“Marketing Due Diligence” in Strategic Mergers and Acquisitions

In the 1990s, seemingly not a day goes by when the business press does not report on multimillion-dollar mergers and acquisitions. Companies of all sizes and all industries worldwide are seizing the opportunities to broaden their competitiveness by forging corporate combinations with strategically synergistic partners. The goals of achieving growth, tapping into new markets, and creating unassailable strategic advantage underlie each transaction.

Corporate merger and acquisition activity continues to thrive, with the annual dollar volume of M&A transactions steadily increasing. For example, in 1994 there were approximately $350 billion in M&A deals in the United States. In 1995, that figure rose to almost $400 billion. The year 1996 saw total deal volume in the United States exceed $620 billion, a figure based on the dollar volume of known deals and projections of unannounced transactions and deal prices. And in 1997, M&A transactions totaled more than $900 billion.

Several factors are fueling the continuing explosion in merger activity. The ability of businesses to successfully achieve economies of scale, broaden geographic market coverage, and more effectively compete globally have helped create an aggressive acquisition marketplace. In addition, the search for cost reductions through M&A—particularly in such mature industries as retailing, banking, and health care—is being used to offset companies’ inability to increase profits through price or production increases. In all likelihood, the merger mania of the late 1990s will carry over into the new millennium as these and other factors drive corporate growth planning.

Today’s merger wave is unlike others seen throughout the 20th century. The focus of M&A today is in stark contrast to the conglomeratization mergers of the 1960s and the frenzied hostile takeovers and leveraged buyouts of the 1980s. Both eras saw dra-
matically more long-term failures than successes. Studies show that 60% of the cross-
industry, conglomerate acquisitions that occurred between 1970 and 1982 were sold or
divested by 1989.

Reports of the major LBO deals of the 1980s typically cite the downfall of those or-
ganizations, which collapsed under the weight of the heavy debt incurred in financing
transactions driven by the promise of quick monetary gain rather than to ably secure
long-term strategic advantage. As a means of longer-term corporate growth, mergers and
acquisitions have understandably gotten a bad name. Bad numbers underscore M&A's
sour reputation. History has shown that 35% to 50% of all deals ultimately fail. Why
such a disastrous track record?

The simple fact is mergers and acquisitions are usually easy to envision, but incredi-
bly complex to execute. Even when the synergies exist on paper, problems can occur al-
most anywhere in the prolonged M&A process. Managers today must closely oversee
every phase of predeal strategic analyses and postmerger integration activities. Of par-
ticular importance is the initial due diligence process, which, when inadequately con-
ducted, prevents merging companies from ever becoming truly integrated,
market-focused organizations.

**TRADITIONAL DUE DILIGENCE: STRATEGIC SHORTCOMINGS**

Due diligence is the series of exploratory activities used in evaluating a target company
prior to finalization of the merger or acquisition. The traditional approach to due dili-
gence focuses on several key areas: financial, legal and regulatory, and accounting and
tax. Without question, each of these areas is highly complex, and scores of business and
academic textbooks have been devoted to the topics. Broad treatment of them is beyond
the scope of this book. Yet it is important for readers to understand the fundamental fi-
nancial and legal orientation toward due diligence investigations in order to identify its
principal shortcoming.

Strategic considerations mark the focus of most M&A deals today. But as we will see,
insufficient attention to strategic marketing issues is a pervasive flaw in traditional pre-
merger due diligence.

When a merger or acquisition is first envisioned, the focus is on whether or not it
makes financial sense. In due diligence, legal and accounting experts are retained to
identify potential fiscal, regulatory, and tax-related liabilities of the target company.
Concurrently, investment bankers are devising the financing strategy, determining
where and how much capital must be raised to complete the transaction, while auditors
pore over the books of the target to arrive at the most accurate valuation. Clearly, tradi-
tional due diligence is largely focused on making the numbers work. Company man-
agement will not pursue a transaction unless assurances are provided that a detailed
examination of the target company’s financial affairs has been conducted. In the broad-
est sense, the goal of due diligence is looking at and beyond the numbers to identify
hidden vulnerabilities.

Due diligence in public company transactions requires analyzing a host of Securities
and Exchange Commission (SEC) filings. These include Forms 8-K, 10-K, and 10-Q,
as well as other documentation providing historical financial data and information on
the quality of earnings. A main focus of due diligence is on identifying under- or over-valued assets and liabilities, which may take the form of property, plant, and equipment; inventory levels; marketable equity securities; work in progress; excess pension plan assets; and intangible assets such as licenses, franchises, trademarks, and patented technology.

Accountants play a central role in this phase of the due diligence process. Serving as financial experts on the team, they spearhead the process of identifying the tax consequences of given transactions, offer insights on different types of deal structures, and determine and fulfill regulatory reporting requirements. Attorneys play a critical role in the due diligence process, as well. Legal issues have a direct impact on the timing, structure, and viability of different transactions. These issues include differences in the jurisdiction of incorporation of the merger partners, whether the partners are publicly traded companies, and securities law ramifications of how the transaction is to be financed and structured.

Other M&A-related legal concerns involve antitrust considerations, a central issue in all sizable deals involving mergers of horizontal competitors. Attorneys advise on the likelihood of challenges to the proposed merger by governmental authorities—potential constraints imposed by federal antitrust laws, particularly Section 7 of the Clayton Act. This statute prohibits acquisitions “where in any line of commerce . . . in any section of the country, the effects of such acquisitions may be substantially to lessen competition or to tend to create a monopoly.” Many factors combine to determine the competitive environment in a given market. However, the government primarily relies on measures of “market concentration” in evaluating mergers and acquisitions between competing, horizontally aligned companies.

Markets are considered to be either “unconcentrated,” “moderately concentrated,” or “highly concentrated.” For instance, under the 1968 Justice Department guidelines, an industry was deemed to be highly concentrated if the four largest companies held at least 75% of the total market. Although this evaluative policy enabled companies to quickly gauge the government’s stance toward a potential merger, it was deemed overly rigid. Its shortcoming lay in its inability to fully and accurately predict the level of decreased industry competitiveness in the wake of the merger of two competitors.

In 1982, the Justice Department introduced the Herfindahl-Hirschman Index (HHI). Instead of simply citing the market share levels of proposed merger partners, the HHI offers more insights on measuring the merger’s impact on industry concentration and overall competitiveness. Analyzing antitrust laws obviously focuses on a basic marketing variable—market share.

This is important to note since market share is one of the few marketing-related aspects of conventional due diligence examinations.

Companies undertake due diligence to dot the legal “i’s” and to make sure the accounting figures work. However, the merger partners have, in most cases, not sufficiently assessed the strategic marketing variables that lie at the heart of the deal.

When everything in the examination process checks out from a financial, legal, and regulatory standpoint, the merger partners typically plunge forward. They assume that the strategic benefits of the merger will necessarily fall into line along with the numbers. Statistics on the dramatic failure rate of M&A transactions suggest this is erroneous thinking.
M&A decision making now requires much closer scrutiny of strategic issues in the process of evaluating merger opportunities and individual target companies. Achieving the elusive “strategic fit” is typically marked by efforts of the merging companies to augment product lines, broaden geographic coverage, gain new distribution channels, and penetrate entirely new markets. These goals relate directly to marketing. Consequently, there is a greater need today for “marketing due diligence” in the current context of strategic mergers and acquisitions.

Marketing due diligence can be defined as an analytical methodology that assesses target companies’ sales and marketing strengths and weaknesses to ensure the success of strategic mergers and acquisitions. By success, we mean that the deal has met the financial, operational, and strategic objectives of the companies involved. The process of marketing due diligence is critical for two main reasons:

1. It helps companies avoid the delays, missteps, and resultant multimillion-dollar losses that can result from inadequate strategic examinations of target companies and the markets in which they operate.

2. Marketing due diligence’s fundamental orientation toward revenue growth—as opposed to cost reduction—is necessary to ensure the true long-term success of the transaction.

Today, strategic marketing consultants must work side by side with the investment bankers, lawyers, certified public accountants (CPAs), and others who have historically comprised the due diligence team. Corporate development officers (CDOs), too, require the input of M&A-focused marketing specialists to help in assessing the strategic attributes and potential of different M&A candidates. Even more so, financial buyers—who typically purchase a company as an investment—have sought the guidance of strategic marketing specialists to help them identify new revenue sources for their investment. It is becoming increasingly commonplace to have marketing advisers assist financial buyers in projecting and uncovering future growth initiatives that can justify more aggressive bids. By all accounts, marketing due diligence brings a different perspective and analytical eye to predeal planning and postmerger integration.

The importance of assembling a broad-based multidisciplinary team that includes marketing and sales specialists is becoming critical.

As we have seen, standard due diligence focuses in large part on a target company’s financial assets and liabilities and how they meld with the acquirer’s balance sheet. Some marketing-related variables are examined, but too often they are merely sketchy assessments of the target’s product sales volume and margins and the general competitive environment.

Marketing due diligence, however, is based on analyzing in significantly greater depth these characteristics and numerous other attributes resident in both the acquirer’s and the target’s marketing systems and capabilities. For instance, marketing due diligence involves looking at not only both firms’ products, but also the promotion behind them as a determinant of those products’ past success. It involves examining not only both firms’ markets, but also the macro- and microenvironmental trends that will affect those markets’ future characteristics. It involves not only studying each firm’s customer
base, but also analyzing the extent to which they have—or can be—penetrated with different product and service offerings.

Conducting financial and legal due diligence is typically the last phase of the M&A process—after the letter of intent is signed and before the transaction closes. Marketing due diligence, however, is rightfully one of the critical first steps in premerger assessments of potential merger candidates. This is because marketing due diligence generates important information that should be factored into target company valuations—which are undertaken soon after the transaction is envisioned and preliminary discussions between the would-be merger partners have commenced.

Let’s now look at target company examinations and how marketing due diligence is useful in supplying information to help calculate an organization’s current worth and its future potential as part of the merged company.

**VALUATION PROCESS: ROLE OF MARKETING INTANGIBLE ASSETS**

Valuation—determining the fair market price for a target company—is an initial, integral phase of the premerger process. Valuation is almost exclusively an arithmetic exercise, the key focus of which is assessing the target’s physical assets, analyzing its current earnings performance and cash flow, and devising future projections based on current figures. The financial data studied include statistics on capital expenditure requirements, working capital requirements, and fixed and variable costs. In addition to financial information, operations-related data are collected. These include figures on the current and projected structure of the target’s costs, personnel-related expenditures and current and future requirements, and labor expenditures. General industry information is also gathered to assess the impact of key trends on revenues and costs.

As predeal planning moves forward, initial financial and operational statistics are

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**INSIDER’S OUTLOOK**

Success in M&A requires assembling a comprehensive due diligence team—one comprised of people with different skill sets and professional backgrounds. At Siemens, we have a lot of M&A specialists because we do a lot of deals. We have on-board CPAs and M&A lawyers. We have four deal-making, corporate development professionals . . . including myself. We’ve got a human resources M&A professional—half of her job is HR and the other half is understanding all the details involved in M&A. We’ve got environmental professionals. So the bottom line is that we put together a very professional team. But that team really has three people at its core. It has the operating manager . . . either the CEO or CFO of the division. The corporate developer, who is the deal expert. And the M&A lawyer. But above all you need people who understand that M&A is a growth alternative. You need people who understand why the deal is being done in the first place . . . people who recognize the corporate growth opportunities inherent in the transaction. This fact alone is why you need people on the due diligence team who truly understand marketing and product development.

—Terence Bentley, Siemens Corporation
challenged, updated, and modified based on additional input generated in the target company examination process. A detailed explanation of statistical valuation methods is also beyond the scope of this book. However, a basic description of the main valuation techniques is in order. These methods include:

- **Discounted cash flow analysis.** The focus of this approach is assigning a value in today’s dollars to future cash flow levels. This analysis lends insights into future financial performance, cash flow, and various balance sheet relationships. However, its shortcoming lies in its inability to accurately reflect pricing trends in the market.

- **Comparable transactions.** Not unlike real estate “comparables,” management arrives at valuation figures based on the prices paid in past transactions involving companies of similar size or industry standing. A key problem of this valuation method lies in the quality and quantity of the comparative data. Information on past deals may be incomplete, inaccurate, outdated, or simply unavailable.

- **Comparable companies.** The focus here is on comparing the proposed value of the acquisition target against the prevailing market price of publicly traded companies similar to the target in terms of size, market standing, and various economic and industry-specific variables. Unfortunately, this approach largely ignores the target’s expected future performance as projected by current financial or operational data.

- **Liquidation analysis.** This method keys on the value of the company’s individual assets if they were to be sold at auction or in a liquidation. Liquidation analysis views a company solely from the standpoint of its current assets, in contrast to its ability to function as a future going concern.

- **Adjusted book value.** This accounting-based approach involves analyses of depreciation of assets and inventory. However, it does not factor in the company’s economic value and its actual or potential earnings performance.

The valuation process focuses on identifying a company’s tangible and intangible assets. Tangible assets include such items as the target’s real property, machinery and equipment, and other physical attributes. The category of intangible assets includes the notion of “goodwill,” which can be defined as those elements of a company’s overall worth that do not appear on a balance sheet. Another definitional aspect of goodwill is that it is comprised of distinct capabilities that cannot be physically removed from the company. Some marketing-related intangibles are evaluated in the valuation process. These include such things as patents, licenses, trademarks, and customer lists.

The fact is, however, that intangible assets relative to a company’s sales and marketing infrastructure can have a significant bearing on its current value, as well as its future ability to contribute significant top-line results as a part of the merged organization. Yet there is an entire realm of marketing-related intangible assets that must be pinpointed and assessed, but which are not typically viewed in traditional valuation methods—critical information necessary to supplement the conventional valuation process.

The increasing importance of the strategic marketing aspects of M&A planning requires a broadened approach to determining the value resident in the target company’s sales and marketing infrastructure. Moreover, achieving long-term strategic objectives via a corporate combination requires a detailed analysis of the marketing-
related variables that will affect the merged company’s ability to actualize those objectives.

Thus, identifying and assessing a target company’s “marketing intangible assets” is necessary to pinpoint specific growth opportunities inherent in a merger or acquisition situation, as well as to compare the attractiveness of different merger candidates.

MARKETING INTANGIBLES: WHERE THEY ARE FOUND

Marketing intangible assets reside in a target company’s sales and marketing systems and capabilities. As detailed throughout this book, marketing due diligence is the process by which marketing intangible assets are discovered via the rigorous collection of qualitative and quantitative data on the target’s people, products, and processes. Each area must be evaluated from the standpoint of its individual strengths, weaknesses, threats, and opportunities.

Qualitative Areas

The term “qualitative” denotes an attribute that cannot be assigned a numerical value. This is not always the case when analyzing marketing intangible assets, which can sometimes have dollar values ascribed to them for the purposes of valuation and for developing financial projections. For the purpose of this introduction to marketing due diligence, let’s look briefly at the main areas of a target company where qualitative marketing-related assets reside.

In the area of people, and people-related variables internal and external to the target company, assets are found in:

- Marketing staff
- Sales force
- Customer base
- Distributors
- Cultural marketing orientation

Marketing staff. For instance, a high experience level, professionalism, creativity, and success rate of the marketing staff is inherently valuable. High marks and thus high worth can be assigned when affirmative answers are provided to the following questions: Is the staff an integral part of the company’s operations, as opposed to being an ineffectual overhead function? Does the staff contribute to the development and execution of strategic initiatives that spark direct top-line results? Are key members of the sales and marketing team content with their positions, with little or no danger of losing them in the wake of the merger? In essence, a strong and committed marketing organization may possess much of the company’s overall “intellectual property” assets.

