Chapter 1
Why a merger or acquisition?

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Why a merger or acquisition?

Although there are other options to growing and developing businesses, mergers and acquisitions continue to offer an attractive option to many organisations. The classic benefits that can be derived from this type of business strategy include the ability to:

- Rapidly add scale to an organisation and so achieve greater economies in efficiency, scale and market reach.
- Gain access to:
  - Distribution networks – ability to leverage new channels;
  - New markets.
- Capture new technologies and product innovations.
- Provide long-term ownership and control over value created.
- Neutralise competition and emerging competitive threats.

Whilst this list is highly attractive it must also be set in the context of the word 'potential'. Whilst the key goal is to increase shareholder value there are few guarantees involved in any merger or acquisition and many attractive scenarios have turned sour as the enticing list of benefits have proved rather elusive. Optimistic projections of huge cost savings and enhanced synergies have all too frequently failed to materialise as the exercise has been submerged under a raft of complex miscalculations in strategy and organisational problems including top management power struggles, culture clashes and major difficulties in terms of systems integration. We only have to reflect on the dramatic examples of AOL & Time Warner and DaimlerChrysler to understand how seriously wrong some ventures can turn out. Both these deals resulted in huge amounts of shareholder value being destroyed.

So any prospective merger or acquisition needs to be carried out with a strong degree of business acumen and a very healthy slice of cynicism and scepticism. Too often in mergers and acquisitions shareholder value is destroyed in the challenge of implementation. Ultimately it is the task of the senior management team to realise the synergies or benefits in a merger or acquisition. It is their understanding of the challenges brought by the event and the actions they subsequently take that ultimately determines whether it is a success or failure. This is a strategic business activity that can (and has) seriously challenged even the most capable of leadership and management teams. The evidence is clear – a merger or acquisition has the potential to seriously damage the process of value creation.

The challenge of the event

Whilst some mergers are profitable many never get near to reaching their projected business or financial goals. Many studies have reviewed the shareholder gains from mergers and acquisitions and the conclusion is that the failure rate is between 40-60 per cent. Some studies have been more pessimistic and gone as far as to suggest that as many as 70 per cent of mergers and acquisitions result in financial disappointment and subsequent divestment. The all too familiar scenario is that company A buys company B only to sell it off some two to three years later as the projected synergies and financial benefits failed to materialise.

One study by BusinessWeek in 2002 tracked deals that were done in the period of 1998 and 2000. It highlighted the fact that at that time some $4 trillion had been spent on deals: more than had been done in the previous 30 years. In conclusion it stated that some 61 per cent of buyers destroyed shareholder value. The report highlighted some startling statistics:

- A year after the deals the losers' average returns were 25 per cent points below their industry peers.
- The gains of the winning minority could not make up for the buyers' losses. The average return for all buyers was 4.3 per cent below their peers and 9.2 per cent below the S&P 500.
- Companies that paid in stock – 65 per cent showed the worst result. After a year they fell behind their peers by 8 per cent. By contrast cash buyers gained 0.3 per cent.

The report concluded that some of the classic failings included:

- **Overpaying** – paying too big a premium – giving future gains away to the shareholder in the target.
- **Over-estimating –** the amount of cost savings and synergies that could be achieved from the transaction.

- **Poor integration execution –** frustrating employees, customers and delaying the capture of any real benefits.
- **Obsessive cost cutting –** damaging the business by giving too much focus on maintaining revenues and keeping top sales people.

It would seem that where mergers and acquisitions are concerned visions of increased revenue and profit streams are far easier to imagine than realise in hard financial terms. So why do these transactions and deals that involve so much management and intellectual talent, frequently produce such dismal results?

Having successfully negotiated the price and overcome the legal and technical hurdles that accompany the completion of any merger or acquisition a senior management team faces a far greater challenge in successfully merging or integrating any newly acquired organisation. Many mergers and acquisitions fail because the implementation issues that were subsequently encountered proved too difficult to unravel and manage. When faced with a seemingly endless list of challenges and overwhelming complexity, managers become frustrated at the lack of progress. Eventually they give up the chase and find some convenient exit from the deal. This departure is often accompanied with some form of post-event rationalisation and rhetoric that tries to disguise the management's all too obvious embarrassment. Significantly, many of the operational issues that proved so difficult to overcome could have been predicted at the beginning of the deal. But all too often, such issues are either ignored or not felt to be sufficiently important to warrant senior management's attention during the detailed planning and negotiating stages of a deal.

Case study: Citibank and Travelers – over ten years on

The mega-merger of Citibank and Travelers took place in October 1998. It was a deal that aimed to create a global giant. The price of Citigroup shares at the time of the deal was $32.50, yet when set against the huge problems associated with the 2008 credit crunch and the US Government bailout that helped Citigroup with billions of losses, the shares now sell for below $3. There is much speculation that the business now needs to be broken up as it has become too large to be managed effectively!

Figure 1 illustrates how a management team can get caught up in the difficult tasks of integration and lose focus on customers, with the resulting impact on financial performance. The organisation soon begins to lose market share and soon afterwards begins to experience a decline in their Return on Earnings (ROE) relative to competitors. A dangerous and alarming situation arises: the sign of a merger going badly wrong.

