

Mergers And Acquisitions

Are You Paying Too Much for That Acquisition?

by Robert G. Eccles, Kersten L. Lanes, and Thomas C. Wilson

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Despite 30 years of evidence demonstrating that most acquisitions don't create value for the acquiring company's shareholders, executives continue to make more deals, and bigger deals, every year. Recent research shows that acquisitions in the 1990s have just as poor a record as they did in the 1970s. There are plenty of reasons for this poor performance: irrational exuberance about the strategic importance of the deal, enthusiasm built up during the excitement of negotiations, and weak integration skills, to name a few. Many failures occur, though, simply because the acquiring company paid too much for the acquisition. It wasn't a good deal on the day it was made—and it never will be. A good example is Quaker Oats' acquisition of Snapple. Some industry analysts estimated that the \$1.7 billion purchase price was as much as \$1 billion too much. The stock price of both companies declined the day the deal was announced. Problems with implementation and a downturn in the market for New Age drinks quickly led to performance problems. Just 28 months later, Quaker sold Snapple to Triarc Companies for less than 20% of what it had paid. Quaker Oats' and Triarc's stock prices went up the day that deal was announced.

How should you think about what to pay for an acquisition? And how should you know when to walk away? In the course of a research project on mergers and acquisitions, we explored those questions with 75 senior executives from 40 companies. All were experienced, skilled acquirers. We learned that there's a systematic way for senior managers to think about pricing acquisitions. We also learned that even experienced acquirers, who should know better, sometimes get too attached to a deal. When that happens, it's essential to have organizational disciplines in place that will rein in the emotion. A combination of analytical rigor and strict process discipline will help senior executives and board members guide their companies toward the right acquisitions at the right price.

No Single, Correct Price

It's tempting to think that the reason so many acquisitions are overpriced is straightforward—just that most deals today are too rich, that executives routinely get caught up in the excitement of the race and offer more than they should. Indeed, that's often the case. But it's not always so simple. In fact, the relationship between the size of the premium and the success of the deal is not linear. Consider the 20 deals listed in the table “Deals with Low Premiums Often Fail—and Vice Versa.” In half the cases, the acquirer paid a low premium, and the total return on investment one year later was negative. In the other half, the acquirer paid a high premium, yet total return one year later was positive.

Deals with Low Premiums Often Fail – and Vice Versa

As you can see from the 20 deals listed below, the size of the premium does not always correlate with the success of the deal. In half the cases, the acquirers paid a low premium, and their total returns on investment one year later were negative. In the other half, the acquirers paid a high premium, but their total one-year returns were positive. In both cases, we controlled for overall market movements in calculating the returns.

Low-premium deals with low returns

Acquirer's name	Target's name	Premium	One-year market return
1 Marshall & Ilsley	Valley Bancorp	19%	-17%
2 Ceridian	Comdata Holdings	19%	-16%
3 Durco International	BW/IP	14%	-17%
4 3Com	U.S. Robotics	13%	-46%
5 Bergesen	Havtor	11%	-21%
6 AT&T	McCaw Cellular Communications	11%	-17%
7 Dresdner Bank	Kleinwort Benson	10%	-16%
8 Washington Mutual	Great Western Financial	6%	-9%
9 Advanced Micro Devices	HexGen	5%	-59%
10 Ultramar	Diamond Shamrock	1%	-18%

High-premium deals with high returns

1 Allegheny Ludlum	Teledyne	115%	33%
2 First Bank System	U.S. Bancorp	85%	12%
3 Northrop	Grumman	65%	12%
4 HealthSouth	Surgical Care Affiliates	61%	30%
5 Praxair	CBI Industries	49%	49%
6 Crompton & Knowles	Uniroyal Chemical	45%	7%
7 Williams Companies	Transco Energy	43%	19%
8 ONA Financial	Continental Corporation	39%	48%
9 Kvaerner	Trafalgar House	35%	15%
10 Frontier	ALC Communications	34%	4%

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The question, then, is not whether an acquirer has paid too high a price in an absolute sense. Rather, it's whether an acquirer has paid more than the acquisition was worth to that particular company. What one company can afford will differ from what

another company can afford and, more than likely, from the asking price. Ultimately, the key to success in buying another company is knowing the maximum price *you* can pay and then having the discipline not to pay a penny more.