Sales force. A well-entrenched, stable sales organization is a distinct area of value. Another aspect relates to the sales function’s level of interaction with other departments,
such as research and development (R&D), manufacturing, and new product development. A sales force that works closely with other corporate functions to furnish and receive market information is likely to be more successful than one that is isolated. From the standpoint of performance, the level of sales volume—collectively and by individual seller—is another indicator of value, as will be addressed in the next section on quantitative areas.

**Customer base.** A strong and loyal customer base is one of the most valuable intangibles a target company can possess. Companies that enjoy high customer commitment have low levels of customer turnover. Value is found in such organizations, which typically have successful programs in place to monitor and meet changing customer needs and to provide world-class customer service. Another key area of value relates to the extent to which sales are dispersed throughout the customer base. Whenever sales are concentrated with a few clients or customers, an element of vulnerability exists; major losses can be incurred if one or more of those large customers is lost postmerger. A strong and loyal customer base, where sales are spread over many different accounts, poses an element of value.

**Distributors.** Distributors represent a key to effective product marketing. Having smooth and solid relations with distributors (whether they are wholesalers, retailers, or other intermediaries) creates value, since products are assured of getting to market in a timely and cost-effective manner. Value can be minimized, however, when “channel conflict” exists between competing distribution arms in multiple-channel paradigms. Identifying existing and potential problems in this regard is essential in order to avoid future complications that may diminish value after or as a result of a merger or acquisition.

**Cultural marketing orientation.** A corporate culture marked by a broad, customer-focused marketing orientation represents a valuable intangible. Today, every person in an organization should assume marketing responsibilities to some degree. Ideally, everyone is customer-focused and employees work together to help meet customer requirements. Thus, value resides in a company where marketing is pervasive throughout the organization and is not relegated to the marketing and sales function. Cultural variables are a critical issue in determining strategic fit between merger partners, and they are discussed in great detail in Chapter 10. Yet, it is important to assess the degree to which culture fosters and enhances the process of sales and marketing throughout the entire organization.

In the realm of *products*, these external and internal factors are a source of marketing intangible assets:

- Market share
- Brand power
- New product development
- Marketplace perceptions
- Competition levels
Market share. The significance of market share in this context is not the numerical percentage held by the company under review. From a qualitative standpoint, occupying a leading position in a product market offers a host of important intangible benefits. For instance, high market share is a main driver of profitability. As was illustrated in the well-known Profit Impact of Market Strategy (PIMS) research program developed by the Strategic Planning Institute, the market share leader in a given category may be three times as profitable as the fifth-place company.

Profitability generates benefits in two basic ways.

1. Overall costs, including those for sales and marketing, are lower due to higher volumes.
2. Marketing-related advantages and cost savings may accrue from learning curve experience gains in product management and promotion.

Marketing due diligence, as you will see, determines the extent to which the company’s market share is sustainable and expandable—and, consequently, a continuing source of potential value.

Brand power. In product marketing, there are few things as valuable as a powerful brand name. A high level of name recognition—ideally coupled with positive market perceptions of product quality and value—facilitates and maximizes sales. What’s more, brand name strength of given products carries over in a positive halo effect to benefit other goods and services offered by the company. Brand power is one of the few marketing intangibles assessed in the valuation category of goodwill. Yet, its broader value to the target company’s overall sales and marketing processes, and, therefore, long-term profitability, often goes unrecognized.

New product development. A company that regularly introduces new products and services offers assets not found in a firm that is slow and ineffective in developing new offerings. For instance, aggressive product-driven companies are viewed in the marketplace as innovators. There is value in possessing this market perception—value that supports individual products and the organization as a whole. Moreover, strong product development capabilities typically indicate that assets reside in the strong working rela-

INSIDER’S OUTLOOK

When you are right at the very beginning of looking at a deal... it’s a good idea to brainstorm with marketing. Go over your entire deal list and get their reactions to things. Get their input on evaluating the market or markets in which given target companies are operating. Many deals eventually fail because of “Marketing 101” type mistakes. I have seen companies make strategically sound deals, but make real marketing errors... such as pumping out products to the distribution network without making sure they were getting to the final customers. Marketing errors are often directly related to a lot of companies’ problem acquisitions.

—Diane Harris, Hypotenuse Enterprises
tionship between the corporate functions that jointly create and market new goods and services, such as R&D, engineering, manufacturing, customer service, and sales. Of course, the rate of new product introductions is not as significant as the actual success rate of those items in the market. Nonetheless, a high degree of product innovation typically illustrates progressiveness and aggressiveness—two valuable traits necessary to achieve and maintain competitiveness, thus increasing the probability of new product success.

**Marketplace perceptions.** The positive perceptions the market holds toward a company’s products represent a fundamental marketing intangible. These may relate to product quality, value, customer service, or other variables. Positive perceptions also relate to the company as a whole. Is the company viewed as being a good corporate citizen? How is the company perceived in terms of its relations with labor unions? Has the company experienced significant public relations (PR) problems in the past? Determining the strength and ultimate value of positive market sentiment requires gauging the views of customers, shareholders, and the business community at large.

**Competition levels.** A weak or decreasingly intensive competitive environment represents a marketing asset in itself. For example, not having to constantly fend off competitive threats enables a company to take an offensive rather than defensive position in the market. Program planning and implementation are not hindered by the disruptions of competitors’ inroads, which may necessitate countermeasures that drain important resources from ongoing initiatives. Naturally, the competitive environment is continually changing. Consequently, the search for marketing intangibles requires evaluating key market trends and their potential impact on the target’s ability to maintain and bolster its competitive standing in the future.

In the area of processes, the following represent sources of marketing intangible assets:

- Marketing and sales planning
- Advertising and marketing communications
- Marketing information systems
- Technology applications and customer databases
- Outsourced relationships
- Organizational communication

**Marketing and sales planning.** Almost every company develops marketing and sales plans. The extent to which a company actually, and regularly, achieves the goals detailed in those plans represents a growth-related intangible asset. Marketing planning is just one area. Long-term corporate strategic plans, as well as short-term action plans for specific promotional or product initiatives, should also be assessed from the standpoint of their substantive foundation, practical execution, and tangible results.

**Advertising and marketing communications.** The bottom-line effectiveness of individual advertising, PR, direct mail, and other marketing communications programs can often be measured. From a broader standpoint, the marketing department that consis-
tently produces creative, impactive, sales-generating marketing campaigns possesses an important intangible asset.

The extent to which products and product lines are well positioned in comparison to competitors’ offerings is another key asset. Many otherwise viable products fail over time because the market does not have a clear understanding of their competitive differentiating characteristics. Of course, a product’s positioning strategy may be sound while the communications execution of that strategy is not. Marketing due diligence addresses that dichotomy and determines methods of closing that gap.

**Marketing information systems.** Data relating to a company’s markets, customers, and competitors should be regularly collected. Surprisingly, many companies do not have even the most rudimentary process of accumulating and disseminating intelligence to key sales and marketing decision makers.

The degree to which the target company gathers and applies marketing information goes well beyond the maintenance of conventional customer lists—another of the handful of marketing-related intangible assets assessed in traditional valuation and due diligence. Significant quantity and quality of marketing information is a key intangible asset. This is particularly true if that information is maintained in sophisticated, technology-based systems.

**Technology applications and customer databases.** Today, information technology (IT) is central to a company’s operations. Yet, the degree to which IT is effectively deployed for marketing purposes—for example, in a marketing information system—often points up a valuable intangible.

The issue, however, is not whether the company uses technology for sales and marketing. The issue is how well that technology is applied to solve marketing problems and to support ongoing and future initiatives. For instance, the era of customized marketing has come upon us. The tool that enabled companies to move from mass marketing to individualized selling is the customer database—a system that tracks customers’ demographic composition, geographic locations, and, most important, their buying history and patterns.

One can argue that a database is a tangible entity on which a dollar value could be placed. However, a company’s customer database should not be viewed as a physical asset, but rather as a compilation of critically important information (an intangible) whose potential benefit transcends the value of the hard drives or disks it is stored on.

**Outsourced relationships.** A target company’s roster of marketing services agencies—such as those for advertising, media buying, PR, direct mail, and sales support—is an integral, albeit external, element of its marketing infrastructure. The quality of the output of those agencies is significant. But the true intangible value lies in a corporate marketing department whose management effectively makes outsourcing decisions; that is, what functions to outsource and to what vendors they should be outsourced. By all accounts, managerial skill is needed to select and manage the work of outside advisers. There is substantial value in that ability, yet no listing on a company’s balance sheet.

**Organizational communication.** Channels of internal communication are an important asset when they report information that directly supports the company’s sales and
marketing efforts. The channels, types, and media through which communications are disseminated in the target company must be assessed. The more an organization imparts sales and marketing news, such as new product introductions and selling strategies, the greater the likelihood that it functions as a customer-focused organization across all levels and locations.

### Quantitative Areas

As the foregoing illustrates, much of the data collected in identifying marketing intangible assets is qualitative in nature. Some marketing intangibles, however, are discovered via statistical analyses. There are three main categories where quantitative measurements point up potential marketing intangible assets. The existence and strength of given quantitative intangible assets can be gauged by developing one or more of the following ratios:

- Marketing investment ratios
- Productivity ratios
- Efficiency ratios

**Marketing investment ratios.** In essence, these ratios relate to resource allocation decisions by the target company for sales and marketing programs. Marketing investment ratios range from information on general marketing expenditures (e.g., growth or decline of advertising expenditures in a given time period) to data on specific marketing resource allocation decisions (e.g., comparisons of spending on different promotional and marketing communications mix elements). How much and how well money is invested for marketing—and the return on those past investments—point up intangible assets from both a strategic and a managerial standpoint.

**Productivity ratios.** These ratio analyses involve measuring the success, or lack thereof, of sales and marketing programs and special initiatives such as strategic alliances and marketing tie-in programs with key stakeholders. For example, these ratios are used to pinpoint revenue gains resulting from specific advertising campaigns, sales promotion programs, direct marketing efforts, and database marketing activities.

The most frequently calculated productivity ratios relate to sales performance—both for individual sellers and for entire sales teams assigned to different corporate divisions or subsidiaries. Therefore, sales productivity can be assessed by analyzing overall sales growth (or decline), average order size by customer, sales volume by individual sellers (e.g., volume in comparison to the number of sales calls made), and other criteria.

**Efficiency ratios.** A number of marketing areas must be assessed in terms of their operational efficiency. One measurement relates directly to customer satisfaction. Quantitative data, for example, can be collected on warranty costs as compared to net and gross sales to identify customer sentiment toward different products and product lines. Qualitative input must also be generated via interviews with customers, and this information must be viewed against the quantitative findings.
Another example of an efficiency analysis relates to the stability of sales and marketing staff. Thus, an employee turnover ratio can provide insights into whether or not the sales and marketing function is being well managed—as well as indicate potential personnel-related problems that must be addressed as you effect postmerger integration.

In each of the qualitative and quantitative areas of investigation, data should be collected from the immediate past and, if possible, as far back as five years. Historical information must be collected and studied in order to spot positive and negative trends that will impact future initiatives, as well as to point up other relevant strengths, weaknesses, and potential threats and opportunities.

However, all marketing-related data on a target company must be assessed two ways. The target must be viewed first as an entity unto itself, then as a component of the merged company. This constitutes the fundamental orientation to growth-focused M&A planning.

On the one hand, areas of weakness in the target company may be mitigated if your company has particular strengths to offset those shortcomings. On the other hand, strengths resident in the target company’s sales and marketing infrastructure represent areas that can conceivably be bolstered as the firms merge and take shape as a forceful new corporate entity.

Marketing due diligence’s unique focus offers you the ability to identify strengths and weaknesses that are critical to both predeal analyses and postdeal integration and growth planning. Initially, the qualitative and quantitative data culled are valuable in assessing the target company’s worth from a valuation standpoint. Going forward, this information is essential for developing forecasts, financial projections, and plans whose focus is forging growth strategies to generate near- and long-term revenues.

Without question, the emphasis on growth represents one of the most dramatic shifts in merger and acquisition planning and execution over the past 10 years. Growth through M&A is the driving force of marketing due diligence and the underlying focus of the guidance provided throughout this book.

**INSIDER’S OUTLOOK**

We run the due diligence process very rigorously. One of the keys is getting the appropriate experts on the team. We have people who are experienced in every aspect of a business’s operations. We have experts in law, finance, tax, environmental compliance, human resources, marketing, sales, and operations. We also use outside advisors to gather specific information on subject areas we may not be totally familiar with. Over all, the due diligence team is multifunctional, multidisciplinary.

—Mufit Cinali, AT&T

**REVENUE ENHANCEMENT OPPORTUNITIES**

The increasing emphasis on marketing due diligence is consistent with an emerging tenet in M&A today: *Cost-reduction synergies, which are often realized through achiev-
ing economies of scale, are becoming much less important than strategic synergies that can generate near- and long-term revenues.

The process and benefits of marketing due diligence to support growth initiatives is best illustrated by a new concept that provides a frame of reference—and represents the methodological underpinnings—of this new approach to evaluating all merger or acquisition opportunities: the “revenue enhancement opportunity” (REO).

Effecting synergies is the goal of any merger or acquisition. But what exactly are synergies? And are there different types?

Certainly, every deal offers different financial and situational benefits to the companies involved. However, whether the deal is of a strategic or financial nature, the orientation that focuses on long-term growth as opposed to short-term cost cutting requires that we view the term “synergies” in a new light. The strategic M&A perspective has spawned a new emphasis on the synergies that can lead to significant top-line revenue gains—REO synergies.

An REO can be defined as: A newly created or strengthened product or service that is forged by the fusion of two distinct attributes of the merger partners and which generates immediate and/or long-term revenue growth.

The process of identifying and realizing REOs is a driving focus of marketing due diligence and, consequently, is treated in detail in Chapter 3. For now, it is important to understand that REO analysis and identification is a key perspective in growth-focused M&A planning.

Marketing due diligence concentrates on delivering instant payoff, but also a filled and prioritized pipeline of revenue enhancers and growth opportunities. It aids in the process of forecasting and delivering revenue growth immediately upon finalization of the deal. But the prioritization aspect allows for the ongoing achievement of successive REO synergies—as will be discussed in detail in Chapter 3—at appropriate points in the postdeal integration timetable. Acknowledging the pipeline concept in the premerger planning stages is critical. It allows the acquirer to focus on revenue enhancers that will deliver both quick hits and incremental gains to stakeholders over the short term, while never losing sight of the revenue enhancement opportunities that will produce a steady stream of future sales. More on this later.

**IDENTIFYING SOURCES OF VALUE**

The search for marketing intangible assets, revenue enhancement opportunities, and other sources of value to ensure the success of strategic mergers and acquisitions requires an exhaustive review of a target company’s overall infrastructure. Effectively conducting this analysis, however, requires adopting a new frame of reference, which is set forth in Part One of this book.

Part Two addresses in detail each element of a target’s operations that will point up marketing-related strengths, weaknesses, threats, and opportunities. In a sense, the forthcoming guidance resembles a conventional Strengths, Weaknesses, Opportunities, Threats (SWOT) analysis—a methodology employed in conducting basic strategic planning. There is an important difference, however. In this context, the analysis is linked di-
rectly to the considerations unique to up-front, predeal planning and postmerger integration.