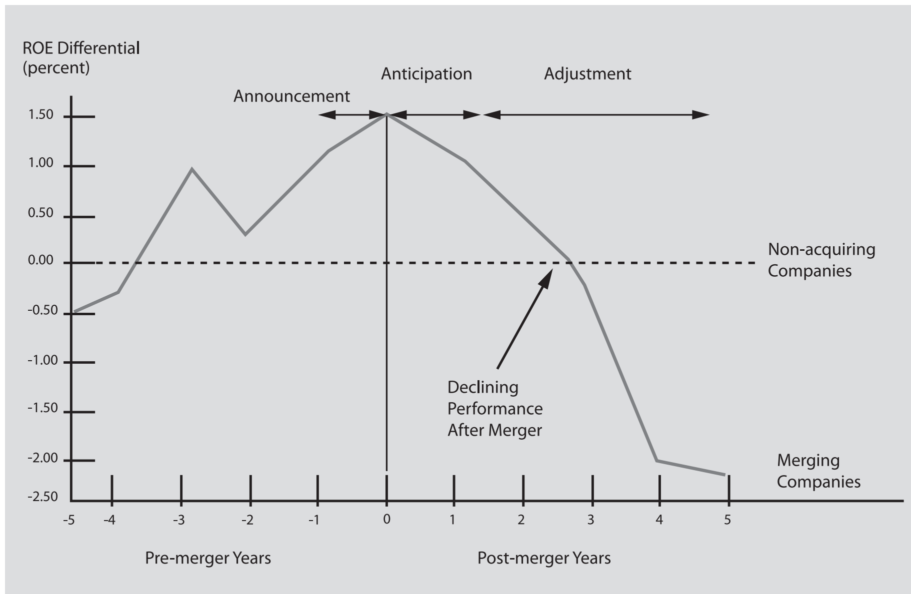

Figure 1

Since as far back as the 1980s and the large number of what can only be termed 'bad buys', much has been written on the need to manage the integration issues associated with mergers and acquisitions. Even in more recent heady times whenever there was a huge wave of activity in the media, financial services and pharmaceutical industries, it is clear that in many cases an improved awareness of the dangers did not mean the lessons of the 1980s and 1990s were learnt.

Case study: The Daimler Chrysler deal – "a merger of equals"

In 1998, Jürgen Schrempp as CEO of the mighty German Daimler Corporation engineered a merger with the US Chrysler Corporation. It was a mega merger. The combined group employed 421,000 employees. Its operating earnings in 1999 were $7.06 billion on revenues of $155.3 billion. It had combined unit sales of some 4 million trucks and cars and ran production facilities in 34 countries and sales in more than 200 countries. Everything about the deal was huge.

In 1999 the deal was set to generate $1.4 billion in cost savings and both businesses were looking for major synergies in joint procurement, combined overhead and shared technology.

Between the period of 1999-2000 the company planned to secure a complete organisation integration and conduct a thorough review of the market position of every model and brand. This would then lead to the assignment of appropriate costs, technology and quality standards.

After 2001 it was estimated that all top management would be realigned and that Shrempp would become the sole CEO with Bob Eaton the former Chrysler CEO and Co-Chairman would retire after the transition process.

At the time it was estimated that in terms of product mix there was little overlap. Mercedes-Benz operated at the luxury end of the market with Chrysler taking up the mainstream offerings. With regard to geography each company was strong where the other was weak – 93 per cent of Chrysler's sales were derived from North America and Mercedes-Benz captured 63 per cent of its business from Europe. Financially both companies were among the world's richest car-makers earning a combined $4.6 billion. Chrysler was also one of the lowest cost producers in the US, something that Mercedes believed it could tap into. So all was looking good.

If there was one potential danger sign it was the issue of corporate culture. The deal was predicated on the belief that it would marry Chrysler's modern manufacturing methods and technology with the quality of Daimler's Mercedes. But that meant marrying Chrysler's fast, flat and fluid approach to the traditional formal and potentially "bureaucratic" and slow methodical German culture.

SO WHAT HAPPENED?

As early as December 2000, DaimlerChrysler, as the new group was called, was forced to issue its fourth profits warning whilst admitting that earnings at its Chrysler operation had collapsed. Profit projects for the operation in 2000 were being set at $500 million, down from $5.19 billion in 1999. This was set against a seriously deteriorating situation in the US car market. Very soon afterwards DaimlerChrysler shares fell to around $47.20 approximately 50 per cent below their post-merger high! Schrempp blamed Chrysler's problems on a combination of sales discounts, launch costs and new models and intense competition. He was reported to have said, "Chrysler did not adjust its cost structure sufficiently to take into account the changed conditions of the market".

Around the same time there was growing investor unrest in the US. Kirk Kerkorian the largest US investor in DaimlerChrysler started legal action against the corporation alleging that the company deceived shareholders by arguing that the 1998 deal created a "merger of equals" rather than a takeover of Chrysler. Kerkorian was seeking $8 billion (including $2 billion in damages) in compensation of a takeover premium that he said he would have received for his Chrysler shares if DaimlerChrysler had reported the deal as a takeover.

Pretty soon the problems of integration were multiplying. There were reports that the new organisation was having difficulties reacting to the demands and rigours of Wall Street. Set against different perspectives between how the Europeans and Americans manage shareholders and investors former Chrysler finance executives were being despatched to Stuttgart to teach the Germans about how they needed to play by Wall Street's rules.

Also it was not long before the so called Chrysler dream team that had built many of the hot new models and generated big profits in the 1990s left under the increasing problems of chaotic operations and costs spinning out of control. Bob Lutz who had been a huge success in developing models that had saved Chrysler from bankruptcy in the early 1990s was given no real role in the new organisation and so left; to be followed by another top dozen executives not long afterwards.

