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Quest for Strategic Advantage through Mergers and Acquisitions

On paper, virtually every merger and acquisition appears to accomplish a specific financial goal. In some instances cost savings and economies of scale are driving the deal. In others, it is an increased access to capital or the belief that an undervalued company can be turned around. Yet behind most mergers today is an underlying and less tangible driver: the quest for "strategic advantage," a term often overused and rarely understood.

Public pronouncements issued by acquirers often reference the term "strategic fit" to imply the expected ease with which a target will be absorbed and cost savings will occur. Financial analysts and reporters often cite the phrase "strategic advantage" in their writings to explain the rationale behind the transaction. But with more than half of the deals of the last three decades failing to deliver their expected results, the true definitions of these terms seem to be in question. Just what do "strategic advantage" and "strategic fit" actually mean?

Understanding these concepts is central to merger and acquisition decision making. Unfortunately, what has been missing in the literature and training rooms of the global business community is a definition of strategic advantage and strategic fit in their most practical sense—a definition that focuses on the various factors that allow them to actually come to fruition. That is the goal of this chapter. By analysis of the drivers that are the motivation behind strategic M&A deals it will become clear that it is not the so often heralded cost saving issues, but rather the growth-oriented synergies and their actualization that lead to a deal's success.

There are 10 strategic drivers that are the distinct motivators behind virtually every strategic merger or acquisition (see list on pages 24 and 25). More than theoretical explanations are needed to understand and apply them. To illustrate these drivers it is helpful to examine how they influenced several of the more complex deals of the decade. Each deal's uniqueness—whether due to size, industry focus, or geographical orientation—has as its primary motivation one of the 10 strategic drivers. Yet as we will illustrate, the transactions that are motivated by at least two strategic drivers have the greatest opportunity to succeed over the long term.

To fully grasp the concept of strategic advantage, one must view M&A from a historical perspective. As many of the deals done in the 1970s, 1980s, and early 1990s have unraveled, the explanation most often cited for their failure is the lack of strategic soundness. In other words, they never delivered the long-term growth and sustained profitability that seemed so possible at first. Too much emphasis was placed on how the two companies fit together in a practical or financial sense, and not enough on whether they could truly combine to make a whole that was greater than the sum of its parts.

STRATEGIC FIT

To understand the concept of strategic fit, it is necessary to key on the word "fit." It connotes compatibility. Historically, strategic fit in an M&A context addressed the issue of combining company attributes under one roof because they were compatible. But in many cases, simply the fact that two companies have differing attributes makes them seem even more attractive. The implication is that the products, services, or qualities exclusive to one company fill a capability gap inherent in the other company and vice versa. This is a justifiable rationale for a merger or acquisition, but it is not enough. It is only the first of many considerations in the acquisition planning process that can help lead to successful results.

Unfortunately, the assumption of strategic fit as the platform for an aggressive cost-cutting approach is what drives many an acquisition strategy. On paper, the numbers look good. In theory, the two companies seem compatible. But in practice the strategy is doomed to fail. Why? In many cases, the benefits of initial cost reductions do not continue past the first year. The economies of scale fail to deliver increased efficiency over the long term. And, what at first seemed to be compatible attributes turn out to be only slight variations in products, services, or operational processes. Compatibility is important—in fact, critical. But it must be incorporated into a much broader framework that tests the complementary nature of corporate attributes beyond their inherent compatibility.

Beyond the obvious attention paid to cost reduction, the primary focus for strategic deals today must be on melding complementary, nonfinancial assets with an eye toward growth and then extending their benefits over the long term through integration. What begins as a vision of either growth or expansion must be seamlessly and continuously developed as a smoothly functioning part of the whole. Just as we do not view an arm or leg as a separate part of our bodies, but an integral part with a discrete function, a partnership between two companies should be forged based on a similar mind-set.

Let us take the human body analogy one step further, and assume that an individual's hand has the ability to firmly grasp a pencil, push a button, or hold a fork. When these discrete capabilities are combined with those of the other hand, the result is greater than simply being able to grasp *two* pencils or hold *two* forks. The new and enhanced ability of both hands working in concert to clap, push, or pull with greater force is the equivalent of two companies joining complementary assets to create something stronger, more effective, and longer lasting than what had previously existed. Each of these asset combinations is referred to as a "synergy." If the only synergy that two hands could deliver was limited to the occasional clap, we would not consider it a long-term benefit. Yet, add the ability to play the piano, and the long-term case for harmoniously integrating the efforts of two hands becomes eminently more compelling.

STRATEGIC ADVANTAGE

Within the corporate world, when two complementary capabilities are combined, leading to a third, enhanced capability, this is referred to as "strategic synergy." When recognized as such and actualized to achieve long-term growth and increased profits, it is the basis for what may rightfully be called strategic advantage. Attaining strategic advantage should be the goal of every merger and acquisition, combining the obvious compatibility issues and taking them one step further. Comprehensive in scope, strategic advantage incorporates the merged company's unique capabilities and takes them to a higher level.

True M&A-driven strategic advantage is comprised of multiple synergies that:

- Focus on growth rather than cost savings.
- Integrate easily to form the merged entity.
- Deliver benefits that materialize over the long term.

When several distinct synergies contain all three of these components, they can combine to create revenue enhancement opportunities (REOs). The essence of REOs is their focus on growth through synergy. Strategic advantage is the realization of strategic synergy.

NONSTRATEGIC ADVANTAGE

Of course, exceptions do exist—particularly when the reason for an acquisition is growth without concern for strategic advantage. For example. some companies acquire for the express purpose of becoming bigger and do not intend to integrate the smaller companies. Over time. the acquirers essentially become loosely connected conglomerates comprised of many separate pieces. so-called bolt-ons. Companies in this mode of growth often subscribe to the theory that economies of scale are the ultimate benefit of an acquisition program. Consequently, they establish corporate structures that thrive on the lack of integration.

Often. these nonintegrated smaller companies are managed separately as divisions or branches. Yet, over time, in order to successfully compete in the marketplace. each individual unit must experience its own growth. either internally or through external means such as strategic alliances, joint ventures, or R&D partnerships. Ultimately, growing pains start to emerge as one unit finds that its products or services overlap with another unit or, worse, finds itself competing directly with its own corporate brethren.

In the past. companies lacking the strategic advantage focus have fallen prey to organizational chaos. A point is reached where it is no longer feasible or profitable to monitor the multiple management teams, production facilities, or marketing efforts. Inevitably, corporate functions and processes (e.g., employee benefits, information systems, distribution networks) cost more to monitor and manage separately than under a centralized system. Hanson Industries is a case in point.

One of the world's largest conglomerates, Hanson was able to house such disparate businesses as building materials, sports equipment, chemicals, and typewriters all under one corporate roof for many years. In fact, from 1976 to 1985, shareholders enjoyed more than a 35% annualized return. Yet, over the next decade, as the pace of acquisitions quickened—with corporate management exerting little effort to integrate—the share price barely budged. In order to drive the top-line revenue growth, Hanson "de-merged" rather than integrate its core businesses.