The focus is on analyzing:

- **Market dynamics and company performance.** Analyzing the markets in which a company operates is a standard area of any acquisition analysis. From a marketing due diligence perspective, however, market analysis takes on an important new dimension. It determines not only where the company is situated in the market, but, more importantly, how the company got there (and where it is going). In other words, it focuses on assessing how well the organization is responding to its particular marketplace threats and opportunities. Attention is paid to a target company’s overall marketing effectiveness as one determinant of its current value and future potential as part of the merged company (see Chapter 4).

- **Product and service lines.** Products and services are the lifeblood of any company. It is necessary to evaluate a target company’s products and services to identify the strategic fit with your own offerings and to assist you in product-related decision making in the postmerger environment.

  Various qualitative and quantitative measures are used in assessing product lines. In particular, variables such as product line strengths and vulnerabilities, product life cycle stages, and marketing communications tactics supporting individual offerings must be evaluated (see Chapter 5).

- **Customers.** Tremendous sources of value and revenue gain opportunities exist in a company’s current customer base. A detailed examination of the firm’s existing and prospective buyers (those with whom the company has had dealings, as well as those it is actively attempting to transform into buyers) must be conducted. The customer base should be analyzed in terms of the categories the merged firm will serve (e.g., consumer, industrial, government); composition (e.g., geographically, demographically, psychologically); and size (e.g., revenues, average purchase amounts, levels of purchase frequency, and the number of employees in an organization). When analyzing the customer base, particular attention must be paid to cross-selling opportunities that will exist vis-à-vis the merged company’s product mix (see Chapter 6).

- **Employees.** A company’s most valuable asset is its employees. Premerger marketing due diligence addresses such analytical areas as departmental structure, lines of reporting, staff size, geographic location, and demographic composition of the employee base. Extensively analyzing the target’s employees is critical in one very important respect: determining the skills and capabilities held by employees—relative to the strategic imperatives of the merged company itself—in order to determine those people’s role in the new organization going forward (see Chapter 7).

- **Management functions and processes.** Skills and capabilities reside not only in a company’s people, but also in the managerial structure and procedures of its various functional units. Marketing due diligence explores the key areas of a target’s management infrastructure for two compelling reasons: to determine outstanding practices and capabilities that can be imported into the new organization, and to determine the extent to which particular managerial processes can support the merged company’s strategic growth initiatives (see Chapter 8).
POSTMERGER INTEGRATION:
PROTECTING AND CULTIVATING SOURCES OF VALUE

The core focus of marketing due diligence is spotting sources of value inherent in a target company. And, as stated, value resides in a company’s people, products, and processes.

Identifying those sources of value is the primary task in growth-focused premerger planning. The other essential responsibility is protecting and transferring value and skill sets in the postmerger environment. Whereas Part Two addresses how to identify sources of value, Part Three addresses the ways to harness and cultivate those capabilities in the future. Guidance is provided in the following areas:

• **Understanding the challenges of integration.** The obstacles to postmerger integration continue to be widely chronicled in the business literature. Employing a best-practices approach to effecting integration first requires understanding the typical roadblocks and problem areas and how to overcome them (see Chapter 9).

  In addition, understanding the dynamics and attributes of different corporate cultures is critical to avoiding the well-publicized “culture clashes” that have killed many a strategically sound transaction. Evaluating the process- and personnel-related variables of an organization’s culture is a crucial means of identifying the critical success factors for successful acquisition integration (see Chapter 10).

• **Aligning products and services.** In horizontal mergers, there are invariably product line overlaps that require determining which goods and services will be supported post-merger. Even in vertical mergers, there are situations where limited monetary and human resources will preclude management from supporting every product and service the combining companies offered prior to the transaction. A disciplined approach is necessary to make sound product and service line decisions relative to integrating the merging companies’ offerings. Moreover, this approach must be based on evaluating the critical considerations of product management, such as branding strategies, pricing, promotion, and distribution (see Chapter 11).

• **Internal communication strategies.** A detailed employee communication program must be planned and implemented as part of the integration process. Devising and executing a communications program helps ensure that employees remain committed, motivated, and productive in the wake of the merger’s close. Communications are also an essential means of effecting understanding between disparate employee bases to support the melding of corporate cultures and to provide a foundation for successful execution of the merged firm’s strategic growth initiatives (see Chapter 12).

• **Training and development curricula.** Training is imperative to effect the all-important transfer of skills that will help the merged company realize the strategic gains sought. Well-designed and well-executed training and development curricula can directly support growth planning initiatives and—like communication—can facilitate integration and the alignment of corporate cultures. And, different forms of training techniques should be employed based on employees’ different staff classifications and the nature of the training content itself (see Chapter 13).

• **Reward and recognition programs.** Employees who support and help facilitate the merged firm’s integration program should be recognized for their contributions and rewarded for loyalty in the midst of change. Companies’ failure to overtly acknowledge
and reinforce such positive behavior is often a key cause of flawed or delayed integration programs and key personnel defections. Reward programs must be structured differently for employees at different levels of the organization. These initiatives must be promoted widely and monitored closely (see Chapter 14).

**INSIDER’S OUTLOOK**

[In due diligence] every team member knows what he or she is supposed to do. They know who they are going to talk to at the target company. They know how much time they are going to spend reviewing documents and visiting facilities. We use extensive checklists in order to do the most comprehensive interviews with all key managers at the target company. And we ask some very tough questions. On, say, a $100 million deal, we probably have a team of a dozen or two dozen people visiting the target company at different times. And we spend as much time as we need to get the information we want. On very complicated deals, we may spend several weeks. On less complicated deals, we’ll spend a little less time.

—Mufit Cinali, AT&T

- **Postmerger external communications.** The content and the timing of external communications aimed at the merged company’s various stakeholders are critical. Messages must be carefully articulated based on the informational needs of different audience segments. Media must be selected to effectively reach those audiences. Media planning strategies must be devised to ensure audiences’ receipt of the intended messages. Of paramount importance is communications planning aimed at the merged company’s existing customers, who will likely be courted by competitors immediately upon announcement of the deal and in the weeks and months following its close (see Chapter 15).

- **Designing the merged firm’s organizational structure.** The consummation of a major merger or acquisition poses the opportunity to begin competing in the marketplace as a formidable new entity. Inherent in this opportunity is the need to revamp the organizational structure of the new firm to capitalize on the human and procedural assets and resources it now has at its disposal, and to directly support the strategic drivers of the transaction itself. A number of fundamental considerations must be addressed in terms of devising new job classifications, determining the nature and number of managerial layers for ongoing oversight of company activities, and establishing the channels and flow of information to maximize operational efficiency (see Chapter 16).

**SUMMARY**

In the past, marketing due diligence issues were viewed as peripheral. In the context of strategic M&A today, they are central.

As the foregoing illustrates, marketing due diligence comprehensively supports each aspect of the predeal planning process:
• It provides qualitative information that can be factored into quantitative analyses of a target company’s current value and future contribution as part of the merged entity. That is, it generates additional data for use in computing acquisition premiums and financial forecasts.

• It identifies strategic synergies whose foundation is revenue generation, not cost reduction.

• It helps facilitate postmerger integration, thereby enabling speedier attainment of potential sales and helping to ensure the ultimate success of the merger itself.

This last point is critical. It reinforces the widely increasing acceptance that adequate predeal planning leads to expeditious postmerger integration. Granted, integrating all corporate functions in the wake of a deal is an enormous undertaking. But of all those functions, sales and marketing is perhaps the most important.

The merged company must have its marketing organization and plans in place in order to swiftly launch growth programs upon consummation of the deal. A delayed or problem-plagued rollout can cause the merged entity to lose momentum, market share, and the backing of customers, prospects, employees, and shareholders. Even worse, the merged company can fail to realize its strategic vision.

Comprehensive predeal marketing due diligence helps expedite postmerger integration, the foundation for launching growth-focused programs that can lead to near- and long-term, top-line revenue gains. By identifying key revenue-building strategies—and planning for their swift attainment after the deal closes—the merged company can immediately begin maximizing its sales potential.

Conversely, inadequate predeal planning can severely delay the company’s ability to operate at its peak marketing and sales capacity. The expression “time is money” is indeed appropriate here.

If projected sales in the postmerger environment are $10 million a month, a two-month-long marketing integration period will flow to the bottom line faster than a six-month-long integration—$40 million in accelerated income, to be exact. Clearly, the merged company has to hit the ground running from a marketing and sales standpoint. In the context of strategic mergers and acquisitions, however, the “run” is a marathon, not a sprint. Effecting expense reductions is an important, albeit short-term, consideration. Realizing and prioritizing revenue enhancement opportunities is the critical factor in ensuring the long-term viability of the deal. By ensuring that these REOs are quickly in place, you will be in a stronger position to satisfy both your short-term cash flow needs and your longer-term growth initiatives.

Marketing due diligence identifies valuable assets inherent in a target company and is focused on harnessing those assets to effect revenue growth. Insights gained regarding the target’s hidden marketing strengths are critical. Equally important, however, is marketing due diligence’s ability to spot marketing weaknesses that can lead to dramatic financial losses.

A well-publicized M&A failure of the mid-1990s serves as the ideal reminder of the need for extensive marketing-focused examinations of a target company and the markets in which it operates.
Late in 1994, the Quaker Oats Company acquired Snapple Beverage Corporation for $1.7 billion. Quaker, already the leader in the sports drink beverage arena with Gatorade, looked to lock up the New Age beverage market as well. Snapple was at the peak of its meteoric rise, having increased revenues 400% since 1990. At the time of the acquisition, Snapple’s sales were approximately $700 million. Two years after the acquisition—and billions of dollars in losses later—Quaker, having purchased a one-product company in a saturated market, was forced to unload Snapple for a paltry $300 million!

Several key marketing-related factors combined to make this one of the most ill-fated deals in the history of corporate mergers and acquisitions.

At the time of the transaction, so-called New Age beverages like Snapple were losing their market momentum as competition was intensifying. Aggressive sales efforts were being launched by Snapple’s major competitors—Fruitopia beverages by Coca-Cola; Lipton iced teas, a joint venture of PepsiCo and Unilever—as well as New Age beverage upstarts like AriZona iced tea and Mistic. In addition, Quaker Oats angered Snapple’s network of bottlers by taking too long to finalize its new distribution system. This delay forced bottlers to reluctantly work in the first quarter of 1995 without a distribution plan in place, which led to irretrievable market share losses for Snapple.

Marketing due diligence’s focus on spotting weaknesses and vulnerabilities from a product management standpoint would have helped Quaker Oats avoid the massive setbacks it suffered. Consider, for example, these examples relative to the three main areas of investigation—people, products, and processes (the “three Ps of Marketing Due Diligence”).

• **People.** The people-related aspects of marketing due diligence include assessing a company’s relationships with key stakeholders (e.g., vendors, suppliers, channel intermediaries). Marketing due diligence would have determined the critical importance of Snapple’s network of bottlers, and would have forecast the negative attitudes held by them because of Quaker Oats’s lack of a distribution strategy, which proved so costly to the company.

• **Products.** A complete study of a target company’s products, vis-à-vis such considerations as the competitive environment, is central to effective marketing due diligence. Performing detailed marketing due diligence would have spotted the competitive inroads being made by the beverage behemoths Coca-Cola and Pepsi, a factor that would have a direct bearing on Snapple’s future revenue stream, as well as fundamental marketing strategies and investments.

• **Processes.** Quickly developing new marketing communications is a key element of postmerger growth planning. In the Snapple acquisition, a change of advertising strategy was needed since the popular TV spots featuring “Wendy the Snapple Lady” were decidedly regional in their appeal. Quaker Oats’s goal to bolster Snapple’s sales beyond the East and West coasts required refining—but not totally revamping—its overall marketing communications approach. Interestingly, it was a full two years after the transaction was finalized that a new national ad campaign was launched. But this new ad campaign mistakenly did not include Wendy, who had become a veritable brand icon. Snapple’s two most successful radio pitchmen, Howard Stern and Rush Limbaugh, also were not utilized in this campaign. Each
had regularly spread the word of Snapple for years on their national radio shows. Marketing due diligence would have identified the need to have this campaign in place much sooner to immediately reposition the product and to help keep pace with the onslaught of competitors’ advertising. Additionally, it would have pointed up the value of Wendy the brand icon and the selling power of two syndicated radio stars.

It is unfair to single out Quaker Oats as having performed inadequate marketing due diligence. The absence of marketing-focused premerger examinations and swift post-merger launches of sales and marketing programs has been an expensive shortcoming in an endless number of deals.

This chapter has looked at the strategic orientation of M&A transactions today and how conventional approaches to due diligence and company valuations now require a much stronger focus on key marketing variables. The overriding goal of strategic M&A is achieving strategic advantage and enhanced competitiveness and profitability. Of course, there are various ways to do so. The next chapter explores how to determine which approach is most appropriate given your company’s current standing and future strategic destination.

The focus of this book is on identifying the ways to ensure “strategic fit” with potential merger partners. We must first, however, define precisely what that amorphous, often overused term means. Ultimately, the challenge is determining what strategic fit means to your company and identifying the potential M&A partners that represent the best possible match. Nonetheless, you must first determine what it is you need before you set out to find and evaluate the M&A candidate that can potentially provide it.
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 strate-
gic 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 than 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 indus-
tries, 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, virtu-
ally 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 in-
dustries. 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 telecommu-
nications 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 corpo-
rate 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 com-
pany’s ability to “make it faster,” “do it better,” and “price it cheaper” is increasingly be-
coming 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 com-
pany 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 com-
panies 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 syn-
ergies meld the products of one company with the services of another, creating a more ef-
ficient 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 in-
tangible 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 checkout-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, an-
other 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.

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**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 at-
tempt 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.
Up to now, the vast majority of mergers and acquisitions have succeeded in one dubious respect: losing vast amounts of money and severely diminishing the combining companies’ overall shareholder value.

The goal going forward is to ensure the success of corporate combinations. Central to this objective is devising ways not only to achieve short-term gains, but also to bolster overall revenue growth to effect the enduring financial viability of the merging companies.

Achieving growth through mergers and acquisitions requires planning that is focused on revenue enhancement synergies as opposed to cost-reduction measures. A revenue-driven perspective should pervade all aspects of target company examinations. Moreover, postmerger integration efforts must continually build on the quest for revenue gains over the long haul. Without the commitment to long-term growth, the potential for optimizing shareholder value cannot occur.

Cost reduction is not a building block because it does not fuel top-line growth (i.e., growth of total revenues). That is not to say that there are no important benefits to a streamlined and financially well-run company. But in order for long-term revenues to increase, it is imperative to acknowledge cost-cutting measures for what they are—a way initially to position the company in the most economical way possible. Once that is accomplished, revenues must be fueled. This can only come from growth strategies and their implementation over an extended period of time.

Everyone is familiar with the concept of the “bottom line.” It is what ultimately trickles down from total revenues to create net earnings. It is often boosted in the wake of a merger by reducing expenses, usually via eliminating duplicative people and processes. But employing these measures to bolster bottom-line results is a short-lived solution and fuels neither long-term growth nor shareholder value.

In fact, for a company to grow, garner additional market share, and become dominant, it must focus on revenue enhancement or growth of the top line. To ensure that top-line growth remains the watchword of mergers and acquisitions, it is necessary to embark on a concerted effort to unearth revenue enhancement opportunities or REOs—a key aspect of the overall marketing due diligence process.