Dieter Zetsche a top notch Daimler executive was soon put in charge of running the Chrysler operation and had to work very hard to offset an earlier comment by Schrempp that he always intended to make Chrysler a division rather than forming a “merger of equals”. It was one of the remarks that had provoked the Kerkorian lawsuit. It was also reported that Schrempp’s unwillingness to meet with the Chrysler Board before the merger was a further symbolic sign of the German takeover of Chrysler. Pretty soon the culture clashes were appearing everywhere. At Supervisory Board meetings in New York the Daimler executives would arrive in their Mercedes S Class cars whilst all the Chrysler executives would arrive in a single mini-van that became known as “the clown car”.

With over 100 post-integration teams established to cover items such as purchasing, financial control, engineering, property, signage, etc. the management workload and pressure intensified. There were persistent stories of huge culture clashes and failures to get the business on a unified track.

In 2001 the Chrysler operation lost $2.18 billion. It had by now made big reductions in its cost base and introduced sweeping restructurings. Jobs were cut by 19,000 and material costs were reduced by 5 per cent with projects for a further 4000 job cuts and shrinkage in costs by 10-15 per cent between 2002 and 2005. Meanwhile since the merger the Daimler-Chrysler share price has been one of the worst performers in the industry and there were growing shareholder criticisms that Daimler should sell off Chrysler. All in all, Chrysler experienced some three major restructurings under its new ownership regime. The arrival of Dieter Zetsche meant he would eventually close six plants and cut the workforce by a third. Also every member of the executive committee was replaced under his regime. He slowly helped to rebuild the business in the US by a disciplined focus on cost and product performance but it was to take some six years and unfortunately it was not to last.

Pretty soon the mighty Mercedes brand was also being beset by quality problems that many people were associating with the failed merger, a seriously troubled organisation and the need to cut costs. By 2005 Mercedes had lost its position as the cash cow of the business when profits fell to €20 million (97 per cent) in 2004 and it reported a first quarter loss in 2005 – the first such losses in a decade.

In July 2005 Jürgen Shrempp resigned as Chief Executive and appointed Dieter Zetsche as his successor. At the time of his resignation the share price rose 8.7 per cent to €39.49. In the intervening years since the merger the market capitalisation of the business fell from €95 billion to €37 billion. Such was the destruction of shareholder value that some investors nicknamed Shrempp "Neutron Jürgen". However, he did manage to defeat the lawsuit waged by Kirk Kerkorian. Some critics argue that his major error was that he paid far too much for a business that was already showing signs of deterioration at the peak of a business cycle.

By February 2007 DaimlerChrysler had hired JP Morgan to explore Chrysler's future. As it announced another loss including a restructuring charge of $1 billion. Part of the plan involved 13,000 job losses in the US together with a reduction of 10-15 per cent fewer dealers and a reduction of 10-20 per cent in the Chrysler model range.

Then in May 2007 Daimler finally broke the knot and sold Chrysler to private equity firm Cerebus Capital for $7.4 billion after ten years of the dreadful results. The deal meant Daimler effectively paid Cerebus more than $600 million to take on board Chrysler's healthcare and pension liabilities that total some $19 billion. Daimler elected to keep some 20 percent of the business and remain a development partner but it was final recognition that the deal had cost almost $50 billion over the past decade. In his closing statements on the deal Dieter Zetsche commented that it was clear in hindsight that the potential for synergies between Chrysler and Mercedes-Benz had been overestimated and that US consumers had not been prepared to pay more for German technology.

THE WISDOM OF HINDSIGHT

There is little doubt that this "merger of equals" was a huge disaster in terms of value creation. In the cold light of day many arguments can be put forward for the failure. Schrempp had allowed his drive and ambition to get the better of him in making the deal happen. He had waged a huge public relations battle to win the deal – spending some $25 million that included making thousands of calls to politicians and union leaders. At the time of the Chrysler deal he also forged major links and investments in Hyundai and Mitsubishi and eventually took control of all their truck businesses. All of which added to the complexity of the business.

He also clearly paid too much at the wrong time. Equally, other commentators have argued that the Daimler management failed to accurately assess the US situation. It was a market full of fundamental challenges – overcapacity, high costs, and high gas consumption models, all coupled with enormous pension and social costs.

Clearly a rigorous approach to the deal might have identified some of these seemingly obvious problems but clearly it did not. Despite the huge amount of intellectual capital that would have surrounded the negotiations.

What is also clear is that there were major problems in trying to bring these two different businesses and managements together. The clash of culture was illustrated in one example when Chrysler sent two seats to Frankfurt with a message that large savings could be delivered to the business by putting them in Mercedes cars. A reply was sent back that the seats had failed Mercedes quality and safety tests and that therefore the US operation was paying too much for a sub-standard product. There was a huge gulf in cultures regarding engineering quality, working processes and standards as well as the potential for a US German cultural rift. It would seem that in hindsight not enough was done to bring the two businesses together. Within two years of the deal Shrempp was arguing that he had always intended to take control and this clearly inflamed the Chrysler attitude towards the merger.

This Briefing will highlight many of the internal organisation and people issues that result from a merger. What we see in the DaimlerChrysler debacle is a highly talented leadership team totally underestimating the significance of these issues. Despite huge effort and resources it seems they never really recovered from the initial underestimation of the size of the integration challenge.

