strategy, of not destroying what is available but seeing how best you can make use of it can, surely, be applied to mergers and acquisitions. It is better to fully understand what you have taken over, although this really needs to be done well in advance of launching an assault on shares and on the business, before you even begin to think about downsizing, delayering and business process re-engineering, all of which actually destroy internal communications, destroy employee support and commitment leading to resentment and possible loss of business.

It can only have been a decade or two ago that we were advised, again management gurus, consultants and business schools spring to mind, that size did not matter. Indeed, big, apparently, meant unwieldy and inflexible; big meant that you could not change direction quickly enough or keep pace with smaller and more nimble companies; and, that big meant inefficiency, over manning and overheads. Some consultants, management gurus and advisors advise that greater efficiencies and more shareholder value can be gained by breaking up unwieldy empires and that this process simultaneously increases competition.

Now, companies in some business sectors are advertising their 'bigness', or their desire to be big, as if size means that they can offer customers and consumers more than smaller organizations and perhaps at competitive prices. Yet others are suggesting that in order to compete in the growing global village companies have to be big or risk being swallowed up by bigger fish. Whatever the supposed reasons given, for the moment bigger and more robust, even in the fashion industry appears to be back in vogue as a management mantra.

In the public sectors we appear to have gone through numerous and prolonged periods of consolidation and re-organization in the provision of healthcare and other medical services as yet more and more levels of unelected management sit above those who allegedly provide the services. This is particularly prevalent in the building of new medical centres for general practitioners to co-locate and in the building of new hospitals where one large regional hospital has replaced 2, 3 or even 4 smaller and more local hospitals. Unfortunately, in most cases where this has happened, the facilities, equipment and beds that are available after consolidation, a form of merger, are often insufficient to meet the demands of the communities they are designed to serve. Is this simply a case of bad organization and planning or poor political decision-making?

In the transport, electricity, water and gas supply sectors consolidation has taken place, after privatisation, and there are moves in the water industry where more financially sound companies' take over less profitable water companies to increase their hold and strength in that sector. But somehow the best interests of consumers do not appear to be part of the equation as the cost of such services continues to increase. I sometimes wonder if privatization is done in the best interests of customers, whether patients or purchasers of products or services, or just in the best interests of shareholders and I suspect that greed often lurks beneath the surface.

However, growth is being achieved not by increasing investment in research and development, introducing new products or services and improving customer service or by more competitive pricing but by the basic route of buying out the opposition. Companies with deep pockets or with access to large sums of money are increasing their sphere of influence through a definite strategy of purchasing companies, making specific products or providing specific services, in a particular business sector. Thus mergers and acquisitions tend to stifle rather than stimulate competition.

Pursuing an acquisitive strategy demands clear purchasing policies and plans, that is being able to identify positive benefits from the purchase in terms of cost versus return on capital employed and whether or not the purchased company provides yet another piece in the jigsaw of the perceived future company. It also demands positive direction and decision-making because procrastination leads to loss of opportunity and is the mother of decline.

When big organizations fail to develop new products quickly enough and bring them to the market or become unwieldy or are caught flat-footed by smaller and nimbler companies what happens is their share price begins to wane. The end result is, more often than not, an aggressive round of cost cutting usually achieved through more programmes of delayering and downsizing. This tends to achieve a short surge in productivity followed by an improvement in profitability and, perhaps, a slight increase in share value. That is until the next minor crisis in overheads and expenses that leads to yet another round of cost cutting, the very measure that caused the loss of staff and expertise in the first place.

Nowadays an alternative response appears to be to look around and see what smaller companies are available for acquisition to improve short-term growth. Once this merry-go-round began many big corporations, over here and over there, began to knock on the door of smaller companies in their haste to grow even bigger. Indeed, there are now many websites that offer a service to would-be acquirer's in terms of advice and general information on availability of companies in numerous sectors.

The result is a general scramble among companies with some clout to have even greater clout by chasing the concept of global dominance by increasing market share and share price through cutting costs, based on the fundamental principle that size really matters, whilst simultaneously exporting or off-shoring jobs and work to developing countries with cheaper labour costs. But does it mean and is there a very real danger that bigger and bigger companies and organizations will begin, or even increase, the amount of political, economic, social and technological clout they already have in countries and globally? With the increase in what is referred to as 'cross-border' takeovers some countries are in danger of 'selling- off' the family silver and once it is gone you cannot get it back.