In Chapter 1 we defined REO. The definition bears repeating here. A revenue en-
Marketing due diligence is designed to spot weaknesses and strengths in a given target company. The REO analysis component of this investigative exercise keys on the latter: pinpointing the particular capabilities and value sources inherent in the target that can help lead to revenue growth. Yet this is by no means a one-way perspective.

Throughout this volume we will discuss the concept of the “merged-company perspective” on predeal planning. This orientation states that viewing a target company and attempting to assess its strengths and weaknesses, without addressing and considering these attributes in relation to those of your own company, will always deliver an incomplete picture.

Certainly, compatibility issues regarding the merging organizations’ cultures, management styles, and structures should be addressed at the earliest possible phase of the acquisition planning process. However, once there is compatibility at the highest of levels, the complementary nature of products, services, personnel, and strategy must then be addressed at the acquirer, target, and merged-company levels. Additionally, examining features of compatibility without the focus on creating and sustaining long-term growth will place a merger or acquisition in a position to fail, even if short-term shareholder value is served in the process.

Examining the core attributes of REOs will, when collectively viewed, help provide the perspective needed to explore the REOs that are unique to a given merger or acquisition situation. Once this is accomplished, you can address the ways to identify revenue enhancement opportunities as a means of focusing on the critical success factors that will drive long-term, top-line growth.

**REO SYNERGIES: OVERLAPS VERSUS OVERLAYS**

Identifying REOs is a core perspective in strategic M&A planning. It is a frame of reference that can best be gained by first understanding the orientation that pervades traditional due diligence.

In standard due diligence, the attributes of the acquirer and the acquiree are compared side by side. Conventional analyses typically seek to uncover operational synergies. These lead to cost-reduction opportunities via the elimination of duplicative operations, processes, and personnel. Such expense-related areas make the deal financially beneficial—in the near term. In contrast, marketing due diligence seeks to unearth REO synergies, which are those sales-, marketing-, and growth-related opportunities that collectively make the deal financially beneficial—in the long term.

In general, the search for REOs begins with an exploration of the conventional internal and external issues that an acquirer faces in any M&A scenario. Factors including company ownership, product and service lines, industry trends, market penetration levels, and corporate cultures are first assessed as singular variables. From an organizational standpoint, all areas of the combining companies that are duplicative represent an overlap—areas that are redundant and that can be dealt with as cost-cutting opportunities.

Cost-reduction synergies are created when there are overlaps between the companies...
coming together. Once an overlap is identified, the weaker of the redundant attributes is eliminated. Here the postmerger benefit is represented by the numerical equation $2 + 2 = 3$.

Often the identification of these overlaps sparks quantifiable savings that bolster the financial justification for the union of two companies. In public companies this is evidenced by a short-term jump in the stock price and the obligatory reports in the press of an eventual gain in shareholder value. Unfortunately, long-term shareholder value is by no means a given unless REO synergies lie at the foundation of the deal.

REO synergies result when the skills and resources of the two companies create complementary overlays that spawn revenue generation opportunities. An overlay occurs when two attributes combine to forge an entity whose whole is truly greater than the sum of its parts. Here the numerical analogy takes the form of the equation $2 + 2 = 5$.

The overlap and overlay concepts can be best understood by envisioning two transparencies on which various parts of a face are drawn. On one of the transparencies we see two eyes, two ears, and the right half of a mouth. On the other, we see a nose, the left half of a mouth, and the same two ears. Viewed separately, each is an incomplete image. However, if we lay one transparency over the other, a face emerges with eyes, ears, a nose, and one full mouth—in other words, a complete image.

Much like the issues faced in a merger, the overlap in this image is the two sets of ears, one set of which can be discarded. In an M&A situation, the areas of the combining firms that represent overlaps are redundant and can be scaled back or eliminated. These typically include duplicative personnel, manufacturing or service delivery capabilities, or other systems and processes. As such, eliminating these overlaps represents the synergies that managers have historically referred to when discussing the financial benefits of a particular M&A transaction.

(As we will discuss in Chapter 16, immediately eliminating duplicative functions is not necessarily the most effective way to proceed. Often, redeploying personnel to other geographic locations or functional areas—or converting manufacturing sites into distribution centers—can be more cost-effective and forward-thinking than simply cutting what is initially perceived as organizational fat.)

The process of identifying REO synergies and devising the tactics to effectively actualize them is illustrated in the following examples:

- A major computer hardware and software manufacturer was exploring the acquisition of a publishing company in order to create a variety of print user-support materials. In the course of marketing due diligence, an opportunity was identified to establish a separate marketing communications function and a subscription-based editorial product line of computer publications designed for distribution to consumers and businesses worldwide. A strategic plan was developed, detailing the product concept and market positioning, staffing requirements (that took into account the disparate, yet complementary, skill bases of the two organizations’ employees), operational procedures, and production timetables. Sales, marketing, and communications strategies and materials were developed to distribute and promote the new product line in domestic and international markets. The accelerated implementation of these strategies spurred immediate sales for the merged company.

- An international consulting firm that provides assessment and selection services for hiring senior-level executives sought to broaden its capabilities by performing Internet-based recruiting. Rather than develop its own Web site capability, the firm opted to ac-
quire a firm already specializing in this area. A revenue enhancement opportunity resulted in the form of a brand-new product offering. By taking the acquirer’s traditional pen-and-paper method of assessing candidates and linking it with the target company’s Web site development expertise, the merged firm was able to create an on-line means of soliciting candidates’ qualifications data while concurrently conducting assessment and selection analyses. A whole new stream of revenues was created by melding the combining firms’ disparate, yet complementary, capabilities.

- A film manufacturing company acquired a major retailer’s photofinishing plants. As part of the acquisition, the manufacturer secured the rights to establish film-processing labs directly within the retailer’s existing outlets, which spanned the country. Not only was the manufacturer able to gain access to the retailer’s customers to develop their film, the manufacturer was able to cross-sell its other photographic products and supplies to those buyers.

REO synergy exploration begins with a comprehensive evaluation of the acquirer’s own products and marketing infrastructure. A target company’s marketing capabilities are then measured against that. In addition to a high-level assessment of marketing and sales variables, detailed marketing intelligence must also be gathered. Data must be culled from a wide variety of public and private sources. And to confirm the initial findings and hypotheses, face-to-face interviews with key players in the marketing process (i.e., managerial and creative executives, outside consultants, customers, and channel intermediaries) are necessary.

The marketing due diligence process brings to light challenges and opportunities that in the past went unnoticed. Today, however, these issues typically mark the difference between a deal that is only praised in a near-term mathematical sense and one that is heralded as a long-term business success.

Certainly, the basic numbers must work to satisfy all parties involved. But the calculations cannot simply speak to the short term. Identifying and planning adequately to realize REOs puts the merged entity in a position to immediately begin focusing on the market in pursuit of its long-range strategic growth objectives.

**INSIDER’S OUTLOOK**

Growth is the goal, and M&A is one part of growth. There’s a whole spectrum of growth opportunities. Therefore, you must approach M&A as a different aspect of growth, with a different list of issues and concerns.

—Terence Bentley, Siemens Corporation

**REOs AS AN ACQUISITION CRITERION**

To ensure that top-line growth remains the watchword of strategic mergers and acquisitions, it is necessary to take a formal approach to discovering REOs. This helps an acquirer focus on the critical success factors that will drive long-term revenue growth and,
in the process, is useful in sizing up the revenue enhancement opportunities posed by different acquisition targets. Thus, the REO analysis can become an important determinant of pursuing one organization as an M&A partner over another.

In general, an REO analysis requires you to ask two basic questions:

1. What long-term benefit or contribution can the target company make to the merged company (other than, but not excluding, operational efficiencies and cost-reduction-oriented synergies)?

2. What are the specific contributions that the acquiring company can make to enhance the attributes of the target company and, thus, ultimately benefit the merged company?

Areas to examine include, but are not limited to, management, research and development, manufacturing, and, of course, marketing and sales. Consider again the merged-company perspective. In REO planning, this is a critical consideration. Viewing a target company and attempting to assess its strengths and weaknesses without reviewing these attributes against those of the acquirer will always deliver an incomplete result. Additionally, examining features of compatibility without the focus on creating and sustaining long-term growth will place a merger or acquisition in a position to fail, even if short-term shareholder value is served in the process.

Identifying REO synergies requires an acute business development focus that takes into account financial variables, but which specifically keys on the marketing strengths and weaknesses of the merger partners. *The essence of conducting the REO analysis, however, is focusing on where strategic overlays exist.*

**REO ANALYSIS: AREAS OF EXPLORATION**

Before attempting to identify REOs, it is necessary to understand the areas in which they typically reside. You must key on the areas where strategic overlays may exist and which, consequently, have the greatest influence on devising revenue growth strategies:

- People
- Products
- Processes
- Markets
- Customers

Let’s explore each area in order to determine where strategic overlays exist and to assess which ones can potentially lead to an increased revenue stream for the merged company.
People

There are a number of ways that divergent, yet complementary, skill sets resident in merging companies’ people can lead to revenue-generating opportunities. For example, a target company may have experts in one functional area that can be deployed to enhance an already existing capability within the acquiring company. Take the situation where a major HR consulting firm sought the capability of a small boutique consultancy that conducted surveys of employees’ likes and dislikes toward the HMO serving a given client company. The acquirer’s goal was to leverage this capability in order to broaden its work for health and welfare clients. This was not a product-driven REO, really, as much as it was a personnel-driven one. That is because the HMO survey product was offered by well-respected consultants who held Ph.D.’s in statistics and applied research. Although the acquiring firm could have conceivably developed its own HMO survey, it did not have the level of research-oriented technical expertise in its current ranks that the acquiring firm had.

Our earlier example of the computer company that acquired a publishing company to create user manuals is another case where the intellectual capital of people in one company was melded with the intellectual capital of people resident in another. The REO that resulted took the form of a new line of publications that linked the subject matter expertise of the acquirer (software and hardware product knowledge) with the technical expertise of the target (publishing, promoting, and circulating subscription-based periodicals).

Frequently, personnel-related REOs occur when one merger partner has the product and the other has the sales force (and usually the distribution channels to go along with selling expertise). Many M&A transactions have been conceived based on the vision of linking a highly marketable yet underperforming product with an organization that had expertise in translating a high-potential offering into significant top-line results. Yet another personnel-related REO occurs when one merger partner has one or more well-known practitioners who are acknowledged experts in their field. Bringing these executives into the fold can enable the merged company to use them as corporate spokespeople and “door openers” in a variety of marketing, PR, and direct-selling situations. Indeed, these types of people represent an important marketing intangible asset.

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<td>[It is important to look for] people who have a “nose for the customer” and know how to make money. You feel it when you’re in an organization. You can see when people know how to turn ideas into something the customer will buy. These people constantly talk about the customer, and talk much less about process.</td>
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Products

A tremendous number of strategic mergers are product-based, where companies seek to acquire items that will round out their product lines or replace goods that are sinking
deeper and deeper into the dreaded decline stage of their product life cycles. But, product-driven REOs arise in other ways as well.

For instance, increased revenues can be generated when an acquirer obtains a product line that is similar to its existing one but represents goods valued in the opposite price range (e.g., a merchandiser of high-end cosmetics acquires a firm that offers similar items at the lower end of the price and quality continuum). Another common product-related REO occurs when the merging companies can effectively bundle their offerings; the classic example is where the maker of handheld electronic games and appliances acquires a battery manufacturer, thus enabling the merged firm to offer both the item and the source of energy that powers it.

The continuing transformation of the American economy from a manufacturing environment to a service environment has spawned another common type of product-driven REO. Many manufacturers today are acquiring companies that bring a complementary service capability to their traditional product offering. Consider, for example, a photocopier maker that acquires a company that provides maintenance and repair services of its machines. Not only does such an acquisition enable the acquirer to meet its warranty obligations, it also provides the ability to offer service more in the consulting vein (e.g., where the acquired firm provides fee-based consulting in such areas as computer output and document management services).

Cross-selling opportunities are another powerful source of product-driven REOs. Recall our earlier example on the film manufacturer that secured the right to establish photofinishing labs in a major retailer’s stores. The product REO in that case was linked to the opportunity to market the manufacturer’s film and film-processing capabilities—and the chance to gain the ability to cross-sell its ancillary photo supplies and equipment.

**Processes**

Many different processes within a combined company can be joined to fuel gains in revenue and profitability. For instance, a company with state-of-the-art manufacturing systems and quality-control measures can bring these valuable attributes to the production of an acquired company’s goods. In such a case, the acquired firm’s products may benefit from higher quality and, perhaps, a lower cost of goods sold. The resultant goods may be more alluring to buyers for their quality and generate higher profit margins as a result of the decrease in manufacturing-related costs.

R&D represents another process that can bolster a merged company’s revenue streams, albeit usually in the long term. The combination of capabilities—wherein one company has the R&D expertise and the other has the ability to produce and successfully commercialize new goods and services—is a process-related REO synergy that has fueled many a strategic merger.

A process-focused REO that can lead to more immediate revenues might involve the linkage of a company known for its products with another company known for its outstanding customer service. A major telephone company merger now pending has this potential REO synergy at its core. One merger partner is renowned for its quality products and overall marketing prowess. It has suffered, however, from complaints by buyers about shoddy customer service.
Conversely, its merger partner is well-known for its world-class customer service. Joining these capabilities—strong products and marketing, combined with expertise in forging and solidifying customer relationships—can lead to massive revenue gains. The REO driver in this case is not one of products as much as it is a process: customer service.

**Markets**

In no area is the concept of strategic overlays more easy to illustrate than in geographical markets. In acquisition candidate evaluation, it is common to graphically depict the locales in which one company operates, then physically place on top of that map another that indicates where a potential merger partner’s geographic markets lie.

Blue Cross and Blue Shield of New Jersey’s combination with Blue Cross of Delaware is a classic case in which an acquisition target was identified based in large part on its geographic area of operation. This deal gave BCBS of New Jersey access not only to the marketplace in Delaware, but entrée to Pennsylvania as well.

**INSIDER’S OUTLOOK**

The first step involves looking at yourself and then aligning yourself with your strategic goals. “Here’s where we are today and here’s where we want to be three to five years from now. What do we need to do to get there?” The expansion of market is first and foremost. So you initially have to determine what market areas you want to expand to, and then determine if you can do that and still maintain and not weaken your current core structure. You must look at the opportunities within those aligning or adjoining markets—in our case our regional markets—and who are the target companies within those markets that represent possible merger, acquisition, or joint venture partners. For example, this was the thinking behind our approach to Blue Cross of Delaware. This deal fit our strategic plan, it fit our three-year goals. It aligns us with a marketplace in Delaware, which in turn aligns us with Pennsylvania and the five-county Philadelphia area, where we have licensure and operate businesses. . . . So this deal begins to complete our regional platform.

—Don Curry, Blue Cross and Blue Shield of New Jersey

**Customers**

A compelling strategic overlay occurs when the customers of two merging companies combine to produce a buyer base that not only increases in size but also manifests complementary compositional traits.

Customers can be analyzed in terms of any number of variables: geographic location, demographic composition, psychographic makeup, and a multitude of combinations thereof. For example, a complementary overlay occurs when the customer base of one company is primarily comprised of buyers in one geographic locale and is linked via the merger to a customer group populating another locale. Assuming the merged company is able to reach those buyers through its distribution channels, the merged company’s buyer base has immediately been broadened. Of course, in the instance where direct
marketers are combining, the issue of having to establish physical distribution channels to reach geographically distant buyers does not arise.