What stimulates merger and acquisition activity?

Where the problems begin!

The stimulus for business leaders to pursue an acquisition or merger often comes from factors such as the:

- Strategic logic and intent of a leadership team.
- Strength of the equity market.
- Availability of capital.
- Restructuring of industries – as recently seen in the pharmaceutical, transport, television and finance industries.
- Senior management ambition and ego.
- Enthusiasm of intermediaries – investment bankers and other professional advisors.
- Need to send messages to the financial markets and community that a business and its management team is proactive and looking for growth.
- Desire to generate cash for further ventures.
- Need to impress competitors.

Clearly the economic cycle plays a significant role in determining the fashionable nature of the activity. The heady days of the 1980s, where the whole business world seemed to become intoxicated with doing deals, were subsequently replaced by the desert like landscape of the early 1990s when very little activity took place. This was subsequently replaced by the high levels of activity in the late 1990s when the pharmaceutical and banking industries became caught up in what seemed like an endless race to either restructure, rationalise, or chase scale and extend their global reach. This was followed by the feeding frenzy of the early 2000s when private equity became a major player in the capital markets and the historic low costs of capital played a massive role in driving huge levels of activity.

Case study: Vodafone and Mannesmann – chasing a big deal

In 2000, Sir Christopher Gent as Chief Executive of mobile telephone group Vodafone launched a hostile £100 plus million takeover of the German Mannesmann Group. The takeover of Germany's flagship telecoms company was the largest corporate merger ever at the time, and made Vodafone the fourth largest company in the world. He was controversially paid a £10 million bonus for simply completing the deal.

Vodafone's share price peaked at 399p in 2000, enabling Sir Christopher to complete his record-breaking acquisitions without drawing a penny from the bank. His all-share deals left Vodafone unencumbered with the kind of debt that weighed down many of its competitors.

However after the glory days of 2000, Vodafone saw over two-thirds the value of its shares wiped out, but the trend was not reflected in Sir Christopher's salary. In 2001, he received £6 million in salary and bonuses in a year when Vodafone posted what remains the largest UK corporate loss in history – £13.6 billion

His critics argued that in two years he spent £200 billion on acquisitions (which was equal at the time to a quarter of UK's GDP). In that time the Vodafone share price fell from 399p to 150p so in effect he spent £200 billion to create a business worth £100 billion. Today in July 2009 the share price is hovering around the 120-130p range.

At the time of writing we are in the middle of the "credit crunch" and the level of merger and acquisition activity has dried up for the time being. With liquidity low and the price of capital very high the conditions for pursuing aggressive deals is at an all time low. However, with the price of assets looking historically very low there is every possibility that the eventual easing of the capital markets and subsequent availability of capital will see a huge uptake of deals as industries restructure and businesses seek to take advantage of the low capital value of some businesses and assets.

Why are we buying in the first place?

Any acquisition or merger should be approached in a highly structured and analytical manner. A statement of the obvious! Well perhaps not. With the value of hindsight many past transactions would seem to have had a flawed or decidedly unclear business logic. It would seem that in many cases senior management approach their mergers and acquisitions with the methodology outlined below (Fig 2).

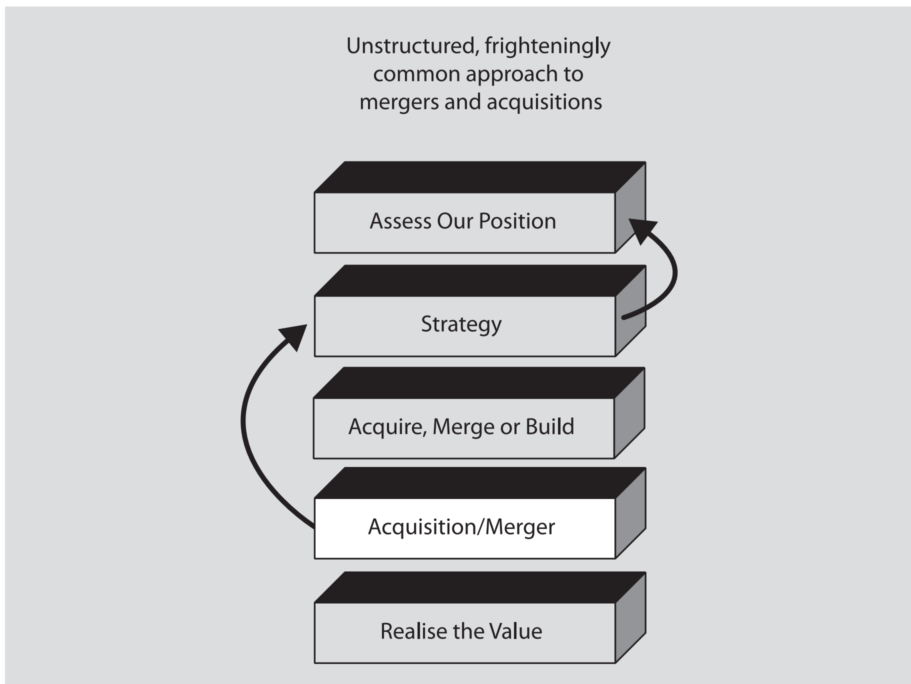

Figure 2

Such an approach may seem perverse but the fact is that this does happen. Management teams can and have acquired or merged businesses without really having thought through the fundamental dynamics of the market or rigorously interrogated the strategic logic behind the business case. In the worst cases deals can simply be the creations of egos and an overzealous and opportunistic leadership team. This alarming approach can always be witnessed when senior managers struggling to implement rationalisation or operational plans, are caught saying, “Just remind me why we actually bought this company!” As a consultant I have actually heard a harassed Chief Executive say, “Why on earth didn’t someone stop me buying this company?” In mergers and acquisitions one of the most difficult decisions to make is often to walk away from a deal.