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The recent bidding war that Bell Atlantic and Vodafone waged to acquire Air-Touch Communications illustrates the point that the right price is relative—that is, there's no single correct price for an acquisition. Rumors that Bell Atlantic was in negotiations to acquire AirTouch first surfaced on December 31, 1998. The terms of the Bell Atlantic bid were publicized four days later: it had offered \$73 per share, or \$45 billion, a 7% premium above Air-Touch's closing share price a week earlier of \$68. Bell Atlantic's stock price immediately declined by 5%. Clearly, the market did not like the deal.

Vodafone entered the fray on January 7 with a bid of around \$55 billion, or \$89 per share. Negotiations continued for the next several days until, on January 15, Vodafone agreed to pay \$97 per share, for a total of \$62 billion. That price was 33% more than Bell Atlantic's original offer and 43% more than AirTouch's share price before the first rumors of Bell Atlantic's offer had surfaced. Implicit in the deal was the fact that for its shareholders to break even, Vodafone would have to find cost savings and revenue generators worth at least \$20 billion. Yet the market liked this deal very much. During the course of this bidding war, Vodafone's stock price actually increased some 14%.

What explains the market's negative reaction to Bell Atlantic's modest premium and its positive reaction to Vodafone's high premium? The answer is that acquiring AirTouch created more valuable synergies for Vodafone than it would have for Bell Atlantic. First of all, Vodafone had a much larger share of the cellular market than Bell Atlantic did in Europe. And as it happened, Vodafone was strong in European countries where AirTouch was not; the two companies complemented each other extremely well. Together, they would create the first complete pan-European cellular telephone company. As a result, they would be able to save a tremendous amount in roaming fees paid to other cellular operators and in interconnection fees paid to fixed line operators. By contrast, a Bell Atlantic–AirTouch combination would not have created a pan-European company, so it had far less potential.

More Deals, More Failures

Pricing an acquisition correctly is extraordinarily important given how many deals there are—and how many fail. During the ...



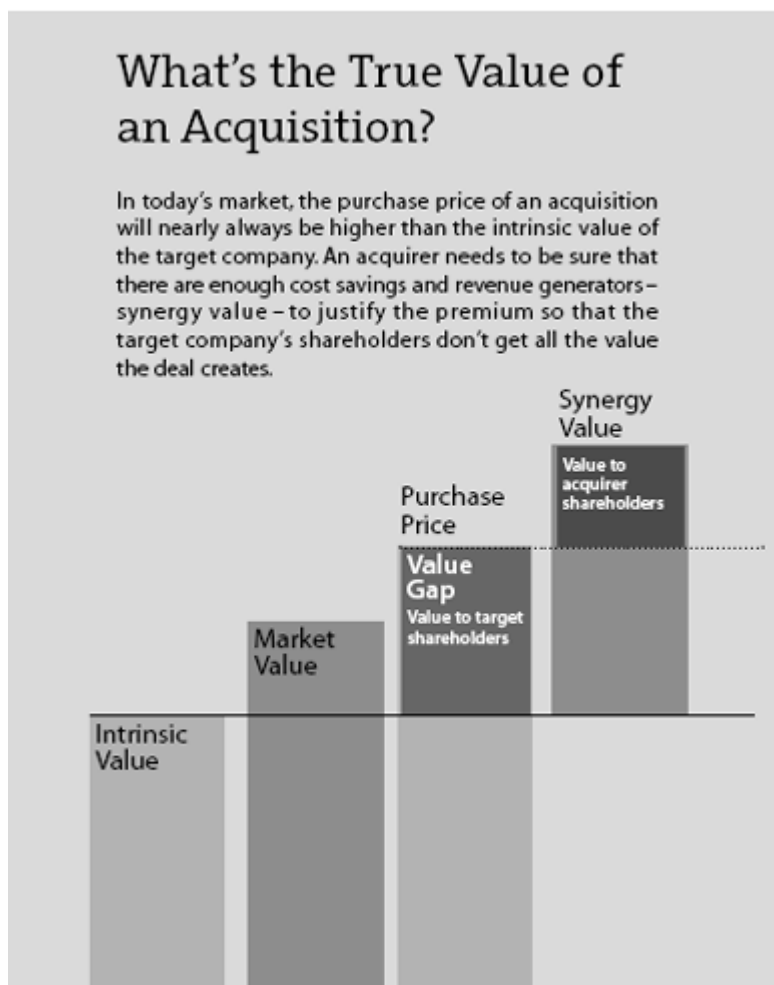
Another source of synergy in the Vodafone-AirTouch deal was the anticipated savings from high-volume purchases of equipment such as handsets, switches, and base stations, which the two companies were already basing on the same technology and buying from the same suppliers. Those savings have been estimated at \$330 million, starting in 2002. Finally, having a common European currency will allow Vodafone to use a pan-European flat-rate pricing plan. Should it move in that direction, Vodafone will put tremendous pressure on competitors operating only within each European country. Such rivals would be forced

