

## **Avoiding a rotten Take over or Merger (TOM)**

The Economist<sup>2</sup> ran a very interesting series on six major TOMs and this article looks at some of the lessons learnt, which are very relevant to the NZ environment, and provides a scorecard for your next TOM.

It is often quoted, and even great leaders seem to forget, that "history has a habit of repeating itself". Company executives, New Zealand directors and the major institutional investors (whose support is often a prerequisite) need to learn the lessons, from both overseas and at home, and think more carefully before they commit to a take-over.

NZ is too small to suffer the losses arising when large TOMs fail. The recent impact to the New Zealand economy on the near collapse of our national air carrier should be a lesson to all.

### The lessons learnt from the 6 mergers featured in The Economist articles

1. Over half of TOMs had destroyed shareholder value, and a further third had made no discernible difference. In other words, a one in 6 chance of increasing shareholder value (per KPMG report as stated in the economist 22<sup>nd</sup> July 2000). TOM advisors and hungry executives are as accurate with potential cost savings estimates as they are with assessing the cost of their own home renovations (in other words pretty hopeless)
2. Defensive TOMs are not a great idea, companies escaping a threat often import its problems into the marriage.
3. During the starry days of courtship, do not limit due diligence in the haste to close the deal as you tend to know less about each other than you think
4. Have a clear strategy for after the merger including who is getting what job thus avoiding the cancerous uncertainty.
5. Murphy's law is at work, the time you are the weakest, post merger the industry is likely to have a major crisis thus it is best undertaken during time of stable growth.
6. As The Economist stated trying to merger two distinct cultures is "like herding cats". Arranged marriages need similar backgrounds, culture, and complementary styles to work (read "the kite and other stories" by Somerset Maugham).
7. Acquisition and merger companies may not have many staff who have worked in senior positions in companies who have managed successful mergers, it would be a good idea to look at the last 10 TOMs they were involved with and assess how accurate their forecasts were.
8. Severance packages can create further wastage as staff leave before generous severance terms disappear.
9. The dirty washing may take years to find and clean.
10. Appearances count, joint CEOs need to be able to work together although eventually only one CEO and one company will survive.
11. Beware of share options being the incentives for a merger (the executives can cash up and leave the shareholders with the infant with soiled nappies).
12. Do not take employees loyalty for granted.

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<sup>2</sup> The Economist Journal 22<sup>nd</sup> July 2000 through to 26<sup>th</sup> August 2000

13. Have all integration projects report through every 4 to 6 weeks to a "council".
14. Merging the operations will distract management from the basic task of making money.
15. Set up an in-house think tank whose task is to speed up integration and to suck out knowledge from the different parts of the joint company and use it in the new organization.

Set out below is a scorecard based on the lessons from which executives need to complete before boldly going where others have mistakenly gone before, (5 out of 6 TOMs fail to achieve the synergism planned).

<b>TOM scorecard</b>	
Has your company got the ability to turn away from a deal if it does not stack up?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you done an evaluation of the potential downside?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Are all the following team players experienced in accurately assessing the full costs of the TOM and accurately estimating synergistic savings?	
Advising Brokers	<input type="checkbox"/> Yes <input type="checkbox"/> No
TOM advisors	<input type="checkbox"/> Yes <input type="checkbox"/> No
Board	<input type="checkbox"/> Yes <input type="checkbox"/> No
Executive	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have all other alternatives to the TOM been fully explored?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have safeguards been put in place to ensure that the benefits from this TOM accrue to shareholders, staff, local community as well as the executive "share option holders"?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Has your company got experience in doing a proper due diligence process?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Has your company enough time to do a proper due diligence process?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Has an impact assessment been undertaken on the New Zealand economy if the TOM fails?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Has the company got enough cash reserves to "weather any eventual storm" arising from the TOM?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you performed a culture audit - a TOM is like merging two families and many problems are overlooked in the frenzied courtship?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you locked-in a portion of your advisors' fees to a successful realization of the proposed TOM benefits? - remember many of your advisors have never worked in an organization which has had a successful TOM.	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you performed an assessment of asset fit - quality, condition and usage?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Is your target company a "CAMEL"? - a company with adequate capital, good	<input type="checkbox"/> Yes <input type="checkbox"/> No