Strategic overlays also occur when customers from the combining firms may be buyers of each merger partner’s products. Consider again the example of an electronic games producer who links up with a battery manufacturer. Not only can those offerings be cross-sold to the customer base, they can also be sold individually by the respective merger partners to buyers, all of whom have a need for either or both of the combining companies’ offerings.

The search for REOs is predicated on identifying strategic overlays. Interestingly, however, the area of customers is one where the notion of overlap is equally important. This is because a merged company that links buyers of similar characteristics creates a situation where the organization has an immediately broader base of buyers to purchase existing and future offerings. Consequently, in the realm of customers, strategic overlays can exist side by side with overlaps, their direct counterpart.

TARGET COMPANY’S “MARKETING MIND-SET”

In Chapter 10, the characteristics of various corporate cultures are discussed in terms of their potential impact in a given merger or acquisition situation. However, in the early stages, when your focus is on growth and REO synergies, assessing the culture of the target company’s sales and marketing functions will aid you in determining revenue enhancement possibilities and the likelihood of successfully actualizing them.

It is first necessary to determine the extent to which a marketing orientation pervades the target organization. Ideally, this mind-set should extend to all employees. In reality, it never truly can. But the extent to which a forward-thinking culture emphasizes a customer orientation and a competitor awareness will make a huge difference in the implementation of firmwide marketing programs.

It is also important to be able to gauge this character trait within your own organization. The ultimate compatibility of this trait for both organizations will impact the integration stage of the merger, as well as subsequent growth initiatives.

Once the organization’s culture as a whole has been assessed, you should turn your attention toward characterizing the culture of the sales and marketing functions. Similar to the broader culture, you must determine the risk orientation of the target’s sales and marketing team. For example, do the main players exude an aggressive or conservative mind-set toward program design and implementation?

Simply identifying this trait can offer great insight into why current initiatives are succeeding or failing. It is also important to assess how senior management views those in sales and marketing positions and how the function, as a whole, is perceived throughout the organization.

Many marketing initiatives fail because they are misdirected, others due to poor planning, and still others because the most effective people are not in the appropriate roles. This latter situation should be explicitly addressed.

Often, only an objective third party can adequately assess this aspect of the target’s overall “people factor.” Is the director of the marketing function from the proverbial old school? Is the marketing department orientation customer- as well as competitor-
focused? Are the goals that have been established for the sales force too far-reaching or are they eminently attainable? Are they linked to the strategic plan? Asking these types of questions will open your eyes to an entirely different perspective than the traditional analysis, which is not focused on revenue growth.

A word of caution: Analyzing the attitudes toward the merger of key sales and marketing managers is also imperative for the purposes of projecting and implementing REO strategies. You will need to quickly assess the sentiments the senior members of the sales and marketing function hold toward the corporate combination.

Having advance insight into whether or not the target’s senior business developers will fully and enthusiastically support the merger will aid you in your program planning and execution. Are these people whose skills and commitment you can count on post-merger? If not, this will directly impact your REO planning.

**REO ANALYSIS: OTHER CONSIDERATIONS**

From an REO planning standpoint, there are areas of analysis that are relatively standard for each merger or acquisition. At the same time, there are several considerations unique to the kind of company under review, as well as to the competitive environment in which it operates.

Specifically, REO planning must take into account the unique corporate attributes that result from the variables of:

- Company size
- Competition

By addressing each of these factors from the standpoint of the unique challenges it poses to devising future revenue streams, you will be able to more readily develop your own REO program.

**Company Size**

The size of a target company often does not affect the areas of analysis that comprise the overall marketing due diligence process. From a revenue-planning perspective, however, there are key characteristics of small to middle-market and large companies that must be understood prior to exploring specific revenue enhancement opportunities.

**Small to middle-market companies.** Companies with revenues in the $10 million to $50 million range are often founded by one individual, a family, or a core group of key individuals who typically control most, if not all, of the stock of the company. They often have not been in business for a prolonged period of time, yet have likely experienced sharp growth in which sales have accelerated faster than the industry as a whole. This may have been due to such factors as excessively low overhead, hands-on management, and, more often than not, a specific product, service, or innovation on which they have capitalized.

At a certain point, middle-market companies typically reach a financial impasse re-
sulting from either erratic profits, sudden and unexpected losses, a severe demand for working capital, or increasingly limited delivery capabilities. Companies of this size have small, if existent, internal sales forces that are often supplemented by the efforts of independent manufacturers’ agents or sales representatives.

On the surface, smaller companies would seem to be the easiest to analyze. The reality is, they often are not. They have their own set of unique characteristics and raise specific issues and questions that must be addressed before any REO analysis occurs. Small to midsize companies:

- Sometimes take as much time and effort to integrate as bigger ones. (Will the result justify the effort?)
- Have a distinct culture that is driven by a clear vision of its senior managers. (Is the vision malleable?)
- May often have an exciting track record of growth, but past performance does not ensure future success. (Is the acquisition focused on buying the future based on the past?)
- Have been built by a core group of people. (Will they choose to stay and, if so, what role will they play in the merged company?)
- Are typically run by people with an entrepreneurial spirit. (What is the likelihood of them continuing to stay motivated as they become employees of the merged company and lose their autonomy and sense of identity?)
- Usually attribute their success to a specialized product, service, or innovation. (Is the uniqueness of this offering sustainable in relation to current and future markets?)

These critical issues revolve around products, markets, and the individuals within the company whose unique talents have made an impact in those discrete areas. In essence, when you analyze a smaller company, you are analyzing a potentially fractious future. More than one acquirer has scooped up a smaller company with a narrow product line only to see the market dry up or quickly become saturated with competitors, making the acquisition a dismal failure.

People issues, in particular, are critical. When you buy a smaller company you are buying the individuals whose vision created it. Their buy-in, enthusiasm, and commitment is essential postmerger. Most critically, in smaller companies the assets go home each night. If for some reason they choose not to return to work the next day, you have acquired an empty shell.

Large companies. While analysis of smaller companies is fraught with issues of uncertain managerial commitment and the questionable viability of slim product lines, the analysis of larger companies carries its own set of concerns. Companies with revenues of more than $50 million have characteristics that are unique unto themselves. How they differ from smaller companies creates a perspective that should be adopted as your revenue-focused analysis is conducted.

With a large company, there is usually a more substantial past that amounts to more than a good idea spawned in somebody’s garage. Large companies have advanced be-
yond the entrepreneurial stage, creating less reliance on a few core employees (thus, minimizing the risk that what you are purchasing will vanish into thin air upon closing). It can also be assumed that management knows how to devise, produce, and commercialize marketable goods and services. Most importantly, there will be documentation of observable growth trends that will have developed over time.

An advantage of examining the current and future revenue generation potential of larger companies is gained when they are publicly traded. The value of the shares of the company has been determined by the equity markets. Yet it is important to recognize that the stock market rewards past growth by placing a premium on share price.

Companies with successive quarters or years of exceptional growth often trade at highly inflated multiples. For example, a company with a book value of $12, annual earnings of $2 per share, and eight consecutive quarters of high-margin growth can easily trade at $50 per share. This premium may not seem extreme when compared to the company’s solid track record and the price-to-earnings ratio of the market in general. But, compared to a private company, a public company’s premium takes into account its potential for acquisition as well as any publicity that surrounds it.

However, if margins decline, earnings dip, or major new competitors enter the market, it may take years for the acquirer of the inflated company to recoup the original investment. Case in point: Snapple Beverage.

Quaker Oats, the manufacturer of Gatorade, negotiated to buy Snapple after years of observing it exhibit triple-digit growth, accelerating profit margins, and dominance of a niche market that it had developed. Snapple’s publicly traded share price, at the time, factored in its past meteoric rise in revenues, the cache of its commercials, its popularity on the east coast (where the major stock markets are concentrated), and its potential as an acquisition target. The price Quaker Oats paid was approximately three times Snapple’s annual revenues at the time of the bid. It seemed like the perfect deal.

But, within weeks of Quaker purchasing this regional purveyor of ready-to-drink iced tea, four formidable beverage rivals attacked the flavored iced tea segment—deflating Snapple’s preeminence and ultimately toppling the iced tea king from its throne. Quaker’s rear-view assessment of Snapple’s spectacular growth guided it into paying an exorbitant premium based on its track record before the acquisition. As discussed earlier, two years after the acquisition—and billions of dollars of losses later—Quaker was forced to sell Snapple for a shockingly low $300 million after initially shelling out $1.7 billion.

Performing basic marketing due diligence and a subsequent REO analysis would have revealed the increasing troubles that Quaker would face if it proceeded with the acquisition. The moral is this: If the purpose of a merger or acquisition is to increase sales, then focusing on every real and potential threat to revenue enhancement must be a primary consideration in all phases of your predeal analysis. Many of these threats exist within the competitive environment.

**Competition**

There are two basic orientations that marketing planners have traditionally assumed: competitor or customer. During the REO analysis you must break the mold of focusing
on just one of these areas. Awareness of both competition and customers in the most detailed sense is critical.

If your quest is to satisfy your customers with little concern for how your competitors are satisfying theirs, you will wake up one morning without any customers. By the same token, if your goal is simply to keep up with your competition, you may both march in lockstep away from the needs of your own buyer base.

Successful marketing planning requires balancing the needs of the customer with the dynamic forces of competition. Both must be addressed in detail during the REO analysis. Indeed, the area of competitive intelligence should be an ongoing process within your organization. You must always be aware of competing products and services in the marketplace, and how your offerings stack up in comparison.

During your marketing due diligence, identifying the key competitors—both public and private—is a critical first task. Again, this is a process that does not end. As you and others within your industry jockey for position, competitive research will be a valuable tool in helping you stay focused on an ever-changing, steadily intensifying competitive landscape.

In any candidate search, you will have compiled detailed market research that explores all aspects of competitors and potential targets. Here again the merged-company perspective applies. When sizing up competitors, envision the products that would be offered after your combination with one or more potential targets. Determine the degree to which the combined company’s products hold a competitive advantage over other companies’ offerings. In those cases where you do hold an advantage, see how that can be leveraged in other revenue-generating ways.

Maintaining a merged-company perspective not only allows you to view your company in relation to the competition, but allows you to anticipate other mergers and acquisitions in your industry that will directly affect you. Remember: If you are the number-three company in a given industry and the number-four and -five competitors join forces, overnight you may drop to number-four.

The potential for you to lose substantial market standing over the course of one day without doing anything different is, by itself, a compelling reason to maintain an aggressive competitive intelligence program. Simply tracking the changing market share levels of competitors is not enough. You must continually forecast how corporate combinations by competitors—via mergers, acquisitions, and joint ventures—can radically alter the market milieu and impact your marketing and sales strategies.

A rarely covered area of investigation is the extent that unrelated products compete with either company’s products. You must determine whether or not your potential competition will come from traditional competitors or new entrants from other industries and market segments. Thinking along these lines will help you better focus your ongoing marketing efforts or even more sharply hone your corporate vision.

For example, the banking industry has taken great strides over the past decade by paying close attention to other products in other industries. Banks have moved from the traditional view of depositories—where you once kept a savings account or wrote checks—to a competitive view in which they serve comprehensive financial needs, such as college funding and retirement planning. Monitoring what were thought to be unrelated services in other industries has kept the banking segment alive and thriving. Your business is probably not much different.
FILLING THE REO PIPELINE

A REO analysis concentrates on delivering instant payoff, but also a filled pipeline of revenue enhancers. It aids in the process of forecasting and delivering revenue growth immediately on finalization of the deal. But a disciplined approach to prioritization allows for the ongoing achievement of successive REO synergies at appropriate points in the postdeal integration timetable.

Acknowledging the pipeline concept in the premerger planning stages is critical. It allows the acquirer to focus on REOs that will deliver incremental gains to stakeholders over the short term, while never losing sight of the REOs that will produce a steady stream of future sales.

Each time a revenue-enhancing overlay is identified, so is an additional opportunity to achieve top-line growth. With each new revenue-creating idea that is posited, an additional reason for the merger to succeed is brought to light. Some of these REOs can be implemented at once. Others will take time to plan more fully. Regardless, throughout the analysis period the objective is to list REOs as they are identified. Ultimately, a long list of potential REOs that can be pursued immediately on the deal’s closing should be developed. It is at this point when priorities must be set.

Setting Priorities

It is important to set priorities when developing plans to actualize REO synergies. Not every opportunity should be acted on immediately. Indeed, not every one can. But, ideally, a loaded and ordered pipeline of executable REOs will allow the merged entity to remain focused on long-term results while delivering incremental successes to stakeholders over the short term.

Consider the case of two regional retailers merging their operations to create a national presence. The process of consolidating their respective customer information records into a powerful database for direct-marketing purposes was a distinct REO synergy. So, too, was the ability of the companies to establish newly revamped retail outlets under the merged company’s new banner. Both actions had potential to generate revenues. Yet the database marketing project was able to yield income quickly—in contrast to the time-consuming task of store redesigns and mass media promotion to create name awareness and build store traffic. In most cases, the basic strategy should be to invest in REO synergies that will generate immediate revenues while, concur-
rently, planning to realize those synergies that will require more time, resources, and capital.

Prioritizing REOs first requires quantifying them. Again, it is imperative to maintain a merged-company perspective throughout this process. It is necessary to assess the synergies and areas of leverage that will be created from the combination of people, products, and processes.

By analyzing each particular variable in the target company and then comparing them against their counterparts in your own organization you will be able to gauge the effectiveness of the current systems and processes in place and determine whether they should be eliminated or improved, and, if so, by how much. These levels of improvement, once quantified and placed in the context of the combined company’s capabilities and strategic imperatives, will set the stage for devising revenue enhancement activities and projections as accurately as possible.

Once the initial assessment of REO opportunities is completed, there will be some REOs that can be easily implemented and others that will be more drawn out and difficult to execute. You must determine which are the growth initiatives that can be implemented quickly to allow the revenue tap to begin flowing right away.

Identifying the steps you can take immediately after the deal’s closing will help you hit the ground running and fuel short-term shareholder value. But this is where many companies stop. They combine these short-term revenue boosts with an aggressive cost-cutting initiative and, although the bottom line jumps, the long term suffers. The REOs unique to your transaction must be prioritized and stretched out to impact the bottom line both early in the process and over the longer term. This can only be done by ensuring that the top line continues to grow.

There will be myriad distractions that will battle effective growth, such as operational snafus, cultural divisiveness, delays in the integration program, and customer and employee defections. Indeed, the guidance to come in ensuing chapters is designed to help you avoid these problem situations. But the revenue engines must not stop after the cost cutting is implemented.

By laying out an extended and ordered list of action steps that focus solely on revenue generation and placing them in a logical, executable order, you will have the best opportunity to maintain and steadily augment shareholder value. For example, on a list of 25 REOs, the revenue generators should be categorized by affordability—placing the easiest and least expensive to perform in the first wave.

Chances are there will be a wide range of REOs that differ widely in terms of their ease and cost of execution. Some will be easy to implement. Others will be more difficult. Some will be inexpensive to launch. Others will cost significant amounts of monetary and human resources. And, still others will be capable of actualization only after executing two or three REOs from the first category has created a platform (and perhaps additional capital) for further development.