to respond through complicated joint ventures or consolidations. While its competitors engage in these time-consuming and expensive activities, Vodafone would have already digested its acquisition of AirTouch and be one step ahead of the game.

As this example shows, there may be a vast difference between the price one company can pay for an acquisition and the price another can pay. Often the two companies are direct competitors. When they are, the company that can least afford it will be sorely tempted to ignore the financial case and overpay. To do so is nearly always a mistake.

Pricing the Deal

Managers and board members judging the merits of a proposed acquisition need to understand several distinct concepts of value. (See the exhibit “What’s the True Value of an Acquisition?”)



What's the True Value of an Acquisition? In today's market, the purchase price of an acquisition will nearly always be higher than the intrinsic value of the target company. An acquirer needs to be sure that there are enough cost savings and revenue generators—synergy value—to justify the premium so that the target company's shareholders don't get all the value the deal creates.

Intrinsic Value.

The most basic value of the company, its intrinsic value, is based principally on the net present value of expected future cash flows completely independent of any acquisition. That assumes the company continues under current management with whatever revenue growth and performance improvements have already been anticipated by the market. AirTouch's intrinsic value was around \$68 per share just before Bell Atlantic's bid.

Market Value.

On top of the intrinsic value, the market may add a premium to reflect the likelihood that an offer for the company will be made (or a higher offer will be tendered than one currently on the table). Market value—commonly called “current market capitalization”—is the same as the share price; it reflects the market participants' valuation of the company. For AirTouch, the market value was \$73 per share on December 31, the day the press first reported that a deal with Bell Atlantic was in the works.

Purchase Price.

Wall Street calls this the “anticipated takeout value.” It's the price that a bidder anticipates having to pay to be accepted by the target shareholders. For AirTouch, the purchase price turned out to be \$97 per share, representing a premium of \$29 a share over its intrinsic value.

Synergy Value.

The net present value of the cash flows that will result from improvements made when the companies are combined. These are improvements above and beyond those the market already anticipates each company would make if the acquisition didn't occur, since those are already incorporated into the intrinsic value of each company. Based on the deal price, Vodafone's estimated synergy value was at least \$20 billion.

Value Gap.

The difference between the intrinsic value and the purchase price.

In today's market, both the acquirer and the target company know that the purchase price will be higher than the intrinsic value—in other words, that the buyer will most likely pay a premium.¹ That premium allocates some of the future benefits of the combination to the target shareholders. Absent a premium, most target shareholders would refuse to sell. The acquirer's managers need to figure out just how large a value gap their company can bridge through synergies. The target, meanwhile, will second-guess the acquirer, trying to calculate how high the price can be pushed. If there's more than one potential acquirer and the bidding gets competitive, that places even more upward pressure on the price.

Calculating Synergy Value

There are two keys to success in pricing an acquisition. The first is to make sure that those individuals calculating a target's synergy value are rigorous and that they work with realistic assumptions. The second is to ensure that the acquirer pays no more than it should, no matter how many arm-waving arguments are aired to the effect that "this is a strategic deal; we'd be crazy not to do it!"

Acquirers generally base their calculations on five types of synergies: cost savings, revenue enhancements, process improvements, financial engineering, and tax benefits. The value of each type of synergy will depend on the particular skills and

circumstances of the acquirer, something vividly illustrated by the different amounts that Bell Atlantic and Vodafone bid for AirTouch and the market's reaction to those bids.

Cost Savings.