Anyone paying even the slightest attention to the media, newspapers, television, magazines or the Internet, over the last 12 to 18 months cannot have failed to notice the sudden almost messianic increase in the spate of reported mergers and acquisitions. Many of these mergers are taking place in the financial services sector, media, telecommunications and the pharmaceutical industries. For example, Chase Manhattan's purchase of Robert Fleming, AXA's purchase of Guardian Royal Exchange, Norwich Union by CGU and other planned acquisitions in banking and insurance. The next step in all those organizations will be to pursue programmes of amalgamation by delayering and downsizing to reduce overheads and then to consider outsourcing or exporting work to developing countries.

In the telecommunications and media sector MCI's acquisition of Worldcom, Time Warner and CNN and Vodaphone's acquisition of Mannesman of Germany and AT&T's quiet acquisition of some of the larger post-production media companies in Hollywood; and suggestions of mergers in the IT sector where a long established computer and associated technology company in California is looking to acquire a company in the same business but I remain unconvinced that their cultures means a smooth acquisition; and, in the pharmaceuticals sector the tie-up between Smith-Kline-Beecham and Glaxo-Wellcome creates an even bigger pharmaceutical company.

Indeed, in the last example the companies had two bites of the cherry before they reached an agreement. The planned merger hinged on the vexed question as to who would end up running the merged company for the basic reason that both Chief Executive Officer's, and presumably other senior managers who had a vested interest, were of the opinion that they should be the one's to reign.

Another example is the more recent failed merger between Deutsche Bank and Dresdner Bank. The merger failed, allegedly, because the two sides could not agree, again, over who would be in charge and, secondly, how to dispose of other financial companies that formed part of the package in the merged organization.

There is merger movement in others areas like the food industry sector; for example, Wal-Mart's acquisition of Asda and Unilever's acquisition of Ben & Jerry's Ice Cream Company and the producers of Slimfast products. However, of concern to consumers, and government's, must be the fact that so many mergers and acquisitions will, undoubtedly, lead to a few big players and thus less competition in the market place meaning less choice for consumers and customers.

A merger, according to the concise oxford dictionary, defines as "the combining of two commercial companies into one" and, an acquisition as, "something acquired (gained or obtained) especially if regarded as useful". That begs the questions when is a merger not a merger and is something acquired always useful? And, just as important, who really benefits from the aspirations of Chairmen and CEO's? Further, if mergers and acquisitions are such good value why then do so many, despite the enthusiasm of senior managers to pursue such a strategy, fail to benefit shareholders and employees?

Whilst cost reduction is an important factor in an acquisition strategy for Anglo-American companies many such mergers fail to produce any shareholder benefits. The figure for failures of merged companies is varyingly estimated at between 60 and 70 per cent, often companies are sold on after a short time and the only people who appear to gain are investment bankers and those involved in the M&A deals.

To deal with the first question most discussions on mergers begin on the basis that there is synergy between business areas, products and operations in the two companies that might work together. In other words companies are looking to expand their area of business and control by buying in other expertise and other goods or services not presently offered by their company. In addition, the desire to merge is driven by the belief that cost savings can be made in the merged company and that it will also lead to greater market share through an increased portfolio and lead to increased revenue. Nothing could be further from the truth.

Basing a merger entirely on cost savings is wrong for the simple reason that a fundamental principle of business is to grow the company through providing the goods and services that customers want. There is no guarantee that all the customers with the first company and the second company will both choose to continue their relationship with the merged organization; indeed, some may decide that since competition may have been reduced that they will look elsewhere to negotiate contracts.

The fundamental flaw in pursuing a merger is the fact that it is difficult to create one organization from two entirely separate companies. Not only do mergers create bigger organizations with greater numbers of staff, until the programmes of delayering, downsizing and resource re-alignment begin to bite, but they tend to reduce motivation, increase layers of conflicting communication and do not encourage commitment.

And, strangely, you can apply the same basic principles to merging existing divisions, sections, groups or even teams with an organization; there will be the same amount of resentment, frustration, lack of direction and lack of commitment when any perceived merger is clearly seen to be not in the best interests of the employees.

Despite being in the same business sector all companies have their own corporate culture and trying to pull together two similar but independent cultures and organizations takes enormous time and effort to complete. That is why it is suggested that the more time and effort spent on determining and agreeing a new management structure and culture before reaching agreement on a merger or an acquisition the greater chance it has to succeed. Unfortunately most senior managers do not 'see the wood for the trees' and convince themselves that a particular merger or acquisition will add value when, in the majority of instances, it is far from the case. However, once the deal is done it is too late to go back and it is not only employees who lose out but also shareholders.

