

Mergers and acquisitions

Coming unstuck

When giant deals fail, life rarely goes back to normal

The Economist, Aug 9th 2014 | NEW YORK | From the print edition

QUEEN VICTORIA sniffed that “We are not interested in the possibilities of defeat.” For empire-builders in the corporate world, failure is all too common. On August 5th the octogenarian Antipodean Rupert Murdoch withdrew 21st Century Fox’s unrequited pursuit of Time Warner. The deal would have been worth at least \$70 billion and have created a media monolith. Hours later Softbank, a Japanese conglomerate which owns Sprint, an American telecoms firm, abandoned its effort to buy control of T-Mobile US, another operator in America, with an enterprise value of more than \$30 billion.

In 2014 there have already been two other big deal making snafus—Pfizer’s abortive bid for a fellow drug maker, AstraZeneca, worth \$125 billion, and the union of Publicis and Omnicom. The two advertising firms were supposedly engaged in a logical impossibility: an amicable Franco-American merger of equals. In fact their executives were fighting like rats in a sack.

In all, bids worth \$390 billion have been terminated or withdrawn so far in 2014 (see chart). That is huge in absolute terms, though it mirrors the surge in mergers and acquisitions (M&A) this year. Typically 10-20% of proposed deals end in tears, and this year has been no exception.

Companies usually overstretch in two ways. They propose combinations that annoy regulators—despite the passionate appeals of Masayoshi Son, Softbank’s founder, American regulators were unimpressed by his plans to shrink the number of big mobile operators from four to three. Or they propose deals that test the limits of their balance-sheets and the patience of their investors. Mr Murdoch was offering a takeover premium of about \$20 billion, more than the capitalised value of the cost savings that could have been achieved, suggesting the deal would have destroyed value for his shareholders. Reflecting this, his own share price had steadily fallen, reducing the value of the stock being offered to Time Warner. If Mr Murdoch chooses to bid again, he would have to find deeper cost savings. After Astra’s board dismissed an offer on May 26th, Pfizer’s shareholders had limited appetite for a dearer bid—although the American firm has not ruled that out.

By tradition, when deals flop, everyone pretends nothing has really changed. Thus Mr Murdoch declared that “21st Century Fox’s future has never been brighter”, while Mr Son said, “Our focus moving forward will be on making Sprint the most successful carrier.”

In fact failed transactions often have lasting consequences. Target firms that cook up ambitious forecasts as part of their defence face the hard task of meeting them. Astra said it expected sales almost to double by 2023 despite their being stagnant today. Share buy-backs are one way to rent some loyalty. Time Warner's shares fell by 13% the day after Mr Murdoch's exit. It plans to repurchase \$5 billion of its shares, equivalent to 8% of its total.

On the other side of the table, the thwarted acquirer may occasionally find it has dodged a bullet. Had Barclays, a British bank, succeeded in buying a Dutch rival, ABN AMRO, in 2007 for \$92 billion it would have committed corporate *hara-kiri*. Royal Bank of Scotland, the ultimate victor in the tussle, ended up nationalised.

But usually a failed giant deal damages the credibility of the acquirer's managers and the coherence of its strategy. On August 6th Sprint said it would remove its chief executive, Daniel Hesse. Botched takeovers have tarnished other careers. Jack Welch, of General Electric, sullied his reputation by failing to buy Honeywell as a last hurrah before he retired in 2001. European regulators blocked the deal. Marius Kloppers, a young star who became chief executive of the world's biggest mining company, BHP Billiton, in 2007, lost his way after trying to buy its arch-rival, Rio Tinto, for \$115 billion in 2008 and then in 2010 the obscure Potash Corp of Saskatchewan for a very unobscure \$43 billion. By 2013 he had left BHP.

The recent rash of failed deals may encourage other firms to be more cautious. The takeover announced on August 6th of Alliance Boots, a British pharmacy chain, by Walgreens, an American counterpart, was a downbeat affair. Walgreens lowered its earnings forecast; and in response to growing American disquiet about firms using takeovers to shift their tax bases abroad ("tax inversions", as they are known), it also dropped a plan to use the deal to move its domicile to Europe.

For failed predators and escaped prey alike the key to re-establishing momentum is to demonstrate strong operating performance. If earnings are rising, investors, staff and clients will forgive almost anything. In 2010 Prudential PLC, a British insurer active in Asia, suffered a humiliating defeat when its own shareholders rebelled against its \$36 billion takeover bid for AIA, a Hong Kong-based rival. Since then Prudential's boss, Tidjane Thiam, has rebuilt his reputation in spectacular style by doubling operating profits.

By this test, the outlook is queasy for some recent failed-dealmakers. Pfizer's underlying pre-tax profits fell by 25% last quarter. Softbank's American mobile arm lost money last year and is losing customers. Publicis said in July that its profits would be lower than expected. Its boss, Maurice Lévy admitted it had been "distracted".

For chief executives, the slog of day-to-day operations is miserable compared with the glamour and gratification of the world of M&A. But they can be assured that if they fail both at deal making and the mundane task of boosting earnings, their shareholders, like Queen Victoria, will not be amused.