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THE UNWRITTEN RULES OF M&A

Mergers and Acquisitions that Deliver Growth

Learning from Private Equity

John Colley

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The Unwritten Rules of M&A

Mergers and Acquisitions that Deliver Growth—Learning from Private Equity

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Foreword

Deal Fever. That's what they call it. You have someone telling you that your business is worth multiples of its current value, and they are willing to give you every penny for it. They confirm all the positive biases you had about your business, appear to share a common vision for its future and are prepared to brush aside the potential limitations which have been nagging you for years. On top of this, the money involved can be life-changing and, depending on your personal situation, might finally mean a tidy exit from the business that had become something of a burden. It all sounds too good to be true. As the buying process progresses, you dismiss the warning signs, or in fact anything that might compromise the deal going through. This is too lucrative a deal to ignore, you tell yourself, 'Let's just get it over the line.'

And that is how it happens; you've been infected with the phenomenon of deal fever.

That is not to say that all deals are bad or impulsive, nor that all actors in M&A deals are out to take advantage of you, but a look at the literature plainly shows that the overwhelming majority of acquisitions destroy value. In order to make an acquisition work for you and your company, you need to go into it with your eyes wide open.

The problem is that the deck is stacked against you. Perhaps this is the first time that you are selling a company you own or manage, and as yet, you don't even know 'what you don't know' about the complex process you have initiated. Instead, you will have to learn the rules of the game as you go, and even to most experienced businesspeople, you will be surprised at how little you actually knew.

A novice to M&A might presume that due diligence is akin to someone looking under a few rocks to check over your figures. In fact, it can be a rigorous, forensic evaluation of *their* data about your business, which you must then defend. Prepare for each loose thread to be tugged to the extreme, in fact, to the point where you begin to question if you have it all wrong. On top of this are the complexities of the game itself, which involves multiple external parties, including lawyers, bankers, advisors and consultants, all with exacting demands that are far from the simple, friendly handshake with which you hoped to close the deal.

Each of these parties has its own intentions and incentives that are seldom aligned solely with what is best for you, and each of these players has a single focus: the deal. You, on the other hand, are still trying to attend to the running of the business which—with the distracting interrogation of the due diligence—may not be performing as well as it might. This is soon to be a point of weakness, exploited as the deal makers ratchet up the speed of the process to the point where you may feel overwhelmed and are losing control. Your confidence is low, stress levels high and time is running out. Eventually, you may agree to a deal—*any* deal—just to restore a sense of normality.

So, should deals be avoided at all costs? No, this benefits few in what may be a prolonged period characterised by no or slow business growth. Going it alone can be risky, and joining a larger group can bring stability and access to new markets and resources. Small business owners always have the risk of cash flow running out, and this can take its toll over the years. There is a way forward, but it relies on you understanding the process of a deal, retaining a sense of control and protecting the inherent value of your business.

My first exposure to an acquisition deal during my career happened in my first tenure as MD. I was running a highly profitable technology company and my shareholders decided to put the business up for sale. Fortunately, I had already received some training in this area. Several years earlier, I had attended a Business School where John Colley was lecturing and later completed my dissertation on M&A with John as my supervisor. Whilst the course I was doing gave a comprehensive account of M&A, the theories in those textbooks did little to prepare me for what was to come.

John and I stayed in touch after my dissertation, and over a period of two years, we had multiple conversations and discussions on how I should approach my situation, as each deal has its own set of unique peculiarities. John was able to offer his advice and experience from his years in business and handling multiple acquisitions. As one of only a handful of 'professors of practice' at Warwick University, he had unique insights into the academic context of how a deal should be run yet was also able to offer the real-world context of what *actually* happens. Whilst my deal may not have gone perfectly, and certainly there were bumps along the way, I was able to navigate them with this vital independent advice from John.