During the process of producing merger plans employees are often quizzed and queried, by outside consultants, who have to learn how the separate organizations are structured and staffed before they can come up with a proposed combined management structure and manpower levels for the new company. Under those circumstances why on earth should people who might lose their jobs really provide advice and support to highly paid consultants? Sure that is a bit like 'turkeys voting for Christmas' or game birds voting for the 'Glorious Twelfth'.

An acquisition is, "something acquired, often to add to a collection", indicating, perhaps, that again it is something pursued to make an even bigger collection of items in a portfolio be they companies or organizations. It is a different kettle of fish from a merger. Most acquisitions occur when a bigger company subsumes smaller companies in order to increase their sphere of influence and control in a specific business sector.

However, sometimes the worm turns and a smaller organization takes over a larger company; or, smaller companies can agree to band together as a means of securing their position or to prevent larger fish swallowing them up. In every case the process is based on the concept that the conjoining process will be of benefit to both or all parties involved.

But the problems involved in the process of joining the acquired company with that of the acquirer is the same as for a merger. Nonetheless, it would appear that many acquisitions or mergers are pursued simply as a means of increasing the size of the company, increasing the size of the company products and, in the process, increasing the size of the senior management remuneration package. Other mergers or acquisitions are brought about in a time of business downturn when, in effect, what one company is doing is buying the customer base of the company it merges with or acquires simply to be seen to be doing something to maintain market share.

Looking at mergers or acquisitions in a simpler format think of the process as a marriage where two apparently willing people agree to form a relationship based on such ideals as trust, openness, integrity, reliability and faithfulness to achieve mutual benefit. The most difficult of such relationships happens when the partners are from different cultures, creeds, habits and traditions leading to tension within the relationships but also from without from other interested parties be they relatives or wider communities.

Often the pressure from one or more sources leads to problems that demand compromise and if it always seems that one partner compromises more than the other it can lead to resentment. So it is with a merger or an acquisition between companies of different cultures, traditions and established processes and procedures. Fundamental principles for increasing the possibility of success in either merging two companies or acquiring and integrating other companies into another organization include:

- **Change** - before proceeding with a merger or an acquisition it is imperative to identify any areas of the combined business that might impinge on a successful integration. These should be established before the process begins in earnest so that solutions to possible problems can be identified.

- **Completion** - once discussions begin establish a management team with responsibility for addressing and agreeing ways to achieve integration. Again, representation should come from both companies.

- **Communication** - keep employees and customers of both organizations aware of what is happening with any planned process. Decisions taken in secret do not encourage commitment.

- **Comment** - allow employees to comment on any proposals for integration. You are more likely to gain commitment to plans if the people it affects are allowed to contribute to the process.

- **Clarity** - make sure you develop a clear purpose of the new merged company and a new Mission Statement that, if possible, incorporates the style and culture of both merged or acquired organizations so that you continue to appeal to both sets of customers.

- **Competencies -** part of the process of integration must be to address the future management structure. To do that, areas of responsibility and accountability must be determined and agreed. Once accepted then any planned changes should be communicated to those affected.

- **Culture –** it is important that the culture of both companies is similar to ease the process of integration. Where two cultures are dissimilar the possibility of the merger or acquisition failing is increased.

The implications and suggestions are that, firstly, any discussion on a merger or acquisition must be kept strictly confidential because competitors could get wind of the plan and submit a spoiling bid. Second, before proceeding each company involved must quantify whether the merged company will provide benefit to both sets of shareholders and that the costs involved can be recouped within a reasonable period of time. And, third, it is absolutely made clear that the money could not be better spent investing in new products and plant, on maintaining services to existing customers in the area of interest and on improving products or services in order to increase productivity and competitiveness.

In many instances it may be better looking to form strategic alliances with companies in similar fields but with diverse locations and customers. An alliance may not be an easy option but sometimes they are easier to handle than an outright acquisition or a very difficult merger of different thoughts, ideas and personalities. You cannot expect to retain employees, even the better ones, and keep them motivated with uncertainty, keep long-established customers happy and maintain focus and growth when it is clearly perceived that only those at the highest levels will benefit financially from a merger.