This is the most common type of synergy and the easiest to estimate. Peter Shaw, head of mergers and acquisitions at the British chemical and pharmaceutical company ICI, refers to cost savings as “hard synergies” and points out that the level of certainty that they will be achieved is quite high. Usually, they come from eliminating jobs, facilities, and related expenses that are no longer needed when functions are consolidated, or they come from economies of scale in purchasing. Cost savings are likely to be especially large when one company acquires another from the same industry in the same country. For example, SBC Communications, the former Southwestern Bell, realized substantial cost savings when it acquired Pacific Telesis. Within the first two years of this merger, SBC saved more than \$200 million in information-technology operating and maintenance costs. It also saved tens of millions of dollars by combining the merged companies' purchasing power.

Even though cost savings are the easiest synergy to calculate, overly optimistic projections certainly do occur, so you need to look very carefully at the numbers you're presented with. If you're evaluating projections, be aware of three common problems. First, analysts may overlook the fact that definitions of cost categories vary from company to company. (For example, are warranty costs included in the cost of production or the cost of sales?) So it may appear that there are more easily eliminated costs in a category than turn out to be the case. Second, costs are incurred in different places depending on the structure of each company. Acquirers may assume they can eliminate more corporate or divisional administrative costs than they actually can because essential work is getting done in unexpected places. Third, it is easier to eliminate positions than the people who fill them. Often

a job is eliminated on paper, but the person in the job is very talented and must be shifted elsewhere in the company. Therefore, if a consolidation seems to suggest that 200 jobs are destined for the ax, that doesn't mean that 200 salaries are, too.

Acquirers often underestimate how long it will take to realize cost savings. Sometimes that happens because the plans specifying how integration will proceed are insufficiently detailed. In other cases, it happens because the people in both companies are resistant to change, and senior managers often delay making tough cost-cutting decisions. And, of course, the longer it takes for cost savings to be realized, the less value they create.

Revenue Enhancements.

It's sometimes possible for an acquirer and its target to achieve a higher level of sales growth together than either company could on its own. Revenue enhancements are notoriously hard to estimate, however, because they involve external variables beyond management's control. The customer base of the acquired company, for instance, may react negatively to different prices and product features. A combined customer base may balk at making too many purchases from a single supplier. And competitors may lower their prices in response to an acquisition. Revenue enhancements are so difficult to predict, in fact, that some wise companies don't even include them when calculating synergy value. Matthew Slatter, the CEO of Bank of Melbourne, says, "We model this [revenue enhancements], but never factor it into the price." Similarly, Peter Shaw at ICI considers them "soft synergies" and discounts them heavily in calculations of synergy value.

Despite their dangers, revenue enhancements can create real value. Sometimes the target brings a superior or complementary product to the more extensive distribution channel of the acquirer. That happened when Lloyds TSB acquired the Cheltenham and Gloucester Building Society (which had a better

home-loan product) and Abbey Life (which had insurance products). In both cases, Lloyds TSB was able to sell those products to its dramatically larger retail customer base, thus generating more revenue than the three entities could have done individually. Similarly, having acquired Duracell for a 20% premium, Gillette was confirmed in its expectation that selling Duracell batteries through Gillette's existing channels for personal care products would increase sales, particularly internationally. Gillette sold Duracell products in 25 new markets in the first year after the acquisition and substantially increased sales in established international markets.

In other instances, a target company's distribution channel can be used to escalate the sales of the acquiring company's product. That occurred at Gillette when it acquired Parker Pen. In calculating what it could pay, Gillette estimated that it would be able to get an additional \$25 million in sales for its own Waterman pens by taking advantage of Parker's distribution channels.

A final kind of revenue enhancement occurs when the bigger, postacquisition company gains sufficient critical mass to attract revenue neither company would have been able to realize alone. Consider what happened when ABN and AMRO merged to form ABN AMRO, the large Dutch bank. Afterward, other large banks pulled the new company in on syndicated loans that neither ABN nor AMRO would have been asked to participate in individually.

Process Improvements.

Cost savings result from eliminating duplication or from purchasing in volume; revenue enhancements are generated from combining different strengths from the two organizations. Process improvements, by contrast, occur when managers transfer best practices and core competencies from one company to another. That results in both cost savings and revenue enhancements.