Case study: Ford and Volvo

In 1999 Ford Motor Co., the world's most profitable carmaker bought the automobile operations of Swedish-based Volvo for $6.45 billion. This was a figure slightly less than Ford's 1998 year profits of $6.57 billion. The take-over was part of a frenzy of mergers and take-overs in an industry that had some 80 surplus assembly plants, able to produce around 15 million cars more than current demand!

By 2008, as the global car industry and in particular the US struggled to come to terms with the credit crunch and a crippling fall in demand, Ford announced it was keen to divest itself of Volvo as it tried to negotiate a multi-billion dollar bailout from the US government.

This Briefing does not aim to provide detailed advice or comment on the strategic analysis and methodology that should be applied in identifying targets for an acquisition or merger. However, it does seem that any disciplined and systematic approach to addressing merger and acquisition strategies should involve the following steps (Fig 3).

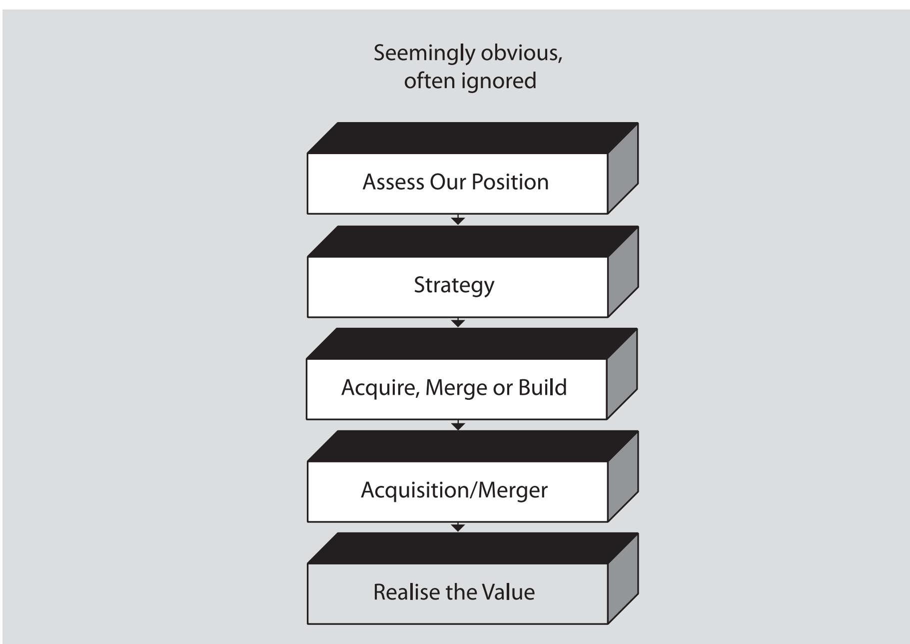

Figure 3

Any merger or acquisition should be the result of a detailed and disciplined analysis of the market and businesses in question. Buying businesses because they are a 'once in a lifetime opportunity' can prove costly. There would appear to be no substitute for cold and clinical analysis. This cautious approach is all the more important in acquisition situations where premium prices may have to be paid by the acquirer. Naturally, demand is reflected in the price – attractive businesses with long-term growth – and in such cases the challenge for management in trying to earn back premiums can be very significant. The graph below details an example of the increase in return on earnings required to break even from the deal (Fig 4).

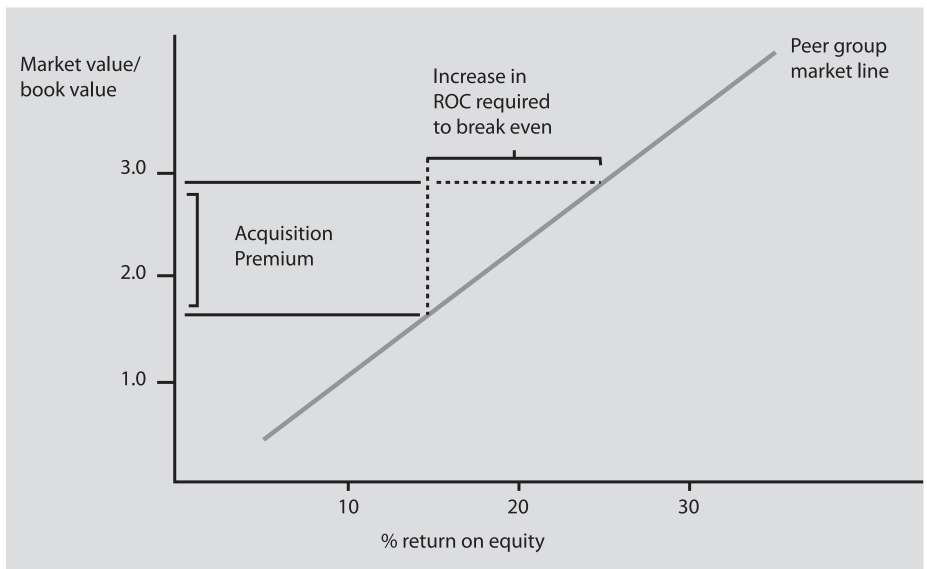

Figure 4

Against this background anything less than a very detailed and disciplined approach to the event may prove very costly. As Ian Smith a senior business and corporate finance consultant advises, "Always sign off on the strategy and not just the price!" But success demands that management not only attend to the questions of strategic logic and fit but also to the post-merger or acquisition plan. It is often this last element that proves fatal, as we have already stressed most shareholder value is destroyed in the implementation phase of a deal. Ultimately it is all about the ability of a leadership and management team to execute the strategy.