Regardless, there is more than enough evidence from academia, as they say over here and over there, to suggest that mergers are not only expensive but that they rarely work. Indeed this view, this opinion, is re-enforced by a survey report in the USA, by KPMG, that suggests only one in six companies that completed a cross-border takeover saw their share value rise. In addition, research by a fellow of Warwick Business School suggests that two-thirds of major takeovers by UK firms were followed by underperformance of their shares. And, further, that companies who rely entirely on mergers or acquisitions as a strategy to achieve growth and boost the share price see rapid growth but then an equally rapid decline because there was no underlying strategy of organic growth in the company.

Even if the proposed, planned or agreed merger takes place it invariably leads to job losses, to pay for the cost of the merger and the respective CEO's bonuses, and to the loss of knowledge and expertise of the people who lose their jobs in the process. And, whilst the senior management and their appointed change managers are concentrating on integrating groups, sections and divisions and producing a fine organizational structure that takes care of their planned integration some of their more experienced people have become disillusioned, disenchanted and disappointed at the proposed re-engineered and re-organized company and are quietly leaving. But that is the nature of the beast of change – a few win and many lose in the process.

Looking at previous indicators it seems that there is often a surge in merger and acquisition (M&A) activity when there is a general slow-down in global economic growth or clear signs of weakness in one economy or currency system or when there is increasing global economic uncertainty. Indeed, I get the impression that such activity is meant to re-assure the proletariat; in other words it is a form of desperation activity that gives some credence to the notion that an economy is sound and growing.

It is a time when bigger players, looking to remain in the game by pursuing, belatedly, a policy of growth, look around for weaker companies. It is a way of beating down the competition and being seen to be vigorous. That way the proletariat thinks economic conditions are still sound and their jobs secure and even economists are fooled into believing growth is not totally subdued and that the market and trading conditions are sound. And, have you ever noticed how M&A activity appears to increase to a particularly high level just before an economic downturn?

Frankly, I should be more convinced that a country's economy was sound and based on solid future employment opportunities through industrial, employment and energy policies if there were announcements indicating much greater investment in new products, plant and educating people rather than on merger and acquisition activity.

Therefore, it seems strange that apart from Chief Executives and boards of directors of companies it is the City, the stock market, which supports if not encourages such action. Indeed, ask yourself the question who really benefits, apart from investment bankers and the chief executives and most senior managers in the acquiring and the acquired company, with any merger or acquisition?

It is the fund managers, banks and large-scale investors who are looking for the quickest possible return on their investment so that they can make money from the deal and it is the board and senior management who are looking to boost their pay packets. Therefore, it is very reasonable to suggest or imply that mergers and acquisitions are designed to do nothing more than maintain the share price in a company and thus the shareholders, big and small, will more readily accept any proposed pay and share deals for the chief executive and the board of directors.

In my view companies, and by that I mean chairmen, chief executives and boards of directors, should take into account the needs of all the interested parties, shareholders, managers, employees, suppliers and customers, before making a decision to sell the company to anyone.

Further, just like purchasing a house, there ought to be some limit on how much a company, or group of individuals, can borrow in order to acquire another company to avoid the very real possibility of such actions leading to the complete loss of both companies within a period of time after the acquisition.

Research from business schools and management consultancies including Deloitte & Touche suggest that poor planning leading to overspending on purchases, poor strategic fit with the existing business and poorly executed mergers and acquisitions are often a cause for businesses under performing and leading to a loss in share price and value. A McKinsey study suggests that up to three-quarters of mergers and acquisitions, others suggest nearer 80 per cent, especially in the high technology sectors fail and destroy value in companies.

And, yet other studies indicate that mergers and acquisitions do not succeed, especially where the acquisition of foreign-owned or foreign-based companies are concerned and they do not always lead to greater investment in research and development. Foreign ownership might be seen as a positive move, but it quickly turns negative if and when there is a downturn in that particular sector and the foreign owner retrenches by closing down his foreign subsidiaries.

It seems that many mergers or acquisitions are pursued simply as a means of defending the position of the dominant company in the face of a declining market or declining margins, a bit like forming strategic alliances in the game of 'Risk', and not necessarily to increase shareholder value, plan for longer-term stability and sustainability through organic growth and maybe even make employment and the company future more secure. And, once a merger has taken place then the real battles begin, the ones behind the scenes in the two companies to determine who comes out on top, whose jobs remain and who is made redundant to reduce costs.

After all, it is shareholder monies and the time, efforts and monies of customers and suppliers and the future of employees that are being gambled in the process; and, such gambles do not often bring greater investment and a return on the costs of the activity. And, not too many at the higher levels really ask the question of their shareholders and customers whether or not they have any doubts, misgivings or are generally happy with a proposed or planned merger or acquisition.