Integration is critical to the success of any strategic merger or acquisition and will be addressed in detail in Part Three. However, the focus of this entire volume is strategic advantage where the quest for synergy, and a commitment to integration, is the rule rather than the exception.

Long after the ledger is closed on a deal, the goal of actualizing and maintaining strategic advantage must continue to be a focus. Yet, it is in the predeal planning phase, before the ledger is even opened, that the groundwork for achieving enduring strategic advantage must be laid. The first step toward achieving this goal is identifying inherent strategic synergies.

The traditional definition of "synergy" in M&A circles is *a potential cost savings that occurs when two companies combine.* The emphasis has always been on savings. However, strategic synergies are the result of combined complementary attributes that focus on growth. It is only through growth that the long-term success of major mergers and acquisitions can be achieved.

STRATEGIC DRIVERS

There are scores of reasons why companies forge unions through corporate combinations. And identifying growth synergies, rather than savings synergies, can be a confusing and arduous process fraught with uncertainty. Determining cost-reduction synergies is easy. Devising and actualizing growth-oriented synergies is hard work.

Developing industry growth projections, studying the strategic and operational findings of acquisition team members, and analyzing myriad marketing and sales variables are just a few aspects of the challenging process of identifying strategic advantage potential. The very thought of compiling this voluminous data often stands in the way of many clearly thought-out acquisitions. But having a forward-thinking map and checklist to guide you through the daunting phases of assessment and analysis is necessary in order to place a target company in perspective relative to your strategic needs.

To begin the process, you must first pinpoint the various synergies posed by a union with a given target company. An analysis of hundreds of mergers, acquisitions, joint ventures, and strategic alliances has revealed 10 basic opportunities for strategic synergy that, in one way or another, act as the strategic drivers behind the majority of deals. They are:

1. Effecting organizational growth
2. Increasing market share
3. Gaining entrée into new markets or access to new distribution channels
4. Obtaining new products

5. Keeping pace with change
6. Capitalizing on political and regulatory change
7. Pursuing innovations/discoveries in products or technology
8. Lessening competition
9. Strengthening reputation or gaining credibility
10. Responding to or capitalizing on economic scenarios

Through examining these drivers in greater detail, it is possible to get a sense of their practical application and their invaluable role in devising a successful, growth-driven acquisition strategy.

Effecting Organizational Growth

Often, a company envisions the opportunity to increase its scope and leverage simply by becoming bigger. This usually increases liquidity and access to the capital markets and broadens name or brand awareness in additional geographic markets. On its own, actualizing the strategic advantage of size can improve a company's financial performance through leveraging basic economies of scale. Yet, when combined with other strategic synergies, the advantage of size can act as the foundation and a catalyst for increased market share, production enhancements, and new market penetration that can, in turn, lead to a distinct competitive advantage.

Obviously, in every merger, the immediate result is increased size. However, after duplicative operations are eliminated, workforces downsized, and noncore operations sold or spun off, the resultant company may not necessarily be bigger. In many cases, the streamlined, merged entity is a smaller, yet more effective company with more muscle and less fat.

Increasing Market Share

Within the confines of a given product market, only so much market share can be claimed. The battle for customers over products and services is a zero-sum competition in which customer bases shift as product loyalty is strengthened or weakened. Increasing market share requires that a company seize already established customer loyalty from a competitor and then build on it to increase its own share further. Just as growing in size does not guarantee success, simply adding market share via a merger or acquisition does not make a company immediately more competitive.

During a target company analysis, one must ask the fundamental question, "Will the addition of the target's attributes to those of the acquirer spawn immediate *and* longer-term increases in market share?" One of the basic investigative areas of marketing due diligence is identifying the sources of future increases in market share. Simply adding the market share of company A to that of company B is not the solution. A synergy must then be developed that takes the sum of those numbers to a higher plane. Only a focus on steady, increasing competitiveness—which is contingent on effective integration—can help the company make that leap.

Gaining Entrée into New Markets or Access to New Distribution Channels

Many strategic acquisitions occur in defined product markets that the acquirer is currently serving. For example, buying a firm that enables you to target a broader or more responsive audience can not only give you access to a greater number of potential buyers, it can also help bring about enhanced production or distribution capabilities in new territories. As businesses have expanded throughout the last decade of this century, the fiercest battles have been fought over existing products in new markets.

Entering a market for the first time, however, is an act fraught with multiple risks. There are buyer-specific and competitive issues that need to be understood before you can successfully gain entrée to a previously unpenetrated market. Acquiring another company that already has a foothold in that segment, and that knows the ropes, can ease the process and minimize your risks.

Obtaining New Products

In the realm of new product development, companies focused on growth agonize over the "make or buy" decision. Those with available cash, depth of resources, access to technology, and strategic vision are in the best position to acquire firms in order to acquire new products. The alternative to buying a new product or capability is a complex, costly, and time-consuming period of product or service development.

Today, the key to gaining strategic advantage via new product development is commercializing those goods before the next wave of competition, which comes more quickly and more intensely every day. Some companies are tooled for it; most are not. Often, by the time a new product has cleared its beta stage, competitors and developers of knockoffs or cheaper versions are already releasing rival offerings.

Technological gains have shortened the time it takes to design, manufacture, promote, and ultimately deliver a product or service to the marketplace. Consequently, the best new product ideas will quickly be replicated by competitors. It is for this primary reason that many companies opt to buy rather than make in order to avoid extended periods of R&D that may be inordinately expensive and may not yield the desired results.

Keeping Pace with Change

A multitude of variables can act as catalysts for change within a given market, industry, or sector. Social, economic, and demographic shifts result from factors beyond a company's control and may be viewed as either opportunities or threats; and they must be acted on accordingly.

The regulatory environment, typically a slower and yet more visible agent of change, is more often the *response* to a shift in social direction rather than a *catalyst*. In other words, regulations typically change in response to socioeconomic evolution rather than vice versa. But when regulations confirm this shift, a company's external change management acumen can be sorely tested.

As change occurs, companies are often forced to modify their services and hone their products and perspectives in order to stay competitive. Sometimes employees must be retrained to effect the behavioral shift that must accompany the new strategic direction. If a massive change in the marketplace prompts a massive change in the corporate vision, the corporate culture must embrace the new vision in order to maintain focus and continue to create value. When this fails, even the most solidly grounded of businesses can run into trouble.

INSIDER'S OUTLOOK

Strategic acquisitions are those made from a position of strength rather than from a position of weakness. Experience shows that acquisitions done because they support the company's growth strategy have a reasonably good chance of working out. On the other hand, acquisitions have tended *not* to work when management thought that, by doing a deal, it will overcome one or more threats posed by changing market conditions or by fundamental errors made in the past. In short, the evidence suggests that acquisitions should not be made from a defensive posture.

—John Levinson, Westway Capital LLC

Keeping pace with change in all its many incarnations forces many companies to merge or acquire when they cannot contend with change themselves. In the 1990s, the practices of contracting for and licensing of technology and research have become commonplace. But these short-term steps must be recognized for what they are—leased capabilities. Because they are not owned and rarely integrated, they are not a reliable foundation for growth. Thus, they cannot be built on. Any advancements garnered can falter or be obviated when a newer technology presents itself, when new competitors appear, or when a licensing agreement expires.

