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ACG: Building Corporate Value Worldwide

Issue Highlights

As Exit Strategies Tighten, Firms Look at Private IPOs

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By the end of 2000, executives at Lawson Software knew they wanted to take their firm public.

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Wall Street Hits Main Street: The Employment Implications of the Corporate Reform Bill

Kenneth G. Sam, Andrew G. Stines, Michael W. Droke

Enron. Adelphia Communications. Global Crossing. WorldCom. These names – and the alleged excesses of their corporate executive teams – have rung through the halls of Congress and corporate America.

Program Builds for InterGrowth® 2003: Glauber, Weld Award Winners To Take the Podium

Much in the news of late, Robert R. Glauber, NASD's chairman and chief executive officer, will keynote a morning session on Friday, May 2, at InterGrowth® 2003.

Presidents Applaud Launch of Vienna Chapter

"I am happy to report the launch of a new ACG international chapter in Vienna on October 10, 2002," writes Ashley Rountree, ACGI vice president of international expansion.

Dorothy Langer

Michael Droke

Ashley Rountree

6 Reasons Alliances Work Better Than Acquisitions

By Dorothy Langer

The awful news about AOL Time Warner's woes and concerns about the newly merged HP/Compaq remind us that many mergers produce less than stellar results.

In a McKinsey & Co. study of 115 acquisitions in the U.S. and U.K., only 23 percent of transactions earned returns greater than the annual cost of capital required for the acquisitions. An earlier study of mergers at the Universities of Chicago and Arizona found that 44% of acquired companies were later sold off, many at a loss.

In contrast, a Booz Allen study of mergers and alliances found that over a five-year period, the average ROI for alliances – nearly 17 percent – was significantly higher than the average ROI of the individual corporations involved in the alliances. This study also reported that alliances have a higher success rate than mergers.

Such research suggests that when considering M&A, management may improve odds by examining some lessons to be learned from a tried-and-true alternative: corporate partnerships. Following is a look at six key differences between alliances and mergers that show attributes of partnerships which may be transferable to mergers.

Buddies From the Get-Go.

Alliances are always friendly and generally have a strong focus on mutuality, with equal commitments and balanced risk-sharing by the partners. This win/win attitude is often missing in mergers, which can be one-sided and hostile from the start. It's similar to the difference between a marriage based on love and a shotgun wedding. Which union would you bet on?

Consider what occurred in Wells Fargo's 1995 take-over of First Interstate. Not wishing to go to the altar with Wells Fargo, First Interstate gave golden parachutes with two years' salary to hundreds of executives and granted all other employees severance packages double the industry average. The resulting mass exodus among First Interstate employees left branches under-staffed and produced serious erosion of the customer base. The hostility behind this debacle would not exist in an alliance.

Money Isn't Everything.

The primary motivation behind a successful alliance is to complement and leverage each partner's resources, such as integrating two technologies. Although financial gain is the ultimate goal, it is frequently secondary or indirect. In contrast, with most mergers the driving force on both sides is direct, short-term financial results. The acquiring firm desires visible revenue and earnings growth or tax advantages while the acquiree's leaders want to cash out or realize significant financial gain within the merged organization. Because the primary motivation is financial the two parties often fail to leverage their resources, ironically hampering achievement of the very financial objectives that originally drove the deal.

Some mergers are winners because their motivation is more akin to that of alliances. In IBM's highly successful acquisition of Lotus Development Corp., the primary focus was not price or short-term gain but a true leveraging of resources. IBM got Notes, and Lotus got IBM's presence in corporate America. Interestingly, this merger began as an alliance, and the two organizations in effect lived together for a while before hooking up.

Focus-Focus-Focus

Most alliances are formed, at least initially, around narrow objectives, such as developing a new product, expanding into new markets, or blocking a competitor. This focus on a few well-defined and attainable goals enables the partnership to focus and deliver clear value. As a result, many partnerships enjoy initial success and often go on to broaden their objectives. In comparison, when two companies are melded together in a merger, objective-setting may be done so broadly that no single goal receives enough attention to achieve potential synergies.

AOL Time Warner is a case in point. The biggest deal in history, this merger of traditional and new media truly is trying to boil the ocean – you've got mail and Time and CNN and HBO and TNT and Netscape and CompuServe and Warner Bros. and Sports Illustrated and People and Fortune and Looney Tunes! As it happens, AOL is currently having enough trouble sustaining its own growth, let alone integrating the many Time Warner properties.

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6 Reasons Alliances Work Better Than Acquisitions

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Give Due Diligence Its Due.

Lust gets in the way of quality due diligence in both mergers and alliances. After all, most dealmakers don't begin serious due diligence until they are pretty sure they want to do the deal. Nonetheless, in a partnership, where the motivation is to leverage specific resources and where the objectives are focused, management instantly knows where to direct due diligence efforts. In many merger situations, however, due diligence is either done too broadly or becomes so focused on the financial and legal aspects of the deal that important specifics get overlooked.

Consider the disastrous $3.5 billion acquisition of game company The Learning Company by toy maker Mattel in 1999. In the excitement of this opportunity to marry Barbie to Carmen San Diego, Mattel's due diligence apparently missed – or ignored – real issues about the future of the CD game market in the face of the Internet and video game technology and the maturity of some of The Learning Company's current offerings. In the end, to stem huge continuing losses at The Learning Company, Mattel literally gave the unit away only 18 months after the merger.

It's the Culture, Stupid.

The all-important issue of culture is treated differently in mergers and alliances. In an acquisition, cultural differences tend to be ignored, overlooked or downplayed because either the buyer's natural instinct is to force the acquired company to adopt its culture or the deal is so enticing that both parties may disregard warning signs of impending culture clashes. When Upjohn and Pharmacia merged in 1996, for instance, they saw the opportunity to significantly accelerate revenues and better position themselves against the giants of their industry. Instead they became mired in endless policy differences, such as employee drug testing, vacations and management reporting methods, which quickly drained much of the vitality from the merger.

In contrast, partners can zero in on specific cultural issues that may impact the success of their narrower objectives. And while they may in fact uncover serious cultural differences, partners often find ways to tolerate those differences because they aren't combining permanently. With no one trying to force cultural change, the chances for success increase.

No Personal Angst Among the Personnel

Mass layoffs and executive infighting about who will stay and who will go are not part of the alliance model. With mergers, however, such issues often take on a life of their own and become paramount to the business purpose that initially prompted the relationship. Senior level distractions or defections that arise can create a leadership vacuum that imperils the merger's success. Combine this with layoffs or an exodus of people at other levels of the organization due to similar concerns about the future, and the merger is in big trouble. On the other hand, people at all levels of partnered organizations are unhampered by such distractions and are therefore free to focus on achieving the alliance's objectives.

In a recent ACG survey, 97% of corporate development executives saw alliances increasing in their organizations, and 82% viewed alliances as an effective means to accelerate growth. To facilitate a more even-handed evaluation of the alliance vs. acquisition question, companies should consider combining the traditional business development function that develops partnerships with the corporate development, or M&A, function. They also should develop meaningful criteria for determining the best structure for proposed business combinations. In many cases, a strategic alliance may in fact make more sense than a merger. And even when a merger is the right way to go, the potential of an improved pay-off may make it worthwhile to examine how to take on the best characteristics of an alliance. ■

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