As far as time parameters are concerned, it is advisable to focus on the first three months after closing the deal to implement the quick-and-easy REOs. Your next block of initiatives should be spread out over the following year. Depending on your budget and resource constraints, it is vital to have programs in place that will extend three to five years into the future as well. This strategy ensures that the early spurt in shareholder value that occurs after the transaction’s close is maintained throughout the integration phase and beyond.
SUMMARY

Today, focusing on top-line revenue growth should be the uppermost consideration in evaluating and planning strategic mergers and acquisitions.

Clearly, there is a distinct place for cost-cutting measures to streamline processes and effect certain operational efficiencies. In fact, in strategic deals, effecting near-term expense reduction synergies is a precursor to the cultivation of a long-term REO process. When this process is actualized, and both cost reductions and revenue enhancements result, true shareholder value can be ensured for years to come. But without keen attention to what you will do for an encore after cuts have been made, the financial benefits of the transaction will be extremely short-lived.

Behind the failure of hundreds of M&A transactions in the past has been management’s inability to follow through on merger-related growth initiatives. Understanding the importance of follow-through is aided by envisioning a karate exhibition—one where an individual breaks boards or bricks with a chop or punch. When these people are asked how they are able to accomplish such a feat that, to most of us, seems impossible, they all respond that they do not try to punch the board to break it. They are, instead, focusing on a point several inches or feet beyond the board, with their goal to reach past the point of contact with the board. In the process, the board is broken as the hand sweeps through it on its way to that imaginary point beyond. They insist that if they focused solely on hitting the board, it would not be possible because physics would stop the hand on impact.

The same goes for one’s golf swing, tennis stroke, or slap shot. Any activity that involves motion in which there is intended contact requires follow-through of momentum to efficiently actualize the movement and maximize the impact. M&A is no exception. To focus on bottom-line cost-cutting strategies without a long-term vision of top-line revenue growth is akin to aiming simply to hit the board without the intent of breaking it.

Revenue growth in mergers and acquisitions must not be an afterthought. It must drive the entire acquisition process. Certainly cost cutting is an ingredient of profitability. But, reducing expenses over an extended period of time cannot be sustained indefinitely, and too many companies have downsized themselves out of competitive existence in the quest for increased shareholder value.

However, had those organizations focused on long-term top-line growth in addition to short-term bottom-line improvements, they would have truly gained competitive advantage and increased their chances of enduring financial success.
As addressed in Part One, there are numerous ways to attain strategic advantage and effect growth through mergers and acquisitions. Any number of avenues can be taken. The key challenge is spotting the multiple drivers resident within a given target company that will take you toward your strategic destination. Once you have determined where you want to be, you must decide how to get there by mapping out a route that is based on a new orientation to evaluating M&A opportunities. That orientation is characterized by a methodology that assesses markets as a precursor to examining the acquisition candidates functioning within them.

M&A growth planning combines traditional market analysis with a broadened perspective that more fully measures a target company’s current standing and future potential. Evaluating an organization in this framework is based on appraising the target as an active participant in a given market through a high-level assessment of the organization’s overall market position and strategic posture. Why is this significant? Because no company is a stagnant entity. An organization is forever moving in myriad ways, impacted by the dynamics of external forces such as the local and global economies and the market in which it operates.

Of course, a company may or may not be moving in the right direction. In fact, it may not even be moving on its own if it is being pushed or pulled by stronger competitors, as opposed to creating its own market momentum. Thus, the initial phase of marketing due diligence-oriented market analysis involves analyzing market characteristics and dynamics but—more importantly—how the target company has historically functioned within the context of prevailing market forces.

This orientation is pivotal to effectively identifying a candidate’s growth-oriented strengths—the basis for pinpointing marketing intangible assets, identifying opportunities for important skills transfer, and envisioning and actualizing revenue enhancement opportunities.
M&A-FOCUSED MARKET ANALYSIS: AREAS OF INVESTIGATION

Mergers and acquisitions done in the bygone days of conglomeratization required members of acquisition teams to study industries with which they were largely unfamiliar. Consequently, target company examinations first entailed understanding the fundamental issues relating to market forces and the target’s quantitative standing within its given industry segment.

In strategic acquisitions, M&A candidates typically function in markets related to the acquiring organization. And, in many cases, management already has an understanding of the various market forces and trends inherent in its own, as well as the target’s, industry and believes in the viability and market attractiveness of the segment in which the target competes.

Guidance on conducting basic market analysis in premerger situations might appear elementary to those to whom this book is geared. However, as the failure rate of transactions creeps higher each day, an overview of this process will help all those involved to better understand the analytical orientation uniquely designed to plan strategic acquisitions.

The process of market analysis, which involves assessing the major external variables affecting the target company, can act as the platform from which all other investigations stem. Included in this process is the identification of the target’s position in the market, an assessment of the competitive environment, and a detailed analysis of industry trends and external forces that continually alter a market’s landscape.

Only after studying marketplace dynamics can the target company’s strategic and tactical approach to that marketplace be fully assessed. Ultimately, the goal is to gauge the target’s “strategic effectiveness” as a precursor to any in-depth study of its products, its organizational composition, and its corporate processes.

The Appendix examines specific methods for collecting the information needed to support this M&A planning process. Conceptually, the information required in such an M&A-focused marketing analysis includes:

- Industry rankings and trends analysis
- Analysis of macroenvironmental forces
- Analysis of competition

Market studies will offer insight into what is currently happening in that segment, who the major players are, and what key market forces are at work. Assessments of the competitive market will help you determine current conditions, as well as provide forecasts on the competitive climate over the next three to five years. Anticipating potential M&A combinations by competitors—and projecting their impact on the overall competitive environment—is central to this phase of the premerger analytical process.

Examinations of each area of the market analysis investigation will collectively provide intelligence on the market in which the target competes.

Industry Rankings

Industry analysis involves studying all key companies operating in the segment, identifying their key similarities and differences, and evaluating the emerging trends with
which all industry players contend. Your critical first step is to determine the specific industry, and industry subsegment, in which the target functions. For example, if the target is a high-tech company, you must probe deeper to determine the specific area of the high-tech industry in which it operates (e.g., hardware, software, semiconductors, Internet).

Pinpointing the appropriate industry segment is an essential component of this data accumulation phase. The most common industry grouping system is the Standard Industrial Classification (SIC) Codes, which is the U.S. government’s system of defining individual industries and specific trades within them. Categories are broken down into SIC code numbers that identify industries in terms of products manufactured, business processes, or functions performed. SIC codes are the most widely referenced classification of industry groups in the United States, with the information used to identify, define, and segment market categories for a wide range of marketing and strategic planning applications.

Other industry groupings can be found in the databases produced through private-company sources. Yet, these typically employ the broad industry categories that are defined by the SIC system.

For instance, one system classifies each of the approximately seven thousand publicly traded U.S. companies into an industry group based on the business segment from which the majority of its revenues are generated, as reported by the company in its annual report. In this system, industries fall into more than 50 basic categories, which are then subdivided into another hundred or so additional industry subsegments. Other information available includes the number of companies in a given category, the total number of employees, and the average number of employees per organization.

Analyses of target companies based on their industry classification address one or more of the following criteria:

- Size
- Growth
- Profitability
- Stock performance

**Size.** These rankings include measures of annual revenues, reported total assets (e.g., real property, plants, and equipment), and market share (a measure of the revenues of the company, divided by the total revenues for the industry group as a whole).

**Growth.** These measures are based on increases (or decreases) in annual revenues, usually in comparison to the prior year’s figures; in profits, that is, the increase or decrease in net income for the current year in comparison to the previous year; in earnings per share, again, for the current year compared to the previous year; or gains in total assets, calculated on a comparative basis with those of prior years.

**Profitability.** These calculations are based on figures depicting net income for the prior year; “profit margins” are determined by dividing net income from the past four quarters by the past four quarters’ revenues; “return on equity (ROE)” is measured by d-
viding common stockholders’ equity by net income for the prior year; and “return on assets (ROA),” which is the quotient gained by dividing net income for the prior year by total assets from the immediate past fiscal year.

**INSIDER’S OUTLOOK**

Part of the art of getting the deal done is not bringing in your [investigative] resources so early that you waste them or so late that you risk losing the deal. You’ve got to “peel the layers of the onion,” to take the next card and keep moving but bring people in at the appropriate time. You can’t bring them in so late that they can’t do the work. At the same time, you don’t want to bring them in so early that you pay a fortune for outside services on a deal that you’re ultimately going to kill. There’s a real skill in figuring out how and when to bring in the resources you need. And every deal’s different.

—Diane Harris, Hypotenuse Enterprises

**Stock performance.** This is gauged by determining the total percent return to an investor holding the company’s stock. Here, stock performance is measured by changes in the stock price over the previous four quarters, plus dividends paid over that time period, divided by the closing stock price of the previous year. Another measure of stock performance is the “price-earnings ratio (P/E),” which is the latest available closing price divided by the earnings per share for the last four quarters.

An important note on industry-specific research is in order here: the vast preponderance of available data pertains to publicly traded companies. Information on private companies operating in the same segment can be remarkably scarce. Yet, the majority of companies in the United States, and many that will be under review as acquisition candidates, are not publicly traded. So, in order to gain a truly accurate picture of the industry segment under investigation, you must include private company analysis in your research.

The preceding measurement criteria will help you identify the size and general characteristics of leading companies in a particular industry segment, which is the starting point for assessing the target company. You should determine industry rankings in several other ways to gain differing and broader perspectives on leading companies’ defining attributes and competitive strengths. As these measurements are determined, you will be aware of obvious links to specific companies whose individual performance can then combine with each other to forge a collective industry landscape and determine a segment’s overall market attractiveness.

**Evaluating Industry Trends**

The size of a given market, its annual growth rate, and its historical profit margins are some of the areas typically cited in evaluations of market attractiveness. The other main focus of determining attractiveness relates to evaluating trends specific to the industry segment—forces which affect all companies operating within it. Industry trends fall into several qualitative categories, which transcend simple measures of the industry’s growth or decline. The main categories include:
Consolidation. Industry segments that are consolidating reflect diminished competition as a result of there being fewer companies operating in that segment. Consolidation is typically driven by a change in regulatory or market forces and is manifested by many companies deciding to discontinue operations, merge, or acquire, hence lessening the number of players.

Consider, for instance, the weapons industry in the United States. The end of the Cold War prompted a sharp drop in defense spending by the federal government. Military contractors that depended on U.S. government work experienced dramatic revenue declines. Many were forced to redirect their business or in some cases shut down. It was not surprising, therefore, when one of the largest mergers in American history—the Boeing Company’s $16.3 billion purchase of the McDonnell Douglas Corporation late in 1996—was traced to the Pentagon’s decision to eliminate McDonnell Douglas from a multibillion-dollar competition to build the nation’s next generation of jet fighters.

Prior to the announcement of the acquisition, there were only a handful of players left in the rapidly consolidating weapons industry. The government’s decision to exclude McDonnell Douglas from the bidding severely weakened the company’s competitive position and dimmed its future prospects. McDonnell Douglas fully realized this and was immediately amenable to Boeing’s acquisitive overtures. As a result, the acquisition created a greater concentration of power held by an even smaller number of companies. If this political trend continues, it is expected that there will be even further consolidation in the weapons industry.

Convergence. Convergence occurs when companies in different industry segments begin to offer similar services and, therefore, become competitors. A prime example is the telecommunications industry, once populated solely by telephone companies offering local and long-distance service. Dramatic advances in technology over the past decade introduced hundreds of new players into the fray, such as those involving cellular phones and other forms of wireless communications.

In theory, this could have been considered an expansion of that industry. However, industry convergence began to occur as the concept of telecommunications expanded beyond the traditional local and long-distance markets. Telephone and other telecommunications providers saw new potential in the cable TV industry; cable TV operators saw new potential in alliances with media and entertainment companies; and media and entertainment companies, along with hundreds of entrepreneurial start-up companies, saw potential in the interactive communicative power of the Internet. In fact, this last group helped spark the creation of an entire new industry subsegment of Web site developers and content providers.

Companies that had never competed with each other before were now direct rivals. Industry lines blurred. Convergence in the telecommunications industry is proceeding so rapidly that even the announcement early in 1996 of US West’s $11.5 billion acquisition of Continental Cablevision drew yawns of disinterest from industry observers, who
viewed yet another telephone company/cable company partnership as a veritable detour for telecommunications companies speeding along the information superhighway.

**Geographic expansion.** Geographic expansion today often refers to the globalization of industry segments. The securities industry, for example, has truly become global with the emergence of 24-hour trading in stock markets in Sydney, Tokyo, Paris, London, and New York. Even the automotive industry—with moves by both Japanese and American companies to establish off-shore manufacturing facilities to capitalize on lower labor costs—may now be considered a global industry.

Industries may also tend to be concentrated in specific geographic regions of a given country yet, over time, begin to function in other locales. An example is retirement-community real estate developments and the attendant offerings such as home health care and nursing now being offered in the same service context. Once relegated to Florida and other Sun Belt locations, such developments are now being created in areas across the United States. As a larger and more geographically dispersed element of the American population reaches retirement age, many are choosing not to move south. Living longer, more active lives, many older Americans prefer to remain near their children and grandchildren rather than move to far away, warmer climes.

As several of these examples indicate, industry trends are often driven by changes to the “macroenvironment,” which is defined as the collective of external forces that either directly or indirectly affect the near-term operations and long-term profitability of organizations. To best understand them, it is helpful to examine these forces in the context of premerger market analysis.

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**INSIDER’S OUTLOOK**

[From an acquisition strategy standpoint] the way to understand where you should invest is driven by the products and markets you want to get into—and stay in—and then understanding in as much detail as possible what’s happening in those markets.

—Terence Bentley, Siemens Corporation

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**Analysis of Macroenvironmental Forces**

Strategic marketing planners should continually study macroenvironmental forces, which are external to the company and typically beyond the control of company management. In contrast to the “microenvironment” (comprising controllable factors such as an organization’s relationships with its customers, suppliers, and channel intermediaries, and the interaction of units within the company itself), macroenvironmental forces may be either intensified, minimized, or neutralized, depending on the organizational dynamics resulting from the M&A transaction.

Microenvironmental forces tie directly to a company’s internal infrastructure—its people, products, and processes—and are discussed in greater detail throughout the book. And, both macro- and microenvironmental forces must be understood and factored into ongoing marketing planning. However, macroenvironmental forces are of par-
ticular consequence in the market analysis phase of M&A planning due to their link to the strategic drivers of the transaction.

Macroenvironmental forces fall into the following five categories:

1. Demographics
2. Economics
3. Technology
4. Legal-regulatory issues
5. Sociocultural traits

The competitive environment is often cited in the context of a company’s macroenvironment. Competitive analysis, however, merits broader treatment than other macroenvironmental variables. Consequently, competitive analysis is addressed in greater detail throughout Part Two. But first, it is recommended that you examine each of these five macroenvironmental areas vis-à-vis a marketing due diligence-focused viewpoint.

**Demographics.** This aspect of traditional macroenvironmental assessments involves studying the target company’s customer base from the standpoint of its demographic composition such as age, gender, and nationality. Premerger market analysis, on the other hand, views the current demographic makeup of customers relative to the products and services purchased by those buyers.