To give a little more personal background to John Colley, he has been a Professor of Practice studying M&A and private equity for many years. He has previously been Group Managing Director at a FTSE100 company and Executive Managing Director at a French CAC40 business. He has chaired many companies, including listed, private equity and family-owned businesses. As a consequence, he has significant practical experience in M&A and draws heavily on example cases he has experienced first-hand as well as those studied from his academic position.

Of course, not everyone will have an M&A professor and deal expert in their corner when their time comes to step into the M&A ring. That's why this book is so important. There are numerous dry academic textbooks out there on the subject that outline integration plans, deal legalities and synergies, but none that are written with the business owner in mind. This book is unique in its practitioner's perspective and a useful guide to anyone wishing to reduce risk and improve their knowledge about what exactly they are signing up for. I certainly wish I had read this book before I stepped into the real world of M&A.

You will note that there are numerous points at which private equity-funded ventures are compared directly to corporate activity. Whilst there are mixed views on the private equity buy–improve–sell model, there is much to be learnt from their approach which John's book argues well.

Each chapter is full of case studies demonstrating key issues and relevant research findings. I found this encouraged me to reappraise some of the biggest M&A deals of recent years and identify with more clarity their costs, benefits, motives and methods. Asking 'what would I have done?' is the self-reflective approach necessary to avert rash decisions and hubris-driven deals. To give any deal you might be involved with now, or in the future, an element of objectivity and rational thinking, the advice that follows is valuable reading.

Coventry, UK

Conor McCarthy, PhD MBA
Managing Director

Preface

Why write a book on M&A? There are plenty of other informative and interesting books on the subject, however, I am yet to find one which genuinely integrates the major research findings with practical insight. In my experience, many of the people who instigate deals as principals know remarkably little about how to create value and more importantly, how it is lost. Indeed, lost for the most part. They learn from experience, and that takes time and can be accompanied by much value destruction. My motivation is to help those involved in instigating growth through deals and integration to avoid the many pitfalls of M&A.

My career path to date has been somewhat unusual. I progressed through a finance background to become Finance Director and Managing Director of large businesses, then later Group Managing Director at an FTSE 100 business. I then moved on to become Executive Managing Director at a large French-owned CAC30 business.

During this time, we bought a significant number of businesses with varying degrees of success. Internally, we never openly accepted this to be the case nor, as long as acquisitions were consistent with our strategy, did we worry too much. We had the usual belief that they would turn out all right in the long run. Strategy ruled and within that framework almost anything went. When appropriate businesses became available, we paid what was necessary and accepted share price dilution. As our approach was generally 'light touch,' we tended not to destroy too much value through integration, yet our acquisitions were often poorly timed, acquiring at the top of the market only to have to nurse these acquisitions through difficult downturns. Performance was often disappointing and rarely achieved the planned returns which formed the basis for internal and in some cases shareholder approval.

I managed some of our successes and mistakes myself. The entire process for all of us, including corporate development, was one of learning from experience. As we were spending many millions on acquiring businesses our learning and development over those years could be a costly affair. Frankly, writing off 50 Ferraris would have been cheaper.

We were eventually bought out in a hostile bid and at a high price from which the acquirer never truly recovered. Indeed, their acquisition strategies reflected ours, frequently destroying value and subsequently dumping acquisitions.

With a far wiser head than two decades earlier, this seemed the prime opportunity to transition into the academic arena and begin investigating some of the questions my career had raised. I retired from full-time major leadership jobs in vast corporates and undertook a Ph.D. in business strategy, going on to teach MBA and executive students at various major business schools. At the same time, I took positions as Non-Executive Chairman and enjoyed a dual role both academic and practical. The insight I had gained gave me a new perspective, and my success rate improved dramatically in buying and selling businesses. The fact that a significant amount of my own money was involved seemed to have helped with improving the success rate, although not always!

I became only more interested in M&A over the years and had seen first-hand what the research consistently finds—most, or at least 60–80% of acquisitions fail to deliver on their proposals, and the majority *destroy* value. This raises a whole series of questions: why are so many M&As undertaken when the chances of success are so low? Why are proposals rarely achieved and should boards not kick back and demand more realistic figures? In short, why do so many go so wrong?