Management must acknowledge and continually plan for social and environmental flux and anticipate the natural evolution of both their products and their markets. In some cases, a visionary leader can bring about change within an entire industry by focusing on synergies that naturally enhance his or her company's own products. This results in the rest of the market being forced to keep pace.

Acquisitions that bring into the fold progressive, marketing-oriented organizations add more than new product capabilities. They can, in some instances, revolutionize the way business is done by imbuing the acquirer's corporate culture with a growth-oriented focus that may not have existed previously.

Whether or not coping with change is the primary driver that fuels a merger or acquisition, it is an issue that every company must seriously and continuously address. How a company chooses to respond to change can tell a lot about how it will react to a takeover threat or how it will approach a target.

Change can be analyzed from the vantage points of both *reactive* companies that merge or acquire to keep pace and *proactive* companies that make visionary decisions that anticipate change or even force it.

Certainly, it was R. J. Reynolds' goal to diversify its tobacco product line when it merged with Nabisco. But half a decade later, share price and profits are still floundering. In fact, there has been more discussion about de-merging these two companies amid the legal and financial fallout from tobacco health claims then there ever was about the potential synergies a marriage like this would create. Oreos and Winstons may have looked good on paper, but, in the real world, they just do not mix.

INSIDER'S OUTLOOK

In general, I view [M&A] deals as complementary to a company's core strategic and operational initiatives. You have to have an internal game plan of how you are going to grow your business in the core markets. Only then could you supplement that game plan with targeted acquisitions that make sense in strategic terms, financial terms, and, of course, in all material contractual terms.

—Mufit Cinali, AT&T

Capitalizing on Political and Regulatory Change

As the major political parties in the United States face off each day to represent their corporate constituencies, the future ground rules of American business are forged. Whether an individual Democrat or Republican is elected to public office rarely influences broad corporate policies. But, occasionally, brief political alignments manage to push their specific agendas into the public eye. When this occurs, there is often a window of opportunity that creates a platform for M&A activity to flourish.

In the early 1990s, as the Clinton Administration led the charge for health care reform; passed the North American Free Trade Agreement (NAFTA), opening U.S. trade borders to the north and south; and rallied against tobacco use and for affirmative action, opportunities were created for companies to capitalize on the political follow-through.

Minority businesses were acquired by companies looking to prevent exclusion from government contracts. Alliances with Mexican companies were forged to gain immediate footholds in that country (and to secure cheaper labor and manufacturing facilities). And, large tobacco manufacturers looked to diversify through acquisition as pressure increased to limit the domestic distribution and use of cigarettes.

These were a few of the more visible political activities of the hundreds that were created. In fact, the Clinton Administration's health care reform initiative set in motion a detailed reevaluation of the country's entire health care delivery system, which spurred a realignment and acquisition frenzy of the entire managed care industry. For example, within three years of the Administration's announcement to revamp American health care, more than half of the hospitals in the state of New Jersey had merged—all this in response to the threat of a change in public policy that was never enacted.

The past two decades have seen increased competition in industries once heavily regulated, such as energy, telecommunications, and banking. In the age of globalization, it is more difficult for companies in those industries to claim regional control over their competition simply by acquisition. More common are scenarios in which current regulations or geographical barriers limit customer access to particular services or products, creating areas where lack of competition is virtually mandated.

The telecommunications and energy industries are clear examples in which the consumer of the service or product has been locked into using one specific provider. In fact, the most obvious industrywide deregulations are occurring right now in these two industries, first established more than 50 years ago to deliver products into our households.

More recently, phone, cable television, natural gas, and electric companies have all been grouped under the heading of utilities. Their corporate structures, as well as the delivery systems of these individual offerings, are just now being shattered by the advent of new technology and changing buyer requirements. Regulation has reined competition in, virtually eliminating it; deregulation is unleashing it again. But as regulations continue to ease and competition increases, it is more common for companies—previously restrained from entering certain businesses—to aggressively pursue entry into once-monopolized sectors.

In recent years, the energy industry has seen a form of distribution deregulation called "wheeling" change the once-oligarchic nature of the natural gas and electric power industries. Wheeling allows a utility, based in one part of the country, to pay for access to a distribution line in another territory and then sell its power to customers in that region, creating competition for prices and service.

Newly established utility partnerships, whose sole intent is to lessen competition by locking up a specific geographic area, have become increasingly tenuous. Within months, a utility from another part of the state or country can come in and undercut that partnership's pricing scheme. Additionally, as utility deregulation advances, mergers and acquisitions between gas and electric companies and between cable TV and telecommunications companies are increasing. All four of these distinct industries are likely to have lines that run into your home. As each becomes less regulated, we will see more corporate combinations among them, each vying for the dominant line that will ultimately carry all four services into the household.

Pursuing Innovations/Discoveries in Products or Technology

Today, manifest destiny seems greatest in the realms of science and technology. A company's ability to "make it faster," "do it better," and "price it cheaper" is increasingly becoming a function of its technological, rather than managerial, know-how.

Each day, we read about another breakthrough in science, medicine, or information systems. Integrating that knowledge into an existing product or process drives many of the strategic acquisitions of our day and will only increase as technological advances do. The application of technology to core processes to take advantage of time compression has accelerated the rate at which technology has played a role in the evolution of various markets. A clear line has been drawn separating those companies on the cutting edge of technology from those that have not yet realized the importance of being on that edge.

When one thinks of advances in technology, it is often within the framework of a company that is in a high-technology industry. What needs to be understood, however, is that it is the inclusion of new technologies into the products and processes of lower-tech companies and industries that is most critical. If a company's strategic objective is to attain competitive advantage, then it must harness technology in virtually every area including engineering and production, operations, human resources, and, most importantly, the functions of marketing, product management, and sales. For instance, ideal strategic synergies meld the products of one company with the services of another, creating a more efficient delivery system or adding a customer service capability to an already strong distribution network.

In strategic alliances or joint ventures in which a company is in search of some technological advantage, one company's competitive advantage may simply be another's basic technology. Thus, how that technology is developed by each partner and whether the collaboration is merely an alliance or the driver for an eventual merger are critical issues that must be addressed in the predeal planning stages.

Is it cheaper to pour money into research and development and create a new technology, buy it from a competitor, or collaborate through cost- and resource-sharing to harness it? Choosing the last option lessens the production risk but forces further collaborative issues in the event that the technology and relationship develop further, fusing the partners.

Lessening Competition

Buying one's competitor would seem like the most natural of drivers, accomplishing the dual goals of negating a competitor's market share while bolstering one's own. However, any time a firm's market standing is heightened by the fall of a competitor, issues of antitrust are immediately raised.

The process of eliminating one's competition through acquisition typically faces severe regulatory hurdles and can never be admitted on the record. But every company that has become the dominant force in its industry has acquired in this manner. Microsoft, Gillette, IBM, Campbell Soup, and Coca-Cola are just a few of the companies that have piled on market share domestically and abroad by acquiring their close competition.