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**INSIDER’S OUTLOOK**

You have to drill down analytically in the given market you’re assessing to find out what the pure grassroots demographics of the market really are. You look at the different market segments in terms of those demographics. For example, in New Jersey there are one million Medicare eligibles, there are 685,000 Medicaid eligibles, there’s an insured population of about four and a half million people. There are all different segments of our state. Then you have to match up how the competition has aligned to those demographics. If we look at the Medicare population in a state and, say, there are 100,000 Medicare eligibles and we view that as a great market opportunity—but a competitor is in there with 80% of the market—that’s certainly less of a market opportunity for us. So you have to align the demographics with your products and services, and then align those against the competition and existing market share that’s been taken out of that market. Then that nets you out to what your market opportunity is. What will it cost for us to compete for that market opportunity in that given area? Number one, can we afford to do that? Number two, what is our profit potential? Number three, where will we be within a three- to five-year period as far as being a market share leader? Are we looking to be the number-one market share player in that region? Well, if we are and we have to displace an incumbent, then it’s going to cost us a heck of a lot more than if we captured critical mass on a profitable basis and maintained a number-three position in the market.

—Don Curry, Blue Cross and Blue Shield of New Jersey
Special attention is paid toward identifying demographic changes to the customer base that will impact postmerger growth initiatives. Consider, for example, a food manufacturer targeting a regional food seller. The strategic intent of the acquisition is to penetrate the geographic market and gain access to the target’s well-entrenched distribution network. Yet, the target’s product line consists of a traditional array of food products typically purchased by older, middle-America-type consumers, in a geographic locale that is seeing a steady influx of younger and more ethnically diverse people.

The target’s products may suffer a slump in sales if the product line is not modified to respond to this demographic shift in the population. Indeed, the offerings of the acquirer may, in fact, help effect this change.

Most references to demographic analysis specifically relate to the area of consumer marketing. Nonetheless, there are demographic shifts that also occur in the business-to-business marketplace. For example, an accounting firm specializing in serving the insurance industry might be considering the acquisition of another audit firm based in the Hartford, Connecticut, area—historically the Mecca of the American insurance industry. But, the exodus of insurance concerns from that locale, prompted by industry consolidation among other factors, points up a demographic shift of consequence to business-to-business marketers. As such, it would lessen the allure of this acquisition strategy.

Economics. Economics relate to the business conditions that impact the demand for and pricing of a company’s products and services. Your market analysis must project, as closely as possible, the postmerger economic climate in which the target company’s goods will be sold. For instance, some goods that are considered luxury items generally do not sell well in periods of economic decline. Of course, gloomy economic projections that will directly affect the success of a target’s product offering may influence the timing of the transaction and whether to pursue it at all.

Beyond product considerations, however, economics also should address another key variable: the geographic areas in which the target operates. For example, let’s assume you are considering acquiring a firm that has a strong regional presence in an area where you do not. The macroenvironmental economic assessment must ascertain how an upturn—or a downturn—in the economic prospects of that area will affect postmerger strategies and the new company’s overall profitability.

Keep in mind, however, that economic considerations do not relate to whether the broad economy is currently in a recession. Nor do they relate to whether it is a good time to make an acquisition based on the general availability or cost of capital. These considerations are valid up front when you are first determining whether to engage in an external growth initiative such as an M&A transaction. But once the process of evaluating acquisition candidates has commenced, they are not really germane.

Technology. As discussed in Chapter 2, attaining new technology is one of the primary drivers of strategic mergers and acquisitions. Clearly, technology now pervades virtually all aspects of product development, manufacturing, and product and service delivery. It is from this perspective that you must view technology issues in macroenvironmental assessments. First, you must ask how changes in technology will affect production of the target company’s products. Then you must address several other issues
such as the impact technology changes may have on pricing strategies or how this will affect the company’s distribution system.

Consider, for example, the Internet. Ten years ago, technology-related analyses would have included a study of the Internet’s emergence as a ubiquitous worldwide communications medium. Without question, the advent of Internet-based communications is one of the most significant technological developments in recent history. Going forward, virtually every business will need to explore Internet applications for product delivery and promotion. The most difficult task of your macroenvironmental investigation is to spot the evolution of the next technological revolution—the applications that will impact the operations, products, and overall marketing performance of the target company and its competitors.

It is necessary to address the extent to which a target is adequately employing technology from a business processes standpoint. Yet, it is important to first view these technology trends from a broader perspective to determine how they may alter the target’s current products and operations and its future direction.

Legal-regulatory issues. The review of legal and regulatory forces in the macroenvironment requires identifying new and proposed laws that will affect the merged company’s operations. Such reviews key on legislative initiatives that will influence issues like product safety, price controls, advertising, and other variables that affect growth planning strategies. Major regulatory developments should be studied at the federal level, but also at the state and local levels in which the merged organization will operate.

Moreover, international issues must be studied if the merged company will operate globally or in specific foreign locales. For example, there are countries to which the U.S. government prohibits the export of American goods, directives resulting from trade sanctions and other punitive measures taken against foreign countries by the federal government.

The macroenvironmental analysis of legal issues should not be confused with the discovery of current or potential lawsuits being leveled against a target company. This falls into the domain of the attorneys conducting legal due diligence. Still, although it is not the responsibility of the professionals charged with M&A planning to spot legal complications, it is incumbent on them to understand the impact that pending or potential lawsuits may have on the provisions and timing of postmerger marketing activities. Indeed, key growth initiatives may have to be postponed, modified, or completely scrapped as a result of restraints engendered by legal actions against the target company.

INSIDER’S OUTLOOK

In M&A planning, it’s imperative to be sensitive to changes in the regulatory environment. Where appropriate, it’s necessary to determine what are the conditions in the regulatory environment in the markets of one of the merger partners versus that of another. You cannot assume that the regulatory environment in which they have become accustomed to working is going to be the same as the one they will be moving into after the merger.

—Rich Rudden, R. J. Rudden Associates
Sociocultural traits. Macroenvironmental factors in the sociocultural realm relate to marketplace trends that influence people’s personal and business lifestyles, and, consequently, their wants and needs from a product and service standpoint. Personal lifestyle shifts are consumer-oriented issues regarding people’s changing attitudes toward such things as food, clothing, and recreation. Business lifestyle variables tie to people’s individual approaches to business, an integral component of almost everyone’s day-to-day existence. Examples of changes in people’s business lifestyles are the move toward such workplace innovations as flextime, telecommuting, and the sanctioning of casual business attire.

Sociocultural changes are significant in premerger planning in two key respects:

1. Changing social attitudes may directly impact market attitudes toward demand for a target company’s products and services.

2. Socially related attitudes impact how people—including, obviously, the target company’s employees—function on a day-to-day basis.

Broad sociocultural traits that may characterize an employee base must be pinpointed as part of the target company analysis. While you are undergoing the formal marketing due diligence and integration planning process, these sociocultural traits must often be viewed in the same vein as company-cultural traits.

Analysis of Competition

Analyzing the competitive environment is the most critical element of market analysis. It is necessary to study this environment and, hence, determine the involved companies’ relative market standing quantitatively and qualitatively.

Quantitatively, the market should be studied in terms of an organization’s rank based on the industry indexes discussed earlier. Qualitatively, the market should be gauged by studying the following aspects of that company and its competitors:

- Core traits
- Market share enhancement strategies
- Distribution power
- Research and development programs
- Marketing investment decisions

By briefly examining each of these qualitative areas of evaluation, you will have a stronger foundation when they are explored more fully in Chapters 5, 6, 7, and 8, which focus on target company analysis.

Core traits. Companies’ market position may be measured in terms of the specific core traits that empower different market players. For example, competitors should be viewed from the standpoints of how well known and regarded they are, how highly they are viewed for product quality and service, and to what extent they possess such
organizational strengths as capable senior managers, dedicated workers, and visionary leaders.

**Market share enhancement strategies.** Market share levels gauge companies’ market standing from a statistical standpoint, but they also reveal particular operating strategies. The focus of companies whose market share is increasing is to steal that share away from competitors. How are they doing so? And to what extent?

Gaining market share is a costly proposition with high risks, since increases in share typically come at the expense of short-term profits. Competitors actively building market share reveal their orientation to long-term growth and a willingness to potentially incur near-term losses. Consequently, how and where companies are investing funds to augment market share is one indicator of their strategic and competitive orientation. Taken together, companies’ market share strategies help characterize the competitive environment.

**Distribution power.** How effectively different companies are getting their products to market is a significant determinant of the competitive landscape. A high-level distribution analysis must be conducted to identify where competitors market their products geographically (a study of the physical location of markets served). Next, studying companies’ network of channel intermediaries lends insight into their respective market standing in different geographic locales.

Most important is determining the extent to which given companies are dominating distribution channels. Companies in this enviable position hold tremendous power over competitors, since firms that cannot find wholesalers or retailers to carry their products are at an extreme competitive disadvantage. Firms that dominate channels also create a strong barrier to entry for market newcomers.

**Research and development programs.** The level of companies’ spending on research and development is a measure of an industry’s competitiveness. Highly dynamic industries such as biotechnology manifest high levels of R&D spending. This aspect of competitive analysis should key on trends—upward or downward—illustrating patterns of R&D investments by the companies functioning in the market under review.

Spending by American companies for R&D is again on the rise after a decline in the early 1990s. As a benchmark, industry sectors that are increasing R&D investments at a rate of 3% or more annually are exceeding the national average. Research and development programs are central to a company’s product-development infrastructure. Consequently, R&D is examined in greater detail in Chapter 5.

**Marketing investment decisions.** Similar to investments made in R&D, companies’ allocation of monetary resources for marketing programs is an indicator of market competitiveness. Information must be collected on how much organizations are spending on promotional initiatives—advertising, sales promotion, public relations, direct selling, and so on. This information is partially provided on the “selling, general and administrative (SG&A)” line item of companies’ income statements.

However, additional information must be culled from advertising tracking services, trade periodicals, and other sources of competitive intelligence. The results of this research
will help you to gain insights on the size and monetary allocation of industry-average sales and marketing budgets—data-gathering techniques addressed in the Appendix.

**INSIDER’S OUTLOOK**

It is important to constantly look at how one company compares to the others within a given industry. This lets you be on top of where the strengths are and where the weaknesses are either from an operating standpoint, from a marketing standpoint, or from a financing standpoint. This ongoing comparative analysis allows us to quickly determine how to bolster a weakness or optimize a particular strength that a company looking to acquire or be acquired may have.

—Dudley Mendenhall, Bank of America

**EVALUATING THE TARGET’S “STRATEGIC EFFECTIVENESS”**

By now you should have a clear understanding of the key factors that define and affect a target company’s market position and standing. These include the organization’s actual ranking in the market, the quantitative variables relating to the market’s size and growth rate, and the marketplace and industry-specific forces impacting the organization now and in the near-term future.

Collecting this information lays the groundwork for your initial growth planning: determining whether a particular target company is effectively contending with the marketplace threats and opportunities confronting it. The goal is to assess the company’s “strategic effectiveness.” This critical aspect of premerger planning involves assessing the target company’s strategic orientation, its marketing operations, and the execution of tactical initiatives. Our experience has shown that a company’s strategic effectiveness depends on its capabilities in the following seven areas:

1. Marketing planning orientation
2. Marketing organization
3. Customer orientation
4. Marketing information systems
5. Resource allocations
6. Tactical flexibility
7. Responsiveness to macroenvironmental changes

A company may be strong in some areas of strategic effectiveness and weak in others. Consequently, assessing each category helps to identify strengths that can be bolstered after the acquisition, as well as areas of weakness that must be eliminated. Strengths are enhanced and weaknesses mitigated through an effective transfer of skills and resources between the merging organizations—the key focus of the integration guidance provided in Part Three. By addressing each of the aforementioned
areas, you can develop a means of gauging the target’s strategic orientation and capabilities.

**Marketing Planning Orientation**

A company’s marketing planning orientation may range from the development of formal, comprehensive documents to simple write-ups detailing a series of promotional activities. The difference in sophistication in companies’ marketing plans may be markedly pronounced in companies of similar size or industry standing.

The size of a marketing plan, of course, is hardly the most significant consideration. The quality of the marketing strategies detailed in the plan is. Strategies may or may not be clearly articulated. They may or may not be based on detailed and timely marketing information. They may or may not be responsive to the specific marketplace threats and opportunities confronting the organization.

Another aspect of the target’s marketing planning relates to whether the company has contingency plans in place. Ideally, companies should have detailed “marketing controls” that allow them to periodically assess the ongoing implementation of marketing activities. What’s more, these controls should detail how the company will alter its activities when market forces or competitors’ moves require enacting tactical shifts.

**Marketing Organization**

Is marketing a strategic function driven by senior management in the companies you are assessing? Surprisingly, this is not the situation in many otherwise well-run companies. In such cases, sales and marketing are not integrated at the top of the organization. As a result, the activities of these groups are not aligned with the company’s broader organizational initiatives.

The quintessential marketing organization, with the support and input of top management, is characterized by a strong level of cooperation between sales and marketing and other divisions within the company—namely (in a product manufacturing company) R&D, production, purchasing, distribution, and finance, or (in a service provider) functional disciplines, client relations, and account management. A sound marketing organization also has a comprehensive new-product development process that is adequately financed, well-structured and professionally staffed. This is addressed in greater detail in Chapter 5.

**Customer Orientation**

Strategic effectiveness is also characterized by management’s commitment to meeting customer needs. Indeed, a customer orientation should be embraced by employees at all levels of the company. Moreover, this perspective should pervade all business decisions made by the organization. Management must continually channel its energies and resources to meet the current and changing needs of its customer segments.

Different needs by different buyers require different offerings. A true customer-oriented company continually explores its customers’ needs and, where appropriate, develops new products or modifies existing ones to meet buyers’ changing requirements. Keep in
Customers are the most important element of a company’s “publics,” but there are other stakeholders that cannot be extricated from the marketing equation. Suppliers, distributors, and other relevant publics must be viewed in light of their roles in developing and delivering new offerings to the company’s end users. Therefore, assessing a company’s customer orientation demands that you evaluate its ongoing dealings with these other relevant groups.

**Marketing Information Systems**

As explained in Chapter 1, an ample collection of marketing data—collected and disseminated to key decision makers on a regular basis—represents an important marketing intangible asset. A company that is not accumulating market information puts itself at a competitive disadvantage. Markets change too quickly today not to have systems in place that indicate important shifts in the competitive landscape.

Your investigation may reveal that the target company does, in fact, have binders full of market research. But how current is it? How professionally was the research conducted? By a respected research organization? Or by professionals untrained in statistically reliable data analysis? Moreover, how comprehensive is the market research? Most important, how accessible is this research repository? Other than simply being compiled, has it actively been used or leveraged?

Ideally, management should have information relative to its customers and competitors. Additionally, the company should generate information that gauges the sales and profitability of different products, market segments, and geographic territories. Information must also be collected to determine the cost-effectiveness of marketing programs and other major business development expenditures.

**Resource Allocations**

Is management effectively deploying its marketing and sales resources? In other words, is management devoting adequate levels of financing to the overall marketing effort as well as to major individual projects? Beyond budgetary decisions, resource allocation proficiency also ties to management’s ability to respond promptly and effectively to market developments.

Today, windows of opportunity open quickly and close even more quickly. You must ascertain whether company management has demonstrated an ability to act on sudden market changes and intelligently redirect financial and human resources accordingly. Acting quickly is one thing; acting correctly is another. You must assess both aspects by studying the target’s past responses to actual marketplace situations.

**Tactical Flexibility**

A company’s ability to develop impactive strategies to meet its marketplace opportunities is an important gauge of its strategic effectiveness. Of perhaps even greater significance is the organization’s agility in altering its actions in response to sudden market changes.