asset quality, good management, record of sound earnings growth and with good liquidity.	
Has an assessment been done on the locked-in employment terms and conditions (especially relevant if acquiring an Australian company)?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Has an evaluation been performed of the current pressure on the environment in which the organization is trading?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Has an assessment been performed on the IT systems integration? - few understand the implications of a TOM and the time-frames involved. The IT team may not have the skills to cope with the now larger environment.	<input type="checkbox"/> Yes <input type="checkbox"/> No
Has the TOM been initiated through sound reasoning? (Many mergers based on a defensive or cost cutting strategy fail).	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you carefully selected the target? Or if you have been approached, have you really ascertained why they want to sell?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you checked the adequacy of provisioning for potential bad debts and under performing loans?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Is the business tied to contractual conditions, which enable customers to pull out of profitable contracts? (a lesson that NAB learnt)	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you established a integration plan which would include the setting up of a "council" which would oversee the key integration projects?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Current relationship between the companies is favorable (in other words have not been fierce rivals in the past).	<input type="checkbox"/> Yes <input type="checkbox"/> No
Do you have the resources to select the new management structure ASAP?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Have you got a contingency plan for the potential loss of key staff? - uncertainty and very generous severance clauses may force executives, who you want to keep, to activate the severance clause for fear of losing the generous terms.	<input type="checkbox"/> Yes <input type="checkbox"/> No
Are you prepared to go through the potential pain of lower revenue as management and staff are diverted by the merger?	<input type="checkbox"/> Yes <input type="checkbox"/> No
Are you prepared to be made surplus to requirements when all the dust has settled and the blood letting finished?	<input type="checkbox"/> Yes <input type="checkbox"/> No

I am looking to develop a pragmatic predictor of TOM risk and would appreciate readers using the scorecard to assess the score of TOMs they have been involved with and contrasting this score with how successful the TOM was. Until waymark solutions gets feedback from readers it suggests the evaluation.

Exhibit xx TOM rating table

less than 15	Stop now, - take a break, and think of another strategy for growth or protection
15-20	High risk TOM - you may be able to increase your score

	through further evaluation and planning
20-25	Well done, look out for the areas where you do not feel inclined to cover, they could be your Achilles heel.
over 25	Congratulations, you are in a unique position - worth having your assessment checked by a third party

### Remember there are other options to a TOM

- Remain being a boutique operator that has strategic alliances, this may be better than the fate of many failed TOMs
- Paying back shareholders the surplus fat and letting them reinvest elsewhere
- Improve performance by focusing on under performing assets (that's often the reason why the other company is interested in you in the first place)
- Look to grow the old fashioned way by expanding from within
- Invest as silent partner in small but fast growing companies with complementary services and extract value by internationalizing their innovation

*I met an interesting investment banker on the plane from Melbourne to Sydney who told about the take-over and merger game that is being played by large investment bankers around the world. It never made any sense to me when everybody knows only one in six mergers breaks even and many have lost billions off the balance sheet!*

*The game is called "transactional fees" and involves the study, by the investment bankers, in minute detail of what are motivational factors of the key players. They end up knowing more about private lives of the CFO, CEO, Board members, Fund managers than they would like their partner to know! Investment bankers go to the CEO and CFO with a proposed merger and acquisition deal and they often fail. The CFOs and CEOs know that these deals seldom work.*

*The investment bankers then go to the influential board members and the CFO and CEO have to fight it in the Board room, which they typically will win. The investment bank who has now spent \$100,000s in research are not finished. They go to the fund managers, who are the major shareholders, and say "the board has lost the plot" they do not recognize the value in this deal" The Fund managers put the hard word on the Board who in turn say to the CEO and CFO. "If we do not do this deal the fund managers will change the board structure, but before that I will see that you go first". The CEO says "What the hell we will do it". The interesting part now starts. The CEO is offered a big sum to go quietly and this with the investment bankers fees are now amortized, through poorly thought out accounting principles, slowing killing combined company for years to come.*