So who is at fault?

In addressing the impact of implementation issues on the success of any merger or acquisition it is clear that in some instances business leaders have failed to critically evaluate the strategic logic and opportunities involved in some deals. But equally it is the role of the financial and other professional intermediaries that prompts most comment. Without going into the rather emotive and controversial issue as to the underlying motivations of why investment bankers and associated financial advisors might try to stimulate or broker ideas and targets for acquisition – namely a desire to foster sound strategic logic or maximise fee income – it could be argued that detailed implementation issues are not often at the top of their agenda. It is perhaps the capital markets desire for volatility and an endless appetite for transactions that sometimes generates the problem.

To balance this assertion any self-respecting advisor would probably argue that they have to be interested in the inherent strategic and financial logic in a deal in order to maintain and ensure their long-term future as a successful advisor. After all, they would point out, there is no benefit in an advisor being associated with failure and deals that destroy rather than create value for shareholders. But if success is measured in terms of the immediate winning or defending of a bid or achieving a merger then a critical point is missed. As we have seen with the likes of DaimlerChrysler and AOL Time Warner, what happens some two to three years later in terms of business performance would in many cases reveal a different verdict on the definition of success. As one analyst said with regard to France Telecom's purchase of UK Mobile company Orange, "From a shareholder point of view it is expensive …… but five years down the road provided they don't kill the animal, people will only remember that they got it, not that they paid through the nose for it".

Case study: France Telecom and Orange

In May 2000 France Telecom agreed to buy UK mobile-phone operator Orange from Vodafone Air Touch in a long-anticipated deal worth £26.9 billion ($40.3 billion) in cash, stock and assumption of debt, creating Europe's second-largest cellular-phone company.

The deal was done at the height of the Dot Com boom and not long after the market collapsed sending prices tumbling. France Telecom was saddled with a huge debt mountain and had to begin cutting costs. Some people have argued that this process led to the erosion of one of the key reasons for buying Orange in the first place, namely its excellent customer service philosophy. Whilst most of France Telecom's 160,000 employees were effectively state-owned employees who received little in the way of incentive payments, Orange employees were used to incentives and stock option schemes.

Hans Snook the visionary leader of Orange combined with Michel Bon the CEO of France Telecom to lead the new business. But there were early potential signs of conflict when it was learnt that Snook was paid four times more than Bon and that Snook did not speak French. Within a few years and set against a huge debt problem both Snook and Bon had left. There were rumblings that the need for savage cost-cutting had badly cut across the Snook vision of "service excellence", with the result that Orange suffered major complaints about poor customer service. Snook was even called out of retirement to comment on some new Orange television advertisements that featured a "hard-nosed" businessman playing tennis. Snook described it as betrayal of everything Orange had stood for. Yet again culture and bad timing had collided to create an uncomfortable marriage. Even today, original Orange customers will complain that the ethos of the business has been lost.

What is clear is that the proceedings surrounding a merger or acquisition are still dominated by lawyers and financiers. Crucial as these specialists are to the transaction side of the process, the critical question is whether they actually have any real interest in the operational realities that ultimately determine whether the deal, in the long-term, is a success or failure? Indeed, due diligence processes still seem to pay relatively poor attention to the organisation and people dimensions. In the heat of complex pricing and legal negotiations it is, perhaps, not surprising that the parties present neglect to focus on the day-to-day practicalities of rationalising or integrating two different, and in some cases radically different, organisations.

Most corporate lawyers or financiers will have had little direct experience of integrating two different businesses. They operate in a deal-driven world where it is very easy to think of businesses as financial or legal abstractions without the attendant issues of product ranges, distribution channels, organisational structures, information management systems and compensation strategies. Of course, it could be argued that corporate financiers and lawyers have no need to be concerned with such issues as they have a different role to play. After all, is it not the management's responsibility to see to any operational issues that might result? The management will ultimately have to takeover the running of the new organisation and bring their expertise to enhancing revenues, rationalising distribution or product lines, developing common management information systems and developing brands etc.

But managers, inexperienced in the art of successfully managing such deals are heavily influenced by their advisors. After all, for most senior managers, buying or merging a business is not something that they do every day of the week. For many Chief Executives and Finance Directors it is the first and sometimes only time that they will be involved in such a situation. Professional advisors, therefore, exert enormous influence in shaping the agenda of their clients in the lead up to completing a deal. The key question is whether the focus is properly balanced between what needs to happen to close the deal and what will need to happen following the deal. A successful completion is only the beginning of the process.

Case study: AOL and Time Warner – a mega disaster and clash of egos and cultures!