Competitiveness is enhanced when management is skilled at determining when given
initiatives should be delayed, adjusted, or discontinued in response to dramatic market shifts. A balance, however, must be struck between staying the course in implementing well-planned marketing strategies and quickly switching direction when market forces or competitors’ initiatives require doing so.

### INSIDER’S OUTLOOK

In devising our acquisition plan, the goal was to take advantage of emerging opportunities in the public sector market. For example, it was clear that the government was going to force Medicaid populations into managed care. They were going to move Medicare eligibles into managed care. We needed to have that infrastructure in place in New Jersey. We basically built three different medical structures in the state to not only comply with government regulations [relative to the Health Care Financing Administration (HCFA)], but also to build out documentation to support the necessary government filings and then get approval and operate those filings.

—Don Curry, Blue Cross and Blue Shield of New Jersey

### Responsiveness to Macroenvironmental Changes

Management’s abilities to make strategic and tactical shifts in response to emerging changes in the macroenvironment are just as important as changes that may be necessitated by sudden marketplace alterations. Generally, the former tend not to require as quick a response. Nonetheless, a company must continually monitor major social, governmental, regulatory, and technological trends that may ultimately have to be acted on.

The target’s marketing information systems should be gathering such long-term trend data. As important as collecting the data is, the issue of greater significance is when and how management acts on that information. It is important that management sees the key trends that are evolving. It is even more critical to know what actions to take to capitalize on the opportunities those trends offer or to mitigate the threats they pose.

Management may have a tendency to view long-term trends as being insignificant in terms of planning near-term tactics. The quickening pace of change, however, suggests that emerging issues may materialize sooner than anticipated. Again, assessing management’s foresight requires looking at their responses to previous trend changes in hindsight.

Target companies that possess a strong level of strategic effectiveness offer intangible assets that increase the value of the company and represent strategic synergies that may translate directly into revenue enhancement opportunities. Keep in mind, however, that successes pointing up strong levels of strategic effectiveness may have been achieved through sheer good fortune (the company being in the proverbial right place at the right time) or benefiting from a universally strong economy or stock market.

Conversely, it is important to recognize that there can be many different reasons for perceived shortcomings in a target’s strategic capabilities. For instance, marketing plans
may have been sound, but the implementation of those plans was flawed. Or, marketing strategies were well-founded and the tactics well-executed, but inadequate monetary resources were allocated, thus rendering successful execution impossible. Additionally, you must remember that there are different gradations of failure. Shortcomings may be identified through programs that fell short of expectations, but not that far short. In such situations, radical changes in procedures or resource allocations may not be warranted as much as some careful fine-tuning of the target company’s approach.

Strategic effectiveness must also be projected from the merged-company vantage point in areas that are both process- and personnel-related. Marketing planning, information systems, and some aspects of operational efficiency are processes that should be measured directly against your corresponding capabilities. The target’s marketing organization, its customer orientation, and its responsiveness to market changes are people-driven attributes that should also be compared to your own.

The goal of any acquisition should be to enhance the merged company’s overall productivity and profitability. Any transaction that does not have the potential to do so is, by nature, strategically flawed. Of course, strategic effectiveness and other opportunities to gain competitive advantage begin as concepts. A comprehensive approach to integration is necessary to translate those concepts into actual growth opportunities; this is the focus of Part Three.

No one would think of conducting M&A planning without performing basic market analysis. But what about studying things such as strategic effectiveness? In the thousands of acquisitions done each year, few address this aspect of a target company’s infrastructure. There are two main reasons why:

1. Time does not always permit conducting the examination; when the pressure is on to consummate the transaction, management might opt to forego this phase of the target company analysis.
2. Managers might be frustrated in their attempts to gain access to the people and company information that must be evaluated in order to gauge strategic effectiveness during the negotiation stages.

Still, strategic effectiveness is an important yardstick of a target company’s potential contribution to the merged company’s operations. Evaluative data must be collected to the fullest extent possible. Gathering even a little information is better than gathering none.

There are many instances in which a firm’s strategic effectiveness is of no interest to acquirers. Many companies buy firms with the express intent of immediately folding them into their existing operations—wherein the target’s operations cease to exist on completion of the deal. In such situations the strategic effectiveness level of the acquired company is virtually inconsequential.

On the other hand, many strategic acquisitions are driven by the goal of having the acquired company function as a self-sustaining element of the corporate whole. In such cases, the acquiring firm needs to know the target is strong in terms of its strategic effectiveness. Moreover, even if the target will operate independently, the acquirer needs to know that there are strategic and tactical marketing skills inherent in the target that can ultimately be imported, as appropriate, into the parent company’s infrastructure. In all
cases, assessing strategic effectiveness is an important indicator of a target company’s ability to help you attain the growth opportunities you seek.

**“MERGED-COMPANY PERSPECTIVE”**

M&A growth planning focuses all market analysis on the target company’s interaction with its markets. This review requires addressing a range of criteria where the company is evaluated in terms of its mission and objectives, its operating strategies, and its tactical initiatives. But the growth planning approach to market analysis also requires a different evaluative perspective. This viewpoint primarily focuses on analyzing the target company in relation to its market; but, most importantly, the target should be viewed not as a corporate entity unto itself, but rather as an element of the merged company.

The growth planning focus, therefore, is comparative. A target company’s strengths should be assessed with an eye toward determining how you can transfer those strengths to the merged entity. At the same time, strategic weaknesses that are unearthed must be evaluated from the standpoint of your ability to eventually eliminate them.

The merged-company perspective is both fundamentally practical and psychologically beneficial. It is valuable to immediately begin viewing a target as a potential component of a newly forged, stronger corporate entity and to start thinking about the specific ways you would translate theoretical synergies into actual gains. The more forethought given to conceptual synergies, the faster they can ultimately be actualized if and when a transaction is finalized.

It is psychologically advantageous to immediately begin thinking about the steps necessary to effect postmerger integration. This task is easier when an integration-focused view characterizes your initial analytical observations. Indeed, all aspects of growth planning are governed by the tenet that premerger decisions must always be made with their postmerger ramifications in mind.

The process of ranking a target by one or more quantitative criteria, assessing the macroenvironmental forces affecting the organization, and analyzing its competition should be conducted by comparing the characteristics of the target company with those of your own. Consequently, it is critical to look at each element of market analysis from the merged-company perspective:

- Industry rankings and trends
- Macroenvironmental forces
- Analysis of competition

**Industry Rankings and Trends**

If the target is in the same industry as you, simple arithmetic determines what the combined market share of the merged organization will be. The same is true for calculations of company size (e.g., revenues or total assets) and growth rate (e.g., net income, total assets). Somewhat more detailed arithmetic calculations must be done to project combined profitability—specifically for measures of profit margins, ROE, and ROA.
Future stock performance, as a measure of profitability, is difficult to calculate since there are myriad financial and market variables that influence changes in stock price, including the equity market’s response to the announcement of cost-cutting initiatives.

From the standpoint of industry trends, suffice it to say the merged company would be contending with the same market forces that the combining firms have dealt with as separate organizations, although the merged company might serve to further industry consolidation if that, in fact, is occurring.

### Macroenvironmental Forces

In this arena, the merged firm would also be subject to the same market forces. At the same time, threats might be minimized and opportunities possibly bolstered as a result of the combined firm’s enhanced capabilities. For example, the external environment in which the merged company will operate can reveal immediate product opportunities. You may discover that changing demographic patterns may enhance the marketability of a new product line planned by the target company.

In terms of economic conditions, products offered by the target firm may be better suited (in comparison, perhaps, to some of your own) to prevailing economic conditions—for instance, if the target offers high-end luxury items at a time when economists are predicting a near-term surge in consumer spending.

In terms of technology, the target may offer cutting-edge products that capitalize on emerging market demand. For example, the target may be developing low-cost satellite dishes at a time when many TV viewers are moving away from cable television to quickly attain the vaunted 500-channel universe. From a regulatory standpoint, consider the case where a subsidiary of the target company has experience selling goods in a foreign market that will soon be opened up to international competition. This may be an area that represents a major new market for your products and services.

In terms of sociocultural trends, benefits might accrue if the target is viewed as an environmentally friendly company at a time when consumers favor dealing with organizations committed to ecology and the protection of natural resources.

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**INSIDER’S OUTLOOK**

It’s important to deal with the basics. I ask, “What’s the world like now and where is it going, and does this acquisition fit strategically with where the market is headed?” It’s one thing to know that an acquisition makes sense today. But is it going to make sense tomorrow because of something that will very likely happen in the market? You have to know if you’re buying systems or products that are obsolete or which will soon become obsolete based on fundamental changes that will occur in the market. Ideally, you’re acquiring something of value. But is that value sustainable over the long term?

—Carolyn Chin, IBM
Analysis of Competition

In Chapter 2, where the importance of recognizing strategic drivers was stressed, the goal of minimizing competition—without incurring the wrath of antitrust regulators—was highlighted. By acquiring a competitor, you eliminate one company from the playing field. The goal of acquiring a competitor is to make your own company more formidable in any number of respects. Greater strength may be achieved through enhanced production efficiencies, distribution channels, and overall marketing muscle.

Remember, though, that one acquisition typically begets another. Your acquisition may well prompt M&A moves by other competitors that further alter the market terrain. This fact of life in today’s business world has major ramifications when projecting near-term market conditions in the wake of the transaction.

FORECASTING THE COMPETITIVE ENVIRONMENT: THE M&A PERSPECTIVE

Forecasting shifts in a market’s competitive landscape is central to the work of strategic planners and senior marketing managers. Developing such projections is somewhat different in the M&A context. Specifically, marketing due diligence and growth planning focus on potential merger and acquisition activity in a given market or industry segment, insofar as it will affect the competitive environment going forward. The orientation is based on identifying possible corporate combinations that may occur between industry players in the future, as is indicated by M&A activity by key industry players in the past.

Companies considering a merger or acquisition necessarily envision what the competitive environment will look like in the wake of the deal. Yet, it is critical that management also envision what the competitive landscape will be if the company does not complete the transaction. In other words, management must determine what possible merger moves other acquirers may make if you, in fact, do not act first on a given transaction. A case in point is the American toy industry.

Earlier, we cited the 1996 acquisition by Mattel, the market leader, of Tyco, the number-three player. The transaction resulted in a company whose market share level significantly exceeded that of the industry’s second-place company, Hasbro.

But, Mattel’s strategic intent transcended simply increasing its market share. Product line considerations were among the main drivers of the deal—namely, that by acquiring Tyco, makers of the popular Matchbox cars, Mattel would gain complete market dominance of the toy car market by offering both Matchbox and Mattel’s popular Hot Wheels. Another of Mattel’s goals was to exercise greater clout over retailers by offering an increasingly expansive array of products that would enable the company to more strongly influence retailers’ choice of the items they will stock.

At the time, everybody watching the toy market knew Mattel was about to strike a major deal, one that would radically alter the competitive environment, because earlier in the year, Mattel had sought unsuccessfully to merge with Hasbro. That transaction was never consummated, as Hasbro backed out in concern that valuable resources would be wasted if antitrust objections ultimately killed the merger (which, by all accounts, was a distinct possibility). Nonetheless, Mattel had revealed its acquisitive intent. Indus-
try analysts knew it was only a matter of time before Mattel sought another combination. The list of potential merger partners was obvious; it would be one of the other top-five industry competitors. Additionally, Mattel had revealed its acquisitive nature years earlier with its purchase of Fisher-Price. Years before the transaction, Mattel had been allowed to review Fisher-Price’s books during an acquisition courtship, but had determined that the timing was not right. Instead, Mattel signed a “stand-still” agreement that prevented it from increasing its share in the company for an extended period. During this time, Fisher-Price strengthened its market position and recorded eight solid quarters of impressive growth. Within weeks of the expiration of the stand-still agreement, Mattel swooped in, as much to garner the additional market share as to prevent any other company from acquiring this jewel.

The guidance to management is this: Any analysis of future market conditions must forecast changes in the competitive market as a result of potential M&A activity. A central task of premerger planning, therefore, is to collect as much market intelligence as possible on M&A transactions—both actual deals and those speculated on in the press and in other business circles.

There are several sources of information that identify M&A activity in different market segments. For example, Mergers & Acquisitions magazine each year publishes an annual roundup and analysis of the prior year’s deals. The data are broken out several different ways, such as by the size of the year’s major transactions, total deal volume by industry, domestic versus foreign transactions, and so forth. Companies analyzing mergers in a given industry, for example, can easily identify the most acquisitive companies in that sector, as well as the average size of the deals being done.

The publication also addresses the important trends driving M&A activity. Consider, for example, the retail business- and office-supplies segment. Recent data show a flurry of M&A activity by national companies acquiring small, regional stationers and business supplies providers. In essence, national chains are being formed to capitalize on the proliferation of home-based businesses and one- and two-person companies—the so-called SOHO (single office, home office) market. Information on this segment shows which companies are making acquisitions, in what dollar volume, and in what geographic locations. Trends and patterns are readily apparent.

Clearly, for a segment like business supplies—with extensive M&A activity continuing unabated—projecting market conditions over the next three to five years would be relatively straightforward. As stated earlier, the information available is largely on public companies. Trade publications, analysts’ reports, and other sources must be scoured for information on private companies.

In a sense, analyzing the competitive environment in terms of current and potential M&A activity is another way to evaluate a target company. Any company that is not considering, or never has considered, an acquisition has failed to explore one of the primary ways that companies effect corporate growth. Does this fact point up a failing on the part of management? Maybe. Growth through the merger or acquisition process is not right for every company. But if the company has never been a potential acquirer or acquiree, there may be operational shortcomings that you should know about.

The notion of assessing a target company from the standpoint of its M&A orientation also relates to the company’s overall strategic effectiveness. That a company has never considered or actively explored a corporate combination may represent a strategic nega-
Conversely, a company that has successfully effected strategic acquisitions exhibits a distinctly positive attribute. Having made successful acquisitions points up management’s ability to assess marketplace dynamics and effect growth through the complex M&A process. Unquestionably, a successful M&A track record speaks to management’s strategic and organizational acumen. This is, however, only one aspect—albeit an increasingly important one—of the company’s strategic effectiveness.

**SUMMARY**

Examining a target company as a stand-alone entity is a relatively straightforward exercise. However, strategic M&A growth planning requires adopting an analytical perspective that views an acquisition candidate not merely as represented by columns of numbers on a balance sheet, but rather as a collective of organizational and strategic attributes that will ultimately meld with your own if and when a merger or acquisition is consummated. Postmerger integration will always be significantly more efficient and expeditious when your premerger analysis takes on a merged-company orientation.

Market analysis in the context of strategic acquisitions, therefore, differs from conventional market assessments, not exclusively in terms of what information is collected but more importantly in how those data are analyzed.

Traditional market analysis looks at a company as a stand-alone organism functioning in a given environment. And, that organism, to build on the biological metaphor, is unicellular. On the other hand, M&A-focused market analysis views a company as a multicellular entity comprising a unique set of organizational, operational, and financial traits that will be augmented after its combination with your firm.

In essence, the key to M&A-focused market analysis is viewing the target as an eventual part of the merged company. It is critically important to maintain this comparative view during all phases of the information-gathering and analysis process.

Evaluating market dynamics and assessing a company’s strategic capabilities require gathering extensive data from multiple sources on products, customers, and employees. The chapters in Part Two highlight the tools and techniques employed in researching acquisition candidates—the first step in launching your formal merger and acquisition program.