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"Siff-ting" through the Family Business: I untangle the problems.

ENTREPRENEURS

The 7 Deadly Sins Of Mergers And Acquisitions

One of the things my firm does is to provide strategic advice on mergers and acquisitions to our middle-market clients. We have been involved with hundreds of deals and have seen how many deals go wrong often for reasons that were predictable, knowable, and avoidable to the buyer.

Here is what I call the 7 Deadly Sins of Mergers and Acquisitions and the pitfalls you must avoid in doing a deal.

1. Not Doing the Math- will 1 plus 1 equal 3?
Let's say you're Company A, and you have your eye on acquiring Company B. Ideally, 1 plus 1 will equal 3 if you buy Company B. Too often, it turns out to be more like 1 plus 1 equals 1.5. Why? – You need to understand what the combined companies will look like. I recommend that you start with a SWOT (strengths, weaknesses, opportunities and threats) analysis of your company, a SWOT analysis of Company B and a combined analysis, the 'layering effect.'

Of course it's easier to do SWOT on your own company (though I am surprised at how often companies don't) than it is do to it on another company, especially a privately held one, but you can still get information on Company B. There are sources like Factiva, Capital IQ, Dun & Bradstreet, Google (and the rest of the Internet) and then there are the industry publications. Have your key management speak to other people in the industry to help size up your target. This can help you get a sense of what the two companies really look like together

2. Getting Emotional
As CEO, you are undoubtedly passionate about your business. That's to be expected and applauded. Getting emotional about completing a deal is different. You get excited about the possibilities of buying Company B, and before you know it your enthusiasm becomes infectious, to the point where your key management does not challenge you about downside risks of doing the deal. Getting emotional can keep you in a deal that shouldn't go forward.

3. Losing Perspective
Losing perspective is about getting lost in the process. If you've invested a lot of resources – time, talent, money – exploring the deal, it's easy to think that you have to go forward with the acquisition irrespective of the price you pay. Ask yourself why you want to buy Company B. In your layering effect analysis, does it contribute to your top line (sales) or bottom line (profitability)? Do you gain a new distribution channel? Does it eliminate a competitor? Make sure that it is a well-founded rationale and a sound business case that is moving you forward, and not the sheer force of momentum.

4. Ignoring Red Flags
Red flags are signals to pause or even stop. Failing to do so is often a byproduct of getting emotional or losing perspective. Don't close your eyes to the red flags. Did Company B have unusual charges or losses that aren't adequately explained? Does the predictive index (assessment) on the CEO show instability? Is there unusually high turnover on its management team? Trouble fulfilling orders? Are there cultural gaps that will make it difficult to combine people and departments from both companies? In my experience, the No. 1 reason mergers fail is because of cultural incompatibility.

There are hundreds of potential red flags. Don't ignore them. Don't try to justify them away. Dig deeper, ask questions, and if you aren't satisfied with the answers or can't find resolution, walk away.

5. Thinking Inside the Box

Let's say you see some red flags, or your layering-effect analysis does not make sense. It's time to review your other options. What if you only bought part of company B? Or maybe it would make sense to partner with another party to buy Company B. What about a joint venture? How about structuring the deal where instead of buying Company B for $30 million outright, you pay $20 million upfront and $20 million in potential earnouts (based upon future performance)?

It is important to understand your alternatives. I had a client who wanted to purchase a company to expand his distribution and increase his overall sales. I worked with management to perform a SWOT analysis of his company, a SWOT analysis of the potential acquisition and a layering-effect analysis. The layering effect showed that the client really needed 20% of the target company. Why pay for 100% of a company if you only need 20%? I recommended that my client partner with one of the other potential acquirers. The end result is that the client paid 10% of the total purchase price for the 20% of the company that he needed.

6. Forgetting to Put Yourself in the Seller's Shoes

Your interest and Company B's are not aligned. You want to pay the lowest price possible and possibly structure the deal with a future payout; they want to get the best price possible—now! Obviously, you both can't get what you want. Sometimes the art of compromise is best described as "both parties end up equally unhappy."

Put yourself in Company B's shoes to understand why they are selling. Is the CEO looking to retire or play a transitional role? Is Company B being sold at the height of the market? Are there negative trends in the industry that are eluding you?

7. Failing to Make a Convincing Case for the Deal

Try to prove your key points as to why you should acquire Company B. Can the two combined cultures really work together or are the management styles and daily ways of operating incompatible? Can you gain incremental customers or will they leave to go to your competitors? Can you really achieve your cost synergies? How will your people and customers fare during the acquisition? Can you structure a deal so that you don't overpay? You need to run worst-case, middle-of-the-road case, and best-case analyses for the acquisition. Once you have proven your layering-effect analysis, you can then put together a 90-day plan for when you own the company.

Avoid the 7 Deadly Sins of Mergers and Acquisitions and you are well on the way in this pre-acquisition process. And remember- your real work begins once you complete the acquisition.

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