Therefore, I suggest, that in the short-term and in the long run it is the duty and responsibility of all stakeholders, from directors and senior managers to all employees as well as customers, suppliers and the local community in which a company is based to take an interest in any proposed merger or acquisition and to make their views and opinions known direct to the senior management and, if necessary, through the media. Again, greed, or perhaps simple over-indulgence, drives the desire to acquire more and more. As Confucius suggested,

> "With rice to eat, with water to drink and my bended arm for a pillow – I have still joy in the midst of these things. Riches and honours acquired by unrighteousness are to me as a floating cloud."
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> **(Confucius (551 – 479BC), Chinese Philosopher and Reformer, Confucian Analects)**

Besides, some companies have existed for a century and some times longer and they have not only provided employment opportunities for local people but they have also contributed to the development and growth of communities. Should they not be valued? In the headlong haste to 'increase shareholder value' many organizations have completely lost track of the other stakeholders who have a vested interest in the existence and growth of companies and the economy will eventually suffer.

But, in the global marketplace companies have to be 'light on their feet' and look for opportunities to change tack or sell-on parts of their business to competitors who are bigger or more efficient. Unfortunately, in their haste to get a foot in another country or even another part of the world, through mergers or acquisitions, and this applies particularly to the telecommunications industry, some companies have ignored the needs and demands of their national customers by failing to invest in research and development to increase or improve products and services and offer competitively priced products or services.

Of course it is paramount that there must be competition to ensure customers get a fair deal and hopefully regulation will ensure that happens. How many of us have got frustrated with some long established company that suddenly does not meet expectations or fails to deliver on quality and price? But if we stop and think what has happened in the high street of most towns and cities we can see that in many instances the customer, the consumer, has lost the battle during the process of creating giant superstore groups.

The gradual disappearance of the local baker, butcher, greengrocer and fishmonger in the high streets, beaten down by supermarkets, is a very clear indicator of the loss of companies and competition; and the many cloth and shirt makers, tailors and shoemakers in the UK, beaten down by imported and cheaper made mass produced products from China and India are testament to the loss of jobs and to the increasing loss of skills associated with such industries and trades.

The loss of the iron and steel business and the associated areas of heavy and light electrical and mechanical engineering, shipbuilding and motor car manufacturing in UK, beaten down by cheaper competition from the Indian sub-continent, Eastern Europe and the Far East, is an indication that the balance of manufacturing and industrial power is shifting from west to east and that will, undoubtedly, be followed by a shift in economic power and influence.

More recently, we have seen the gradual shift of jobs in the information technology (IT) sectors from software and hardware design and also call centres to parts of India. Soon there will be a reverse process of acquisition activity once companies based in those countries make increasing amounts of money and profit and then begin to flex their economic muscle and put added pressure on western companies; then what will western companies and governments do?

The complete openness of the UK business market to mergers, acquisitions and takeovers must be open for much greater discussion because this complete openness does not appear to happen in other nations and certainly not among all advanced, industrial countries. Already Britain's utility companies in electricity and water are owned by American, French and German companies and some of our financial companies are now fully or part-owned by other national companies. And, once the 'family silver' and the companies have been sold off and once those skills are lost, in each and every area of industry and commerce, it will be very difficult to get them back.

Companies consist of people; they provide goods and services to people who purchase those products or services through the efforts of yet other people and their primary objective must always be to serve people, customers and consumers. Companies belong to shareholders but they also belong to customers, local communities and sometimes countries and that is why free-markets are free-markets but only as far as individual governments will allow them to be totally free of any kind of laws, guidelines, rules and regulation and scrutiny for mergers and acquisition.

Issues are sometimes confused by talk of synergy between the merging companies or between the company acquiring and the company being acquired. Frankly companies, all companies, should concentrate more on investment in research and development and on products and people rather than on mergers or acquisitions.

Unless there is a strong possibility of a very real win-win situation for all the stakeholders and very clear and definable gains to be made it might be better not to proceed with a merger or an acquisition. And, it would be very useful if large scale investors and other heavy investors in any company paid much greater attention to the area of corporate governance, and many areas of governance are weak and open to interpretation, to merger or acquisition strategies, to huge pay and share awards to chief executives and directors, and voted against such moves if they were clearly not in the best interest of all stakeholders.

(5170 including quotations**)**

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