The transfer of best practices can flow in either direction. The acquirer may buy a company because the target is especially good at something. Conversely, the acquirer may see that it can drastically improve the target's performance in a key area because of some competence the acquirer has already mastered.

Take the case of National Australia Bank's purchase of Florida mortgage lender HomeSide. HomeSide has an extremely efficient mortgage-servicing process that NAB plans to transfer to its banking operations in Australia, New Zealand, and the United Kingdom. The same was true of ABN AMRO when it acquired the U.S. commercial bank Standard & Federal. In that case, process improvements went hand in hand with cost savings: because its mortgage operation was so efficient, S&F eventually took over the combined bank's entire mortgage business.

Product development processes can also be improved so that new products can be produced at lower cost and get to market faster. Such was the case when Johnson Controls acquired Prince Corporation, a maker of rearview mirrors, door panels, visors, and other parts of automobile interiors. Prince was better than Johnson Controls at understanding customers' needs—both existing and anticipated—and consequently it produced higher-margin products. Prince also had an excellent process for ramping up production of new products, which enabled it to move from design to mass production about twice as fast as Johnson Controls could, maintaining higher quality levels while speeding cycle times. Johnson learned from Prince and was soon able to apply those advantages to its own products.

For an example of the process improvements an acquiring company can bring to the table, take a look at newspaper giant Gannett. Gannett has a database of financial and nonfinancial measures for each of its 85 newspapers; executives use this rich resource to determine best practices, both boosting revenue and lowering costs. Larry Miller, Gannett's CFO, explains, "We have been able to dramatically improve the papers we've bought. The

key for us is knowing in very minute detail how to run a business. This gives us very specific ideas for improvement.” Through more efficient production and distribution processes, Gannett has been able to extend its deadlines for news and advertising copy while simultaneously delivering the newspaper more quickly. That helps advertisers and improves Gannett’s revenue. Gannett is also able to determine where classified rates are too high, hurting volume, and where they are too low, leaving money on the table. Because it can expect to yield quick, substantial process improvements, Gannett can pay very high premiums for its acquisitions. When you consider that many of the acquisitions are run independently—and so don’t offer many consolidation opportunities—the high premiums are quite extraordinary. In fact, Miller has told us, “People are often shocked at what we pay.” In nearly all cases, though, performance improvements after the fact have justified the high prices.

The synergies of cost savings, revenue enhancements, and process improvements may be easy to understand conceptually, but our research demonstrates how hard they are to forecast accurately. Why? Most calculations of synergy value occur under horrendous conditions: time pressure is intense, information is limited, and confidentiality must be maintained. Since conditions are so far from ideal, the managers and board members responsible for the final decision should always scrutinize the assumptions underlying the numbers.

Financial Engineering.

Acquirers often think—and hope—that if they borrow cash to finance a transaction, they’ll reduce the weighted average cost of capital. That is not a good reason to do a deal. If either the acquirer or the target company could afford to take on more debt, each could have borrowed it on its own.

However, some companies can find genuine synergies through financial engineering. For example, an acquisition can increase the size of a company to a level where there are clear economic benefits to pooling working-capital finance requirements and surplus cash, as well as netting currency positions. These benefits can be quite substantial. When the Credit Suisse Group merged with Winterthur, 10% of the forecasted synergies came from reducing funding costs through optimized capital management.

Here's another genuine financial-engineering synergy: a transaction may allow a company to refinance the target's debt at the acquirer's more favorable borrowing rate without affecting the acquirer's credit rating. That is especially likely to happen in the financial services sector because those companies are big and their risk is diversified.

Tax Benefits.

Tax considerations are often a barrier that must be overcome to justify a deal, a fact that makes tax-related synergies very difficult to assess. It's useful to distinguish between tax "structuring," which makes the deal possible, and tax "engineering" (also called tax planning), which ensures that the overall tax rate of the combined company is equal to or lower than the blended tax rates of the two companies before the deal. Regulators often believe that companies using perfectly legitimate structuring and engineering techniques to avoid incurring additional costs are simply taking advantage of loopholes. Thus companies are not anxious to disclose any clever techniques they may have used.

The goal of tax structuring is to avoid as many onetime tax costs as possible. Those costs may include capital and transfer duties, as well as change-of-ownership provisions that can trigger capital gains or prevent tax losses from being carried forward.