Even longer is the list of companies whose acquisitive designs were squelched by conflicts with prevailing antitrust laws. Acquisitions of this nature typically take a long time to close, are very costly, and can perform short-term gymnastics on a company's stock price. But, if and when these transactions survive regulatory scrutiny and do ultimately close, they place the acquirer in a position not just to claim additional market share but—to a broad extent—to heavily influence the market itself and in some cases dominate it.

To push the potentially problematic deal through, its champions focus largely on increased efficiencies resulting from cost cutting and the elimination of duplicative operations. And, without question, synergies such as these can deliver instant and tangible results that are quickly reflected in the bottom lines of 10-Qs, 10-Ks, and even stock prices. But the focus on economies of scale, although a component of a successful acquisition, must be subjugated beneath the more relevant long-term growth-oriented synergies being discussed.

Strengthening Reputation or Gaining Credibility

There truly is a value in a company's image and it can be heightened, weakened, or transferred through acquisition. Many acquisitions are made to bring a target company's stellar reputation to the buying company. The reverse is also true, where an organization gladly agrees to be purchased by another whose reputation or credibility will create a positive halo effect that directly benefits the acquired company.

Throughout the years, revenues of many companies have seesawed as their perception in the marketplace has risen and fallen. To properly address issues regarding the most intangible of marketing intangible assets—reputation—all stakeholders and perceivers of this reputation must be identified. The community in which a company operates, whether it is the local community or the global community at large, will be the final decision maker and assessor of changes in reputation. Specific audiences include stock- or bondholders, financial analysts, customers, suppliers, distributors, and even employees.

Today, the reputation of a company, a product line, or a single product can directly influence the buying patterns of Main Street America and the financial decision making of Wall Street. Conversely, the tarnishing or lack of a good reputation can negatively influence sales and lessen corporate profitability. Reputation must be carefully and strategically monitored and nurtured.

Issues of customer service, product quality, environmental sensitivity, philanthropy, and social responsibility are but a few of the intangible components of reputation. All are important in that they reflect some type of commitment to stakeholders, and at the same time, influence competitive differentiation. One need only look at the TV commercials of Nike, Burger King, and MTV targeting the teenage market to see that they sell image not product. The durability, quality, or benefit of the product takes a backseat in their advertising to that of being accepted or "cool." Should any of these companies or their products experience a falloff in the "cool factor" then they would soon experience defections to the next "coolest" competitor. As intangible as image or reputation may be, it must never be minimized when contemplating the decision to acquire or merge.

Responding to or Capitalizing on Economic Scenarios

In periods of lower interest rates or overvalued stock markets, it is easy to be blinded by the financial successes seen around us each day. When interest rates are low, the opportunity to access cheaper capital often sparks a flurry of acquisitions by companies who could not previously afford to borrow. There are many advantages to a looser monetary policy for an acquisitive company. It can foster the refinancing of past acquisitions at lower rates while granting access to the capital markets using previously unaffordable methods.

On the other hand, when equity markets are heated up, a company's overvalued stock price can be the catalyst for fueling an acquisition program with stock as currency. But a caveat for the acquirer is this: Rising stock markets, with their attendant inflated valuations, often give a rosier impression of a target company's true value, and can mask weaknesses that lie beneath the surface. Additionally, sudden hiccups or drops in stability in these markets can substantially alter or void a transaction when stock is the currency of choice. Economic scenarios must be viewed as somewhat short-term, unpredictable, and potentially volatile and should never be viewed as the sole driver for a long-term strategic partnership.

THE NONSTRATEGIC DRIVER

The foregoing discussion of strategic drivers seems to necessitate a mention of their counterpart, the nonstrategic driver.

Many deals that are driven by favorable economic conditions are simply investments by companies that feel that a target is underachieving and believe that an infusion of cash and/or management expertise will either generate increased revenues or transform the entity into a profitable one. There may be strategic advantages that can be realized later, but the driving force behind these nonstrategic "remedy" investments is the "I can run it better" philosophy.

There are also instances in which a company is solely exploring a partnership or searching to incorporate a specific business function into the main corporate infrastructure. In such cases, the appropriate partnership would be a licensing or distribution pact, a technology exchange, or an R&D contract. It is questionable whether these can truly be termed strategic unless a long-term synthesis is desired.

Essentially, alliances that do not result in exclusive permanent partnership arrangements can only be viewed as leases, in which a specific function is borrowed from another company for a finite period of time. No holistic ownership can be felt, no empowerment can take place, and, realistically, no long-term strategic synergies can be realized when there is a time limit on a relationship.

INSIDER'S OUTLOOK

You have to articulate a vision for the merged company and stay committed to it. Many times management will invest lots of money for strategic planning and staff infrastructure development without having a clear sense of what markets they are going to serve and with what products and services. Then, they staff-up and allocate resources that are completely noncommensurate with the pace at which they could reasonably enter any of the markets they are targeting. Ultimately, they start out in a certain direction of one market, only to abandon it and then move into another one, then abandon that and move into a third market . . . never quite completing the process in any particular marketplace. Now, this is not to say you shouldn't shift gears when marketplace conditions require your doing so. But it does mean that you should take the time to craft a vision and work diligently to achieve it. Implicit in that, of course, is doing as comprehensive a job of market planning as possible.

—Rich Rudden, R. J. Rudden Associates

IDENTIFYING MULTIPLE STRATEGIC DRIVERS

Merely having an awareness of the drivers of strategic mergers and acquisitions does not assure the ultimate attainment of strategic advantage. It is only the beginning. Strategic drivers must provide the focus in formulating your acquisition strategy, be incorporated into the analysis of given target companies, and be built on throughout the rest of the predeal planning process.

In most deals, the merger partners cite growth as the number-one reason for the combination. Yet, many of these deals never focus beyond this most common and generic of drivers. The participants either are motivated by the sole vision of organizational growth or assume other drivers will follow. When those other benefits do not materialize, the blame is placed on such factors as unreceptive markets or a weakness in the economy. But that blame has been misdirected. The culprit is often the fact that management failed to identify and work toward actualizing multiple strategic drivers.

Oftentimes, once one driver is secured, others typically fall into place. But this is by no means a certainty. There must be a concerted effort to identify and realize multiple strategic drivers. Why? The more opportunities there are for attaining strategic advantage, the greater the likelihood you will successfully actualize it. If there is only one strategic reason to buy a company, then as that one reason weakens or becomes less significant over time, the acquisition will become less relevant or critical to the whole. When this occurs, more often than not it leads to flagging profits and, ultimately, divestiture.

In order for a strategic acquisition to succeed over the long term, more than one driver should motivate that company to acquire or merge with another. Indeed, there are many transactions that focus on one particular driver; the goal, however, should be to maximize your M&A investment by striving—whenever possible—to realize more than a single driver. However, it must be stressed that although each strategic driver can complement other drivers, each is unique and must be fully explored before combining it with others.

