

M&A Process

Introduction

Mergers and Acquisitions, in short M&A, refers to the business process in which a company purchases another company. Several reasons drive M&A. For instance, M&A enables companies to scale their business more rapidly than organic growth it would allow. Furthermore, a company can purchase another company to diversify its service and product portfolio, to acquire valuable innovations or to get access to talents which misses in the organization so far.

An Exemplary M&A Story

In 2021, SAP SE acquired Signavio wherefore SAP SE can make use of Signavio's leading technologies in business process intelligence for accelerating their customers' journey of the digital transformation.¹

Characteristics of the M&A Process

In general, the M&A process comprises multiple phases, like defining an overall business strategy, deriving an acquisition strategy, searching and identifying suitable acquisition candidates, assessing acquisition candidates, negotiating valuations and contracts, applying for approvals from regulatory authorities and closing the deal. Due to time constraints and to control for the complexity, we will consider only an excerpt of the M&A process, which starts after the CEO has declared a company as a suitable acquisition candidate. The excerpt comprises the evaluation of this acquisition candidate as well as the preparation of relevant documents that the CEO can take an informed decision whether the acquisition candidate should be purchased. Thus, preparing a ready to sign contract represents the goal of the process. Therefore, multiple experts contribute:

1. Financial experts assess whether the acquisition candidate's KPIs, like the revenue or the profit, reflect the reality or have been manipulated. Furthermore, they calculate the value of the acquisition candidate.
2. Sales experts estimate how much the acquisition candidate can sell in the future.
3. Lawyers organize approvals from external authorities, like from the cartel office.
4. Psychologists evaluate the acquisition candidate's company culture and use their expertise in human relationships to drive the negotiations.

A key document represents the *Due Diligence* sheet, which summarizes the findings about an acquisition candidate and indicates the state of the M&A process. An empty Due Diligence sheet is created from a template automatically when the CEO declares a company as a suitable acquisition candidate.

¹ <https://www.signavio.com/de/news/signavio-joins-sap/>

Perspective: Financial Expert

You take the perspective of a financial expert, wherefore you assess the acquisition candidate's accounting and finances during the M&A process.

Therefore, you take responsibility for two tasks:

1. For *assessing the accounting trustworthiness*, you need balance sheets, business assessments and other internal financial data from the acquisition candidate, which the negotiation leading psychologists obtain and provide you. As soon as you have access to these documents, you evaluate whether the presented figures reflect reality or have been manipulated.
2. For *calculating a reasonable valuation*, you use the same information as for assessing the accounting trustworthiness. Additionally, you need an estimate of the expected revenue of the acquisition candidate in the next three years, which the sales experts create. Your valuation consists of a lower and an upper price point. For instance, the upper price point expresses the amount of money which one should spend at most for acquiring the acquisition candidate. The negotiation leading psychologists need your valuation for negotiating a deal, wherefore, you send them it after you have calculated it.

You conduct each of both tasks exactly once. However, you decide in which sequence. For each of your two tasks, you must write a detailed report outlining your findings. It is up to you whether you write a report immediately after completing a task or after you have completed both tasks. Additionally, you must enrich the Due Diligence with a summary for each of your tasks.

Perspective: Sales Expert

You take the perspective of a sales expert, which is responsible for estimating the sales potential of the acquisition candidate. Therefore, you take responsibility for three tasks:

1. During the *market environment analysis*, you consider the products of the acquisition candidate and how they compete against competitors' products in the market segment. Furthermore, you figure out who could be interested in the products and who is already a customer of the acquisition candidate. For analysing the market environment, you need reliable information. Either you gather them from the market environment, e.g., by speaking with randomly or tactically selected organizations or persons, or you ask the negotiation leading psychologists that they obtain and provide you with internal information from the acquisition candidate.
2. Using your market environment analysis, you can *estimate the competitive advantage* which the acquisition could cause. In other words, you answer the question, which effects would have the fusion of your company and the acquisition candidate in terms of competing in the market.
3. Using your market environment analysis, you *forecast the order book* of the acquisition candidate for the next five years. Forecasting the order book for an upcoming year means that you give a reasoned estimate of the acquisition candidate's revenue in the given year. Immediately after finishing the forecasting, you send your results to the financial experts that they can use your findings in their analyses.

For each task, you write a detailed report which outlines your findings. Additionally, you contribute a summary of your market environment analysis, of your order book forecast and of your analysis of the competitive advantage to the Due Diligence sheet.

Perspective: Lawyer

You take the perspective of a lawyer who coordinates the approvals from external authorities and considers legal risks. Thus, you contribute to the M&A process as follows:

1. You *check all agreements* with the acquisition candidate before they are closed. For instance, the term sheet and the deal represent such agreements. The term sheet is an agreement which defines a framework of the M&A process, like guaranteeing that exchanged information will be kept confidential. The deal records how and to which price shares will be exchanged. It is the responsibility of the other roles to send you the agreements for your check. If you identify a risk within an agreement, you request the negotiation leading psychologists to negotiate an adapted agreement. By checking all agreements before they are closed, you ensure that no contract is signed that could be detrimental to the company.
2. The M&A must comply with certain legal regulations. For instance, an acquisition may require the approval of responsible national antitrust authorities. Therefore, you check which legal regulations hold in terms of acquiring the acquisition candidate. For each identified legal regulation, you write a documentation which reasons that the current acquisition complies to this regulation. Furthermore, you request the approval from external authorities, if necessary. Perhaps, you may fail to organize a relevant approval from an external authority, wherefore you need to cancel the M&A process.

Perspective: Psychologist

You take the perspective of a psychologist and, thereby, you have three responsibilities.

Establishing a Confidential Communication Channel

You use your expertise in psychology in the communication with the acquisition candidate.

It is your task, to *establish a contact with representatives* of the acquisition candidate. For instance, the acquisition candidate's CEO or the shareholders represent representatives. After establishing an initial contact, you *strengthen the connection* to the acquisition candidate that a confidential communication is possible. For instance, when your teammates ask you to acquire different information, you draw on the established contact.

Leading the Negotiations

You use your expertise in psychology to lead the negotiation. In general, you negotiate three agreements:

1. The *letter of intent* defines rules and the reason for the communication with the acquisition candidate. Thereby, the M&A context implies the reason. Furthermore, a non-disclosure agreement, a guarantee that exchanged information will be kept confidentially, represents a common example for a communication rule.
2. However, the letter of intent represents only a rough baseline for the communication. As soon as the letter of intent is signed, you start with negotiating the *term sheet* to mature the communication modalities. In contrast to the letter of intent, the term sheet shows more the structure of a contract.
3. The final negotiation is the negotiation of a deal. A deal defines how and to which price shares will be exchanged. For starting the deal negotiation, you need a valuation calculation of the acquisition candidate. The valuation consists of a lower and an upper price point. For instance, the upper price point expresses the amount of money which one should spend at most on acquiring a company. You ask the financial expert in your team to create the calculation for you.

Potentially, a negotiation may fail. Then, you cancel the M&A process.

Assessing the Acquisition Candidate's Company Culture

Your third and last responsibility within the M&A process represents a contribution to the Due Diligence sheet. You use your expertise in psychology to conduct a cultural check of the acquisition candidate. Due to your vivid contact with the acquisition candidate, you get insights on how it is organized internally, about the company culture and about potential internal conflicts. The cultural check assesses on the base of this information whether the acquisition candidate matches from a cultural perspective to your organization. You write a report about the results of your cultural check and enrich the Due Diligence sheet with a summary of your results.