Assuming that analysts have identified structuring techniques that make the deal feasible, it is then possible to look for real tax-related synergies. One of the most common is the transfer of brands and other intellectual property to a low-tax subsidiary. But there are a host of other potential synergies: placing shared services and central purchasing in tax-advantaged locations; reorganizing within a country to pool taxes; pushing down debt into high-tax subsidiaries; and obtaining tax benefits that neither company could have realized on its own.

Even when real benefits can be obtained from tax engineering, companies should not make deals based on those benefits alone. The reason to pursue a merger or an acquisition is to achieve a better competitive position in the marketplace—a lower cost structure, for example, or a better platform for growth. While financial and tax-engineering tactics can produce value for shareholders, by themselves they do not strengthen a company's competitive position. Furthermore, the difficulty of integrating two companies can overwhelm purely financial and tax benefits.

On Doing Deals for Strategic Reasons

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The most disciplined thing to do is walk away. If the numbers don't work, it's not a good deal. That's the practice at ABN AMRO, says Harry Tempest. "We have a rule on the Executive Committee. When someone says 'strategic,' the rest of us say, 'too expensive.'"

"We have a rule on the Executive Committee," says Harry Tempest of ABN AMRO. "When someone says 'strategic,' the rest of us say, 'too expensive.'"

Doubtless there are deals that should happen for strategic reasons even when the numbers don't sound promising, but they are few and far between. Before undertaking such an acquisition, senior managers should look with extraordinary rigor at the emotional state of those backing the deal—and then at the strategic reasons themselves.

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First, the emotional atmosphere. A lot of deals happen because managers fall in love with the idea of the deal. Successful executives, after all, are competitive people who hate to lose, and nothing brings out the competitive juices like going after another company, particularly when one's rivals are in hot pursuit. Anyone who has lived through a deal can tell you how exciting it can get. But as Tempest says, "You have to be careful not to let the thrill of the chase get the testosterone flowing."

Two of the most common arguments for ignoring the numbers are especially dangerous. When you hear someone say, “It’s the last deal of its kind,” beware. It’s never the last deal. Deals fall apart all the time—and what’s more, divestitures are nearly as common as acquisitions in today’s market. Assets unavailable today could easily be up for sale tomorrow.

Weak Links

Our research focused on highly competent acquirers. Nevertheless, we have identified two areas that even ...



The second argument is, “If you don’t acquire a target, a major competitor will.” But the fact is, if the numbers don’t work for you, you should let your rival have the target company. Often that company will overpay and weaken its own competitive position. Better it than you.

If you feel compelled to move forward with a deal when the numbers tell you to stop, analyze the strategic reasons themselves as rigorously as you can. Remember that most strategic reasons to do deals boil down to some form of revenue generator or cost savings, which should be reflected in the numbers. Poke holes in the arguments and see if they still hold up. What could go wrong? What if the assumptions about the direction of technology and prices are wrong? What regulatory changes could make the deal fail, and how likely are they to occur? How could competitors react to the deal in ways that could hurt you—even if they hurt themselves as well? Make sure that the group reviewing acquisition candidates includes strong skeptics with persuasive voices.

It may also make sense to introduce more sophisticated analytical techniques. Real-options valuation, for example, can help managers quantify potential, but not definite, future benefits. (See Timothy A. Luehrman's "Investment Opportunities as Real Options: Getting Started on the Numbers," HBR July–August 1998.) That approach calculates a value for each of the options that the deal creates. Thus if the target company is developing a new, potentially valuable technology that could change the rules of competition in your industry, analysts can use real-options techniques to quantify the value of that technology based on a range of possible outcomes. For example, value can be realized by licensing the technology to others, by selling it off, or by investing in it further to develop a commercial product. Real-options thinking can also help managers identify the decisions they will have to make about future investments or other courses of action, and when those decisions need to be made.

Organizational Discipline and Pricing

Successful acquiring companies know how to calculate synergy value, and they know how to walk away from a deal that seems fabulous until someone runs the numbers. However, they also know that sometimes human nature takes over in the heat of an exciting deal, and so they have developed process disciplines that help them stick to what the numbers tell them.