In addition to the original motivation that spawns a strategic merger or acquisition, you must delve further to understand the other drivers that influence the deal. By definition, "strategic" means beneficial on a series of levels. Additional drivers must not be viewed as secondary or less important motivators. Their actualization is as relevant to the predeal planning stage as the original driver that first prompted your pursuit of the transaction.

STRATEGIC DRIVERS: CASE STUDIES

By examining several major deals of the past decade, it will be made clear why focusing on multiple drivers significantly increases the likelihood of the success of a merger or acquisition. Beyond the obvious quest for growth, many other strategic drivers help to create the vision of strategic advantage.

In some of these deals, there truly was synergy. In others there were roadblocks or factors that may have given early warning signs that the deal was a forced situation, doomed to failure.

And then, of course, there are the deals that never happened. As mentioned earlier, antitrust law can act as the greatest stumbling block to what would otherwise seem like the perfect union of companies. Some of the most strategically sound acquisitions are never consummated because they are, in fact, too good. Their completion would create a company that would be deemed by regulators to be an impediment to future competition. Regardless of whether the transaction ultimately occurred, an analysis of the motivation for these unrealized deals lends valuable insight into the planning that is necessary to achieve strategic advantage. Let us first examine one of the most synergistically sound acquisition attempts of the decade—Rite Aid's proposed purchase of Revco.

Rite Aid/Revco: Too Good to Be True

Rite Aid Corporation's $1.8 billion attempted acquisition of Revco. D.S., in 1995 would have created the nation's largest drugstore chain. By leveraging no less than five strategic drivers, many important synergies would have been achieved by the completion of this deal:

- Rite Aid would have been able to claim a larger piece of the retail beauty products business.
- The anticipated revenue flow of $11 billion would have placed the company head-to-head with Walgreen, the industry leader.
- The new size and increased scope of operations would have helped Rite Aid attract health insurance business, a major growth vehicle in the retail drugstore industry.
- Rite Aid could have managed its inventory more efficiently using Revco's point of sale (POS) technology, in which cosmetics are reordered based on data from check-out-counter scanning devices.
- The Revlon name, prominently displayed in Rite Aid stores, would have created an image for Rite Aid of being an upscale cosmetics retailer.

Rite Aid did not just focus on the driver of effecting organizational growth. The company was motivated by multiple drivers. The company attempted to lessen competition, strengthen its reputation, gain entrée into new markets and access to new products, and capitalize on technology. All of these strategic drivers gelled with Rite Aid's strategic plan, which was to grow by acquisition in a rapidly imploding market.

When earlier in 1994 Thrift Drug merged with PayLess and Kerr Drug, Rite Aid responded by purchasing Hook/SupeRx, another drugstore chain. The acquisition increased Rite Aid's piece of the pie, but did little to widen its footprint in the marketplace. In order to truly increase market share, Rite Aid needed a bigger pie. So in 1995 the company made its play for Revco, seeking synergies that could not necessarily be gained through a purely horizontal acquisition. The potential benefits of such an acquisition were:

- Increased market share
- Product line enhancement
- Product line additions
- New industry segments
- Improved inventory management
- Economies of both scope and scale
- Increased operational efficiencies
- Access to new territories
- Cross-selling opportunities

The proposed deal was met with a long period of regulatory scrutiny and in May 1996 was abandoned altogether by Rite Aid so that it could pursue its acquisition of Thrift, another growing retail drugstore chain. The company managed to complete that deal before year-end.

The Rite Aid–Revco deal looked good on paper, but was bogged down and ultimately thwarted by issues of antitrust. The breadth of synergies and multiple drivers put forth in the planning stages would have given this merger a greater chance of success than if the sole motivator had been just effecting organizational growth.

The Megamergers

The strategic advantage of achieving organizational growth can be accomplished in many ways and for many reasons. The 1990s have been a fertile period for the "megamerger," in which two behemoths with sales in the billions combine to become an even larger corporation in search of competitive advantage. With the exception of those in the pharmaceutical industry, most megamergers have taken a vertical path, combining different industries or sectors into one semiconglomeratized larger entity. Starting with RJR Nabisco and Time Warner, whose megamergers took leaders of two discrete sectors of similar industries and combined them, the trend has continued with very mixed results.

The merger of Time Inc. and Warner Communications Inc. looked better in theory than it has turned out in reality. A host of issues have prevented Time Warner from integrating the different cultures and complex operations into a seamless, profitable company. When companies of equal size, such as Time Inc. and Warner Communications, are megamerged, there are internal issues of the dominant culture, battles of ego, and clashing of long-established relationships.

In the case of RJR Nabisco, it has long been expected that Nabisco would ultimately break away from its tobacco sibling, R. J. Reynolds. There never was and never will be a strategic fit. The arcane 1980s merger concept of "bigger is better" drove this merger, which has never been able to integrate the products, markets, or cultures of these two diverse companies.

When Time Inc. and Warner Communications combined their two companies in 1989, they created the first of the giant media conglomerates. They focused on dominating—through size and leverage—all aspects of that market from print to television to movies and now electronic media. In Time Warner's case, the blend of content and distribution was one of the first media mergers that appeared strategically sound. Yet, more than a decade later, the lack of a unified synergistic culture, a floundering stock price, unimpressive earnings, and continued reliance on debt have stood in the way of this union being termed a success.

Yet, there are exceptions to the megamerger track record of failure and a lesson for others to build on. Let's examine several deals that are considered successes because of the attention paid to the predeal planning process, the postdeal integration, and, specifically, the multiple drivers that motivated each deal from the start.

Novartis: A Prescription for Success

In 1995, Glaxo PLC's acquisition of Wellcome PLC hammered home the reality that, in the pharmaceutical industry, mass was critical in order to compete against the onslaught of generic and branded drug competition. During the previous 30 years, pharmaceutical companies kept their drug pipelines deep and their margins high. Yet, in the 1990s, health maintenance organizations (HMOs) and drug formularies forced prices and margins down, while a record number of drug patents expired, changing the complexion and direction of the pharmaceutical industry forever. The message was clear: Traditional strategies for success that had worked in the past for pharmaceutical companies could no longer be employed in the new age of health care.

In 1996, as the drug industry continued to consolidate, two Swiss competitors, Sandoz Ltd. and Ciba-Geigy Ltd., proposed a $36 billion merger to create a new company called Novartis, from the Latin for new arts or skills. Following the lead of the merging Pharmacia AB and Upjohn Company, equal to each other in size, Sandoz, the 12th-largest drug company, approached Ciba, the 10th, in an attempt to dominate the pharmaceutical and immunological markets. The combined company had initial sales of roughly $30 billion and a market value of roughly $79 billion, making it the 12th-largest corporation in the world.

Sandoz felt that to truly grow its core pharmaceuticals business, it would have to shed those pieces that did not align, such as its industrial chemicals division. Additionally, Sandoz believed that future growth must be the result of pure fusion, rooted in the philosophy that a hostile or one-sided move would defeat the synthesis of cultures and result in the domination of one company's mind-set over that of the other. This was an intellectual decision, soundly rooted in synergy with the goal of creating strategic advantage.