Working with private equity (PE) in both buy-outs, chairing businesses owned by PE, and as an industry expert made me realise how professional and thorough they are at every stage of the process. In effect they make major returns consistently over the years through very similar activities to those we see corporates struggling with. What do they do differently and is there anything for corporates to learn from their approach?

I go on to explore the kinds of PE strategies which do appear to work, from identifying viable integrations and sources of value creation to optimising benefits without risking entire ventures. I also explain why corporates often unnecessarily pay too much or unwittingly destroy value.

You may argue that for the inexperienced there are advisors only too eager to help with all of the above processes. Certainly, these are helpful, and in some areas entirely necessary, however, it's easy to forget that consultants and advisers are not solely driven by helping you but also by maximising their fees. This nearly always means pushing the deal, and they may not be as transparent with you about prospects for success as they might. During a negotiation, you are almost always having to negotiate with your own advisors first as they attempt to draw you into considering substantial compromises to accelerate deal completion. Once the deal is completed then the consultants disappear, and the consequences and responsibility are yours alone.

Researchers attempt to categorise the potentially problematic stages, focusing on strategy, integration and pricing. But few conclude how and why these are so problematic. They are often put down to deal heat or the excitement of getting a deal done. Experiencing, learning and then studying how expensive such underperforming M&A can be has lent more force to my core question: Can such a costly learning curve be avoided? As with all business ventures, there are no quick fixes or simple solutions. There are, however, words of experience, the facts and case studies to explain them and suggestions throughout each chapter on how to navigate the complexities of M&A with the best possible outcome.

Coventry, UK John Colley

Acknowledgements

Many senior business people are aware of the risky nature of M&A and the likelihood of value destruction and failure. However, few can tell you why or what can be done about it. Others view it as a specialist activity to be left to advisors. Some also consider it as a rare event which is unlikely to trouble them during their careers. From my discussions with classes of executive students over the many years and acting as informal advisors to some as their careers subsequently develop into more senior roles, it has become increasingly clear how much this book is needed. It is to these many students that my thanks go for their candid input and open discussion.

M&A is a frequent event for larger organisations which affects many of their people in terms of strategy, due diligence and integration. Failure can be avoided, and this book draws on students' experiences to identify the key areas of failure and how these can and should be remedied. Research allied to my own extensive practical experience provides real insight into the process from a management and leadership perspective.

I would also like to thank the many colleagues and advisors I have worked with over the years who have lent me their practical experience and insight. There is always something to be learnt from every situation and, during a very lengthy career as a senior business person and an academic, I have found you never stop learning. When you do think that, then it is time to do something else.

I am sincerely grateful to Warwick Business School for creating a learning environment in which ideas can flourish and offering the opportunity to meet so many talented academics and students, whose differing perspectives provide challenge and development of thought.

I am particularly thankful to Rosemary Morrison for her patience and persistence in overseeing this project to completion. Her role and work as a development editor has been critical in keeping the project on track. Special thanks also go to Seethalakshmi Vijayasarathy and both Liz Barlow and Stephen Partridge at Palgrave MacMillan.

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Lastly, I would like to express my appreciation to my wife, Jackie Colley, for her unwavering support throughout this project.

John Colley

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About the Author

John Colley is Professor of Practice and Associate Dean at Warwick Business School teaching MBA and executive education students. From Finance Director and Managing Director at British Gypsum, John rose through leadership roles to become Group Managing Director at a FTSE 100 business and Executive Managing Director at a French CAC 40 business. Having chaired a listed business and a number of privately owned businesses, including private equity and family owned, he remains sought after for advice at board level. He has conducted corporate transactions throughout his career and studies and teaches strategy, M&A and private equity. Entering academia with a PhD from Nottingham University, Professor Colley has unique business insight that bridges practise and theory. He is highly quoted for his expertise and has written for the international press and popular business journals.

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Part I

Introduction