In 2001 the publishing and media giant Time Warner merged with the exciting new world of the internet and AOL. At the time the deal was heralded as a great internet triumph. The merger would bring together two core capabilities, in the form of Time Warner's extensive stable of brands and the brave new world of new media distribution via the internet. Such was the size of the deal that it was estimated that the new giant would touch the lives of people around the world an incredible 2.5 billion times each day through magazines, cable and movies. Within the context of the deal it was generally accepted that AOL was the dominant partner. As one commentator said, "The nerds have won". Indeed the hype and optimistic forecasts surrounding AOL's ability to exploit the internet meant it was seen as the sexy partner. AOL would turbocharge the world of old media and bring it into the internet century. This perspective would play a crucial factor in the integration process.

The transaction was enormous and described as the deal of the century with Time Warner paying $164 billion at the height of the dot com bubble.

As a later CEO Richard Parsons would comment, "In hindsight we can all look back and ask, 'what were we thinking?'" As so often is the case in mergers, events would prove that Time Warner had paid massively too much for AOL.

Within a few years the deal proved to be the biggest merger disaster of all time. By 2002 the new business announced a loss of $99 billion and by December 2002 it was being estimated that the deal had wiped out a stunning $280 billion in value. The company was soon submerged into a siege and crisis mentality.

Admittedly the deal was done at the height of the dot com boom only to run into a devastating meltdown within a year or so. The share price at the time of the deal in 2000 was north of $60 but by July 2002 it had collapsed to around $8.70. But it equally became clear that the integration was beset by huge clashes in culture and management style. Even before the deal was completed it seemed that Steve Case the founder of AOL (who would later become Chairman) and Jerry Levin the head of Time Warner were locked in a power battle. Levin was greatly concerned that Case and AOL would try to dominate the newly combined business. There were also subsequent concerns expressed in parts of Time Warner about the aggressive projections of a quick 30 per cent in profits that was used to win over Wall Street's support for the deal.

Within just a few months of the deal many conflicts were surfacing as the AOL executives buoyed by the internet boom did indeed develop a condescending attitude to what they perceived to be the conservative world of old media. Time Warner staff also soon came to resent the aggressive cost cuts that were imposed to meet the aggressive earnings goals that had pushed the merger through. As the internet boom came to a shuddering halt and advertising revenues collapsed, AOL was soon struggling to hit what were hugely optimistic revenue targets; within a year AOL's advertising revenue had fallen by some 30 per cent.

At the time of the deal there was an even distribution of the senior roles between the two businesses yet it was not long before clashes at the leadership level began in earnest. Given the background to the deal it was the AOL executives who ended up running the business in the post-merger period. But as AOL soon became an albatross around the neck of Time Warner many senior executives resented the behaviour of the new Chief Operating Office Bob Pitman. He quickly developed a reputation for his brusque manner and brought a brash and ruthless style from AOL to Time Warner. During the initial merger phase Pitman had swept out a lot of Time Warner executives and this has clearly created a culture of suspicion and resentment. Indeed Pitman was soon seen to be jockeying and competing for Levin's CEO role. He even appeared on the front cover of BusinessWeek with the headline 'Bob Pittman's Job is to Implement the Biggest Merger in History'. Within the first year it was clear that AOL would miss its projected $11 billion cash flow target by some $1 billion. Pretty soon afterwards Case and Levin were in almost open disagreement and in December 2001 Levin abruptly resigned although he did manage to get Time Warner veteran Richard Parsons appointed over Pittman. As the financial situation deteriorated at a rapid pace Pittman soon left the business as criticism of his overly optimistic pre-merger financial forecasts mounted. It would be a little while longer before Case would leave in January 2003. But in the intervening period Parsons set about appointing an almost entirely new team made up of Time Warner executives.

During this period AOL suffered a series of huge write downs reflecting the decline in the asset values and an ever challenging customer and competitive landscape that saw major rivals like Yahoo and Google march well ahead. At the same time AOL had major difficulties in making the transition from an analogue to broadband internet service provider and soon lost out on online advertising as Google's model came to dominate the market.

Ted Turner the US billionaire was the biggest private shareholder in Time Warner. He had earlier sold his media empire that encompassed CNN, New Line Cinema and the MGM film library to Time Warner and was worth an estimated $2.1 billion. One year after the AOL Time Warner deal Turner's wealth was estimated at $9.1 billion but by 2003 his worth was valued at less than the $2.1 billion he had started with in 1995. During the merger his role on the board had been increasingly sidelined by Case and when he was replaced as the leader of CNN and Turner Broadcasting he resigned from the Board. He is perhaps one of the world's best examples of how a merger can destroy shareholder value.

> After many years of struggle and shareholder dissatisfaction in May 2009, Jeff Bewkes the CEO of Time Warner announced that he would spin off AOL by the end of the year. It would bring to an end one of the most abysmal mergers of all time. Never before has a deal promised so much and delivered so little.

As a merger or acquisition represents a huge financial risk it is imperative that the primary elements of a rigorous mergers and acquisitions process are put into place. This means securing solid information from the right resources, substantiating it with sound reasoning and providing a well defined methodology and all the necessary organisational disciplines to follow the process through to a clear conclusion. Experts in mergers and acquisitions can help many firms avoid some of the classic failings.

The strength of a good mergers and acquisitions leader comes from their ability to work with real functional business experts from areas such as information technology, sales, marketing, production and HR. The key need is to balance the quantitative and qualitative elements of all the relevant information. It is imperative that the financial side of the process does not over-ride the business experts in the early stage of the process. It seems that too often the Excel spreadsheets and discounted cash flow projections come to dominate the proceedings with the result that critical operational issues and concerns get lost until it is far too late.