The combination of vast corporate resources and the broadest product range of any of the pharmaceutical competitors has made the merged company a world leader in many therapeutic areas, including immunology; inflammatory disease; central nervous system disorders; cardiovascular, endocrine, and metabolic disease; oncology; and dermatology. Additionally, the combined technology and research efforts place them in the forefront of emerging gene-, cell-, and organ-based therapies as well as xenotransplantation (the process of transplanting animal organs into humans).

The merger enhances and links the two companies' pharmaceutical and nutrition product lines, creating the largest health food producer in Europe. And in the United States, a focus on brand enhancement continues at a rapid pace. Acquired in 1994 by Sandoz, Gerber Products Company provides the perfect base from which to expand nutritional growth in the United States, by leveraging its infant food, children's nutrition, Ovaltine beverages, and health food products. This interlocking of products offers each company entrée into new markets as well as access to new products and distribution channels. Where one company is weak, the other's strength fills in, forging a bond that will lead to a successful marriage.

But why these two companies came to merge is probably less important than how, lining up multiple strategic drivers for growth and focusing on integration in the predeal planning stage. The lessons to be learned from this merger can help you approach deals in the same manner.

The confidential nature of the merger limited on-site visits and certain aspects of the traditional due diligence process. But, the homogeneity of the Swiss "consensus cultures" within each company formed the foundation for trust and a belief that postdeal integration would be easily attained. Strategic fit was a given—so much so that, instead of traditional team due diligence being implemented, an honor system due diligence initiative was agreed on as both Sandoz and Ciba made good-faith disclosures the foundation for all synergies that would develop.

The global pharmaceutical market is a highly fragmented one. And Novartis, now number two in the world, behind Glaxo, claims less than 5% of this worldwide market. Yet, because of the benign nature of the exchange, no cash or deal premium was wasted, leaving Novartis with a larger amount of cash on hand than any of its competitors, to fuel its research and development efforts. Although the focus of this book is on growth, not cost cutting, it should be noted that incorporating multiple growth drivers into the predeal planning stage can foster additional opportunities to reduce expenses.

In Novartis's case, the long-term benefit of this "fusion for growth" is the company's continued ability to finance aggressive R&D projects that will produce the next generation of cutting-edge drugs well into the 21st century. Additionally, the paring of 10,000 jobs from the combined worldwide ranks of 100,000 and a 3%-per-year cost cutting initiative continues to fuel earnings. The stock market reacted favorably to the promise of Novartis's improved earnings, sending Sandoz shares skyrocketing 30% on the day following the announcement, with Ciba rallying 20%. But the strategic benefits should have longer-lasting implications to future growth.

The fuel for this growth is twofold: broader distribution channels and a commanding position in each of the company's defined markets. Sandoz's decision to merge with Ciba was strategically a sound one. Yet, even more critical to the success of this deal was the predeal planning that structured the resultant company with cash-rich coffers. Due to the friendly nature of the merger, no premium was paid, no debt was incurred, and no new shares were issued. This liquidity will allow for new investments in the future without the restrictive burdens of financing, and will sustain the broad and aggressive marketing of existing and new products.

In time, it will become evident whether the strategic drivers that motivated the Sandoz/Ciba-Geigy merger will truly have staying power. But the fact that so many strategic drivers are present, beyond the simple quest for growth, gives this fusion more levels on which it can succeed.

INSIDER'S OUTLOOK

The purest example of a strategic acquisition is when the deal is a *natural* extension of the acquirer's enterprise—a transaction that doesn't take the company into a totally new business. Keep in mind that "business" is an amorphous word. For example, are railroad companies in the same "business" as airlines since they're both involved in transportation? I don't think so. Consequently, defining the word business is the first thing to consider when sizing up the prospects of a given transaction. Having said that, if the transaction is one where the acquirer will not be getting into another business (properly defined), there's generally going to be a much higher probability that the deal is going to work.

—John Levinson, Westway Capital LLC

Cadbury Schweppes/Dr Pepper: Avoiding the "Snapple Syndrome"

An acquisition of smaller size than Novartis but of comparable import occurred between the third- and fourth-ranked competitors in the beverage industry—Cadbury Schweppes and Dr Pepper/Seven-Up. Years later, a host of synergies have been released and revenue enhancement opportunities realized as the successful combination has created the number-one noncola soft drink company in North America. The primary strategic driver in this instance was the lessening of competition in the marketplace by acquisition.

In 1994, Dallas-based Dr Pepper/Seven-Up Group was the third-largest soft drink company in the United States behind Coke and Pepsi, with roughly 11% of the U.S. carbonated soft drink market. Its beverage lineup included the regular and diet versions of both Dr Pepper and 7-Up, as well as the Welch's soft drink line and IBC root beer and cream soda. At that time, the United Kingdom-based Cadbury Schweppes Group was a major global player in the confectionery and beverage markets, with distribution in more than 170 countries. The third-largest soft drink company in the world behind Coke and Pepsi, Cadbury Schweppes was fourth in the United States behind Dr Pepper/Seven-Up.

In its quest to dominate the market, Cadbury Schweppes first acquired A&W Brands, the largest root beer manufacturer in North America, and then took a 25.9% stake in Dr Pepper/Seven-Up, a fraction away from triggering a prohibitive poison pill. This defensive measure implemented by Dr Pepper would have forced the issuance of additional shares, diluting the value of the stock, should an unfriendly suitor attempt to own more than 26% of the company. The poison pill assured Dr Pepper that, if it was ever acquired, it would only be on its terms. A trading relationship had already been established, with Dr Pepper producing the bulk of Cadbury's soft drink concentrates in the United States, so it was no surprise that in late 1994, Dr Pepper agreed to be acquired by Cadbury for $1.7 billion.

Upon consummating the deal in 1995, the combined company instantly became the number-one noncola beverage company in North America, while controlling almost 50% of that market worldwide. Recognizing that growth in the cola arena had plateaued, Cadbury's goal was to combine Dr Pepper, 7-Up, Mott's, IBC, Schweppes, Crush, A&W, Canada Dry, Welch's, and the international beverage Oasis all under one roof, catapulting Cadbury's market share from 4.8% of the U.S. market to over 16%. The company was successful.

Seeking to avoid the costly mistakes of Quaker Oats in its acquisition of Snapple, Dr Pepper USA and Dr Pepper/Seven-Up Fountain/Food Service remained headquartered in Dallas, maintaining the same overall organizational structure to ensure the momentum of the Dr Pepper brand, which surpassed Diet Pepsi as the number-four soft drink in the United States. In fact, Cadbury Beverages North America quickly changed its corporate moniker to Dr Pepper/Cadbury North America to increase acceptance of the Cadbury name. Growth continues and the acquisition succeeds because of early implementation of promotional and marketing strategies all working to accomplish a joint goal.

Clearly, the motivation behind the acquirer's strategy and the target's eager acquiescence was to gain the competitive edge in the noncola marketplace. On a product basis alone, strategic advantage has been accomplished. Only time will tell whether the consolidation of this "Uncola" empire will produce the envisioned longer-term synergies.

But Cadbury's focus on the multiple drivers of gaining entrée to new markets, lessening its competition, and strengthening its reputation ensured that strategic advantage existed on many levels.