Many companies don't allow the negotiating manager to price the deal for fear that he or she will become too personally invested and overpay. Often a higher-level manager sets a price ceiling before negotiations begin; any negotiator or business-unit manager who wants to go over the ceiling must explain why and get explicit approval. Hutchison Whampoa and AlliedSignal both use that approach. In fact, AlliedSignal's CEO, Larry Bossidy, has ultimate authority over all prices unless a deal is so large that it requires board approval.

The Interpublic Group of Companies (IPG) has a different approach to discipline. The large advertising and marketing-communications company has made more than 400 acquisitions in the past 15 years; because the group has been so active, a lot of the pricing and negotiations have to occur at the business-unit level. The company has decreed that every target has to achieve at least a 12% return on investment within five to seven years. In addition, operating managers are required to meet operating targets within five years. And those requirements are backed up with messages that managers understand. Says Gene Beard, vice chairman of finance and operations, “Failure to meet these targets significantly lowers the long-term incentive awards our managers receive.”

Frank Borelli, the CFO of Marsh & McLennan, has a good example of how strict process discipline can pay off. Within Marsh & McLennan, which offers insurance services, investment management, and human-resource-management consulting, Borelli is adamant about three criteria for doing any deal. The deal has to earn at least the company’s cost of capital, it can’t dilute earnings, and the target company’s growth rate has to be higher than Marsh & McLennan’s itself.

In the 1990s, the company had the chance to acquire two companies in the consolidating insurance-brokerage industry: Frank B. Hall in 1992 and Alexander & Alexander in 1996. The top managers in the insurance services unit were anxious to pursue both deals. However, neither company met all three criteria, and Borelli refused to bend the rules. The insurance services executives were dismayed when a major competitor, Aon, acquired both companies. When an opportunity to buy Minet came along in late 1996, the insurance services executives were more anxious than ever to do the deal. However, Borelli resisted that one as well. He thought it could be what he termed a “huge disaster” because Marsh & McLennan could not protect itself

against contingent liabilities. By that point, the insurance services executives “were really upset with me, to say the least,” Borelli says.

In March of 1997, a fourth opportunity presented itself: this time, the target was a top-rate competitor, Johnson & Higgins. That acquisition met Borelli’s three criteria and created substantial value for the company. By resisting the temptation to do unattractive deals even when a major competitor was also considering them, Marsh & McLennan left itself in a good position to take advantage of a better opportunity when it came along. Borelli believes that if Marsh & McLennan had acquired the much less attractive Alexander & Alexander, it would not have been in a position to acquire Johnson & Higgins. “You can only digest so much,” he says.

Another example of discipline in the pricing process comes from Saint-Gobain, the French manufacturing and distribution company. Every acquisition is expected to improve its prior year’s return on equity in the first year after being acquired and exceed its preacquisition return on assets by the third year. CFO Jean-François Phelizon explains that Saint-Gobain takes a global approach to analyzing its acquisitions: “We compare the value created by the acquisition to the value that could be created by buying back our own shares.” If the latter generates more value, the acquisition is not made.

Some companies routinely review each completed acquisition rigorously to better understand what makes for success or failure. That, too, is a form of process discipline. Other companies keep data on the performance of previous acquisitions to help them price future deals. Nearly all the companies in our study used some kind of a posttransaction-monitoring process to track how well the acquisition or merger was performing relative to expectations and to draw lessons about what should be done differently in the future. • • •

The lessons on pricing acquisitions and mergers that we've outlined here are straightforward. In fact, they may strike readers as simple common sense. We would not disagree with that judgment. Yet the fact remains that over half the deals being done today will destroy value for the acquiring company's shareholders.

What's the reason for the disparity between these simple lessons and these poor results? We believe that far too many companies neglect the organizational discipline needed to ensure that analytical rigor triumphs over emotion and ego. Such discipline is the responsibility of executive managers and the board of directors. If the returns to shareholders from acquisitions and mergers over the next ten years are no better than they have been for the past 100, it will be because companies have not created systematic corporate governance processes that put these simple lessons into practice.

1. The usual exceptions are when someone negotiates to buy a privately held company or in a stock-for-stock merger transaction when the two companies are of comparable size and value. However, premiums can even be paid in stock deals, especially when one company is much smaller than the other or when a disproportionate amount of the synergies will be obtained from one of the companies.

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