A good methodology should entail the following:

- Begin the mergers and acquisitions process before a specific target is identified.
- Analyse the entire industry segment; rather than individual companies in isolation – what is happening across the industry?
- Identify the critical attributes of profitability in a targeted segment.
- Review any companies against these attributes.

Validate any projected revenue and cost synergies with tangible action plans that are rigorously reviewed and validated by the team responsible for delivering the post integration plan.

The issue of ego and personality

Senior management's ambitions and powerful egos can also be key factors in determining the direction of events. It would seem very easy for senior business leaders to become blind to the obvious dangers that lie in the shadows of potential deals. For big egos, the thrill of the chase can prove both exhilarating and intoxicating and therefore interest in 'matters of operational detail' that might emerge get overlooked. The danger is that the only objective on the table is to win! Of course, the notion that something as loose and imprecise as ego or personality might actually play a critical role in such a highly complex and precise business context is often not taken too seriously by those close to the event. It is argued that mergers and acquisitions are about hard analysis and objectivity – there is no room for emotion or sentiment when so much money is at stake! But of course this is not reflected in the reality of many deals. Anyone wanting a real insight into the power and ego side of things need look no further than Bryan Burrough and John Helyar's excellent '*Barbarians at the Gate*' (Arrow paperback 1990), a thrilling but highly factual account of the infamous RJR Nabisco take over by the legendary Kohlberg, Kravis, Roberts and Co in 1988. The book explains, in detail, the rivalries and tensions that arise not just between competing managements but also between teams of professional advisors. The truth is that ego and emotion are always at play. The legendary American investor Warren Buffet best summarised the potential danger when he was reported as saying:

> ***"A merger or an acquisition is an event where managerial intellect wilts in the face of adrenaline!"***

Another excellent work in this field has been written by Bill Vlasic and Bradley Stertz. Their book '*Taken for a Ride: How Daimler-Benz drove off with Chrysler*' (John Wiley Publishers) provides a detailed account of the Daimler Chrysler merger and whilst it is influenced heavily by a US and Chrysler perspective it nonetheless provides a fascinating insight into of some of the human emotions at play. The impact of personality is all powerful and the desire of senior business leaders to win can be all pervasive, hence matters may not be looked at with the clarity that might actually be required. How easy is it then for professional advisors to critically challenge their clients – some of whom will not just have big but also very thin egos? Is it always in the motivation and interests of professional advisors to advise their clients to walk away from something that looks a little too risky – bearing in mind that investment banks will makes tens of millions of dollars on a successful transaction? No doubt good advisors always do but what about the others who under temptation and pressure encourage their clients to continue, even though logic might be dictating a different perspective.

So, whose fault is it that important implementation issues may get missed at such a critical stage? Conspiracy theories aside, the problem is probably the apparent failure of both parties. But the fact is that this failure simply postpones much bigger problems until a later date. Professional advisors who are heavily rewarded for completing a deal, combine with senior managers who in many cases are grossly inexperienced in the art of buying and selling businesses.

At the same time there can be a very real and serious danger that Chairs, Chief Executives and Group Finance Directors start to see the exercise as a financial equation; focusing on the key ratios to the exclusion of seemingly irrelevant issues that, as we know, will have a huge ability to either destroy or promote any projected synergies. A resulting cocktail of extreme time pressures, lengthy adversarial negotiations, large management and advisor egos and relatively narrow financial and legal agendas can push adrenaline levels to a point where important and critical operational issues get overlooked or, at worst, ignored.

But to dare to raise the issue of differences in management style and culture at a time when the majority of people are arguing about prospective PE ratios, Dividend Yield, Debt to Equity Ratios and valuation methodologies may seem a severely career limiting action. Yet it is precisely at this stage of the proceedings that someone needs to be provoking some thought about such matters and that these issues should have already been explored well in advance of getting near the negotiating table.

What follows in the immediate aftermath of an acquisition or merger is that commercial logic and reason are often substituted by a complex mixture of emotions encompassing elation, excitement, fear, suspicion, mistrust and betrayal. All of which can play havoc with even the best laid strategic plans for value added synergies, cost savings and increased market share. So that six months later the situation looks anything but a deal made in heaven!

Case study: Alcatel-Lucent

In 2006 Alcatel, the French owned telecoms business, announced a merger with US based Lucent. The goal of the merger was to create the world's largest supplier of telecoms infrastructure. But by 2008 the business had never turned a profit and its share price had halved in value. Again, cultural differences and a toughening market, which included new low-cost Asian suppliers, marred the integration process. The business was also accused of backing some wrong technologies that ultimately resulted in Alcatel paying too much for Lucent. But as ever there was much adverse comment about the clash of cultures and leadership styles. Serge Tchuruk as Chairman was the 70 year-old leader of Alcatel. As a former oil industry executive he had steered the company through tough times since taking over in 1996. Pat Russo was one of the US's highest profile women leaders and she promised as CEO to learn French and work from Paris as part of the merger. But reports stated that she never felt comfortable in the more politicised world of French business. Significantly she also failed to learn French and continued to commute to Paris. Suggestions were that she and Tchuruk did not see things in the same way and that Tchuruk was not comfortable stepping back from the day-to-day business.

In the period the share price had collapsed from around €13.5 to €4. For 2008, the company posted revenues of €16.984 billion and a net loss of €5.215 billion and announced continued plans for restructuring and job losses.