INSIDER'S OUTLOOK

IBM's acquisitions are not done for internal investment. We're not intent on being a holding company that's simply a portfolio of unrelated businesses. We acquire companies when we feel there is real strategic value to be gained—when those companies will fill a strategic void we have, or when we feel that an acquisition will help us decrease the cost and the time-to-market of developing an important new product ourselves.

—Carolyn Chin, IBM

Mattel/Tyco: Leveraging Size

Often the market leader of a particular product will acquire smaller competitors to increase its base and help it gain an edge over the number-two and -three rivals. The ensuing increase in size can then provide the necessary leverage with suppliers and distributors to make even greater inroads within that market.

When Mattel Inc., maker of Barbie dolls and Hot Wheels miniature cars, leapfrogged over number-two Hasbro Inc. to swallow up number-three Tyco Toys Inc., the strategy was clear. In addition to adding Tyco's Matchbox cars to its own fleet of miniature autos, Mattel added Tyco's 3% share of the $17.5 billion U.S. toy market to its own 16% share. Hasbro, the creator of GI Joe, owned almost 12% of the market at the time of the deal and went from threatening Mattel's preeminence to falling substantially behind the new stronger leader.

The expanded product line delivered more to Mattel than its new combined 19% share of the market. More critically, it increased Mattel's leverage with retailers, who now had to acquiesce and stock Mattel's slower-selling toys and games in order to gain access to its most popular ones. By leveraging this newly acquired shelf-space muscle, Mattel is now on track to increase its market share beyond current levels. By not pursuing a once-contemplated acquisition of Hasbro, Mattel avoided costly antitrust litigation. Instead, Mattel added to its already formidable industry lead in sales and profits, strengthening its reputation, lessening market competition, and gaining access to new products while expanding its distribution channels.

Primergy Corporation: A Band-Aid Merger Attempt

In May 1996, Milwaukee-based Wisconsin Energy Corporation announced a deal to merge with another Midwest utility, Northern States Power Company. As equal partners in Primergy Corporation, a potentially new $6 billion holding company, the companies sought a combination of marketing muscle, financial resources, and power generating capacity. The proximity of the two companies' service territories and energy delivery systems created an opportunity to merge all operations and pool fuel contracts with an immediate projected savings of $2 billion. The payoff to consumers was expected to be lower rates and a temporary rate freeze.

The joint goal of this merger was to become a better, more competitive company than either one envisioned for themselves on a stand-alone basis. Yet, in the energy industry, especially among natural gas and electric suppliers, reaching an agreement to create Primergy was far easier than the 12- to 18-month trek through federal and state regulatory agencies.

The two companies have many obvious similarities: Both serve growing territories in the upper Midwest, and both have clean balance sheets, experienced workforces, and low electric rates. Although the two companies have run lean, profitable, efficient operations, each has taken a different approach toward its individual successes. In 1993, Wisconsin Energy, with approximately four thousand employees, launched a sweeping restructuring program that involved a realignment of the company's organizational structure, starting with a review of most of its workflow processes and resulting in a change in job descriptions and their core functions. To that same end, Northern States, with seven thousand employees, invested $150 million in information systems equipment that automated processes and has allowed a trimming of the payroll. But the company has cut only about 250 to 300 jobs annually since 1992, and therefore has never performed the massive self-examination so critical to assessing a strategic fit of core competencies in a merger partner.

In the past, representatives of the two utilities have not agreed on the future of Wisconsin's power industry and therefore approached their nonutility businesses quite differently. Wisconsin Energy has concentrated on real estate development, venture capital, and other financing activities. Wispark Corporation, its most visible nonutility venture, has developed several southeastern Wisconsin industrial parks, which contribute healthily to the bottom line. Northern States has stayed closer to the energy business and, through its NRG Energy Inc. subsidiary, invested $100 million in two German energy concerns and an Australian power plant. Another subsidiary markets energy management services.

On the surface, a Wisconsin Energy-Northern States merger would appear to create a Midwest regional monopoly by pushing smaller utilities to consolidate and squeezing out independently owned power producers, leaving customers with fewer choices. Unfortunately for the two utilities seeking to merge, the regulators took this threat very seriously and—in the quest to maintain a competitive energy environment—responded with very specific directives that would prevent the possibility of future monopolization of the region's energy. These demands seemed too restrictive to the two companies, so they broke off the negotiations. Had the deal proceeded, this merger would have accomplished the strategic advantage of increasing competitiveness in a specific geographical region. However, in the quickly deregulating U.S. energy industry, territorial control would have proved less relevant than other strategic drivers such as diversification, gaining entrée into new markets, and capitalizing on global relationships.

In hindsight, the regulators probably did these two companies a favor. It was indeed questionable whether the two companies had enough synergies left to make this a successful long-term merger. As wheeling invades the north central states, this merger attempt may have just proved to be a short-term fix for a continuing and longer-term problem.

IBM/Lotus: Acquiring Technology

When IBM acquired Lotus Development Corporation in 1995 for $3.5 billion, many considered it a stroke of genius. For IBM, the centerpiece of the acquisition was Lotus's groupware product, Notes, which at the time was the world's leading document-sharing technology. Marketplace observers believed IBM's financial and marketing muscle could rejuvenate and help Lotus penetrate the corporate marketplace in the spreadsheet and document-sharing arena. This acquisition helped extend IBM's lead in the enterprise computing field over rival Microsoft Corporation.

Prior to the acquisition of Lotus by IBM, the market had been hesitant to fully embrace Notes, fearing that Lotus might not be able to deliver the technological support it required. There were those who felt that Lotus was too weak financially to even stay in business. However, once IBM announced the acquisition, Lotus customers knew they were now dealing with a company with deep pockets and staying power, unlike so many other technology companies. In fact, putting IBM's reputation, focus, and marketing muscle behind Notes has made a difference, quadrupling the number of Notes computing seats in the first year after the acquisition. But in that same year, Internet and intranet applications took center stage as the number-one issue in corporate computing circles.

Lotus is making money. But was IBM's prized acquisition a misplaced bet on yesterday's technology? Internet technology is advancing at a feverish pace. It is expected that groupware product technology will evolve radically in the next few years. If Lotus can complete Notes's transition to the World Wide Web before any radical Web technology makes it obsolete, then IBM will have a captive market. But, basic Internet groupware companies, such as Microsoft, are aggressively chipping away at the Lotus groupware theme. Irrespective of the competition, however, IBM boosted its technological reputation and know-how by becoming synonymous with Notes.

Its instant entry into an otherwise closed market was secured with the acquisition of Notes, and two years later, IBM—once considered weak in the groupware arena—is considered a leader. IBM is now charged with the task of fully integrating Lotus not only into its broader corporate entity, but also into the wave of advancing technology. Big Blue has already begun: Notes was recently outfitted with capabilities for Web publishing, browsing, and managed Internet access.

Creating and applying new knowledge and technology has long been critical to a company's financial success. With increasing resource requirements for technological advancement and acceleration in the rate of global technology diffusion, strategic thinking about technology must go beyond the simple development of new products or services. IBM boosted both its own market standing and the product of the company it acquired when it bought Lotus.

PaineWebber/Kidder Peabody: Strengthening Reputation

The six main ingredients that contribute to a company's public reputation are size, level of socially responsible behavior, financial performance, quality/durability of its products or services, media coverage, and advertising. And although advertising and image-building campaigns have done much to define markets and target specific audiences, in one fell swoop an acquisition can either eliminate or mask a poor reputation.

PaineWebber's 1994 acquisition of General Electric's Kidder Peabody unit is an excellent case in point. Kidder Peabody had finally shaken the fallout from its involvement in the 1987 Ivan Boesky insider-trading scandal to build itself into a premier niche investment bank rivaling the likes of Salomon Brothers, Morgan Stanley, and CS First Boston. In addition, the firm had become the market leader in derivative securities—specifically collateralized mortgage obligations (CMOs)—catering to institutions and high net-worth individuals.

PaineWebber, on the other hand, had built its reputation as a mass-market brokerage firm that asked critical financial questions of its investing public in order to help them develop sound financial planning. Their customer-focused ad campaigns—"Thank You, PaineWebber," "He Asked . . . ," and "We Invest in Relationships"—had changed the nature of how brokerage firms attracted the individual investor. Yet, the firm had little name recognition as a competitive investment bank in the institutional markets. Clearly, the two firms played to distinctly different markets.

In 1994, Kidder revealed to its parent, General Electric, that it had reported false profits to conceal losses on its government bond desk. The media ran wild with the story of Joseph Jett, whom they alleged to be a rogue bond trader, culminating in a *60 Minutes* exclusive report on Kidder management's lack of oversight on the government bond desk. The fallout from the public flowed through Kidder straight to GE. For days, articles in the press pointed a finger at GE's upper management for mishandling the situation. GE needed to shed the cloud of suspicion that hung over it, and parting with Kidder was the only answer.

A window of opportunity existed and PaineWebber quickly acquired the battered investment bank, its assets, and most of its employees for a mere $650 million, bolstering its institutional presence with more than a thousand new brokers and derivatives traders, and a sophisticated investment banking unit. The acquisition instantly gave PaineWebber entrée into new markets and access to new products and distribution channels.

Kidder, a small yet powerful competitor, was eliminated, with PaineWebber effecting organizational growth by absorbing the entire operating unit. Integrity is critical in the securities business, and PaineWebber distanced itself from the scandal by dissolving the Kidder name and quickly integrating the two firms. Years later, PaineWebber effectively competes in both individual and institutional markets, its reputation intact, while the name of Kidder Peabody is simply one from a bygone era that included the likes of EF Hutton and Drexel Burnham Lambert.

General Electric/Tungsram: Going Global

While domestic political changes have spurred M&A in the United States, under the Bush Administration the door to Europe was kicked right off its hinges as the Berlin Wall's collapse paved the way for a unified Europe. With the fall of the wall came cracks in the trade barriers of Russia and China. In fact, when eastern Europe opened its doors to foreigners, one of the first to enter was General Electric. GE moved quickly to acquire Tungsram, the previously state-owned Hungarian lightbulb manufacturer, and its 7%

market share in Europe's $2.5 billion lighting market. Combined with GE's 13% piece of that market, which had been bolstered in 1991 by acquiring Thorn EMI, Britain's largest lighting firm, Tungsram's 7% share put GE in a toe-to-toe battle with Philips Electronics N.V. as the global lighting leader.

Although GE quickly found that Hungarian production facilities were flawed, bills were unpaid, and rocks filled bulb cartons in otherwise empty warehouses, GE wanted the name recognition and the geographical presence that the Hungarian stalwart provided. As the veil of Communism fell, GE realized that a once-in-a-lifetime opportunity awaited and felt the strategic advantage of an eastern European presence outweighed any financial drawbacks.

Political barriers to expansion still exist in the United States and certainly throughout the rest of the world. Decisions to enter these markets must be carefully evaluated. The political risk in emerging markets combined with the potential for civil unrest and unstable currencies make transactions in these parts of the world extremely uncertain.

In fact, prior to the introduction of Western acquisitions in eastern Europe, emerging-market due diligence was often done after the deal was closed. In the area of post-deal integration, cultural difficulties such as managing a foreign labor force according to U.S. standards can very quickly spell the failure of a deal of this nature. Deciding whether to be the first entrant into an untapped market can be laborious and fraught with hidden risks. But the clout of being first in the door can act as a strong platform from which to build.

SUMMARY

The more popular motivation for an acquisition or merger has its genesis in the belief by one company that an absorption of another company, a service, or a product with one or more of its own will result in some longer-term success or growth by leveraging existing resources, processes, personnel, or products. Yet in the development and actualization of synergy often comes the stark reality that the stakeholders (customers, stockholders, employees, and management) are more focused on instant or short-term benefits such as cost reduction or share price increase. This often forces decisions to be made that sacrifice long-term goals in favor of realizing the tangible short-term savings generated by early reductions in overhead, staff, and basic costs. Even if the motivation for an acquisition or merger is to achieve strategic advantage, the urgency to attain—and the fear of not delivering—bottom-line dollar benefits often obfuscates what would otherwise be defined as a brilliant long-term strategic move.

So often companies will claim strategic fit because they both employ differing skill sets or sell dissimilar products. The fact that two companies are in different businesses does not necessarily make them somehow complementary or strategically a good fit. This misconception has driven many deals to failure. The key to success is being able to take the differences inherent in two companies and meld them to create an enhanced capability. The ultimate goal of all business is profit. And the pursuit of that goal is often driven through a mission for growth. Achieving growth has always been the hallmark of every strategic deal.

The concept of bigger is better heralded much of the M&A activity of the 1980s. Yet, as mentioned earlier, increasing a company's size for the sake of size alone is ill-advised if it ignores the commitment to attain strategic advantage. The series of spin-offs and divestitures that have flooded the markets throughout the 1990s are the by-products of this merger myopia. In this current period of streamlining, restructuring, and reengineering, management has been forced to reexamine and ultimately accept its mistakes as the by-products of so simple a motivator as increasing size.

Achieving strategic advantage by keying on multiple strategic drivers to release synergies is like any marriage. The goal is for the created entity to truly transcend what was first envisioned as a combination of two parties. Just as in any long-term human relationship, there must be more in common than simple attraction. If two individuals have the same backgrounds, similar goals, and aligned perceptions, then the odds of a long-lasting and successful relationship are greater. In the corporate world, if all of those issues are addressed after the union has already occurred and it is determined that none of these characteristics do indeed align, then it will be obvious that this is a deal that should not have been done.

When companies seek to merge or acquire, and can cite more than two strategic drivers as reasons to come together, then the chances of success are higher. In the next chapter, attention is paid to leveraging strategic fit to generate revenue enhancement opportunities. This lays the groundwork for the alignment of other characteristics that may help to determine long-term synergies and ensure success of the transaction. These are the true proving grounds for whether or not *theoretical* synergies can be transformed into *actual* short- and long-term revenue growth programs.