How to Avoid Four Common Problems in Mergers

Mistake No. 1: Assuming that experience with previous mergers is a good thing

BY SYDNEY FINKELSTEIN

MERGERS AND acquisitions have been on overdrive for more than a year. Every company wants to grow, and M&A is traditionally seen as one of the key drivers for growth.

Making it happen, however, can be challenging.

After studying M&A for decades, and working with a variety of companies on their growth strategies, I've seen firsthand some of the best, and worst. Here are some of the most common mistakes companies make in the takeover game, and what they can do to get it right.

THE PROBLEM
You think previous merger experience gives you a leg up.

Most managers assume experience adds value. Sometimes it does. But my research has shown that a company is more likely to do worse on its second acquisition than its first. How could this be? Because each of us has a tendency to over-generalize from small sample sizes. So, if we've done something once and it went well, we assume we know how to do it again.

But each merger is different. Even when making a deal in the same industry, the people and the culture will be different from company to company. As a result, what worked the first time won't necessarily work the next time, and what didn't work the first time may actually be useful the second time.

In other words, you could end up learning the wrong lessons from experience. For example, combining distribution networks might make sense if after a merger you have two products that are similar enough to go through the same channels. But the same strategy won't work if the new company uses independent distributors. It is easy to get lulled into believing an early success means you've got it figured out. Odds are you don't.

THE SOLUTION
Mix up your M&A team

If you want to reduce the risk of learning the wrong lessons from past deals, ensure that the team examining any acquisition candidate has diverse experiences and capabilities. That means rotating in some fresh-thinking operational people to complement the experienced corporate development staff.

It is especially important to capture the learning from each acquisition you're involved with, making adjustments as you go along to avoid believing you've got it all figured out. Take the time to review what went right and what went wrong, and why.

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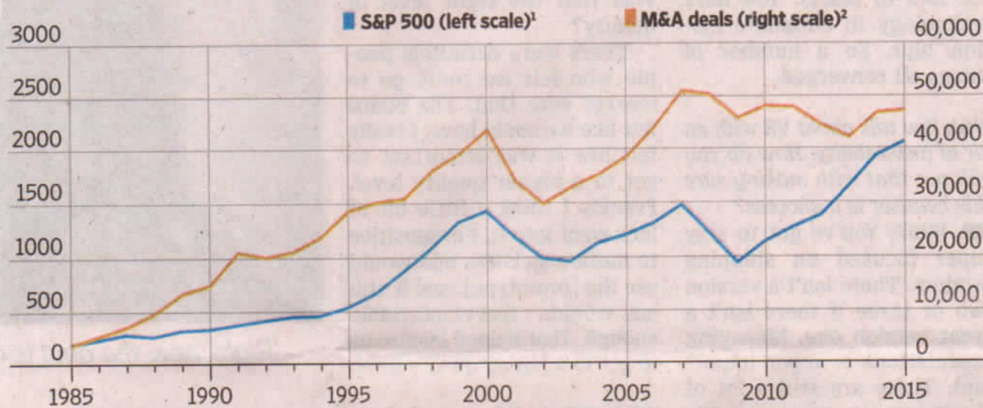
THE PROBLEM
The high price of going with the crowd

Top executives turn their attention to M&A when they have money to burn. That is why merger activity rises when the stock market goes up. When stock prices are flush, shares become the currency to do deals. It is almost like money burning a hole in your pocket, and you've got to spend it.

It is compelling until you realize that the companies you're looking to buy are also benefiting from a bull market. So target prices are higher, and because many companies get in a frenzy to buy, premiums inevitably go up as well.

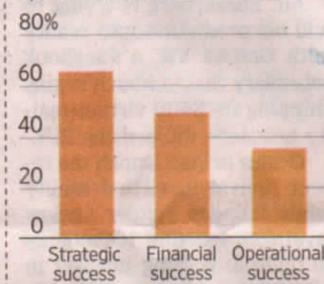
CEOs and boards can fall into a similar trap when they see their competitors buying up companies. Pressure starts to build, bankers start bringing by all sorts of potential deals that never made sense before, but now there is a "new normal." In both in-



[1]Each year's average of the monthly averages of daily closing prices.

[2]Number of announced M&A deals by year.

Sources: ThompsonOne and Robert Shiller via Sydney Finkelstein



Source: PwC LLP survey of 106 executives at Fortune 1000 companies, 2013

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stances, it's easy to see how momentum starts to take over.

THE SOLUTION

Go back to first principles

Specifically, ask yourself: What is the strategic rationale for the deal? Why are we the right buyers? How will we create value? How will we manage the downside risks?

When everyone else is making deals, remember what your mother told you: Just because someone else is doing it doesn't mean you should, too. Stick to analytics and logic, and avoid an added risk: When you're late to the party, don't expect to find all the cute guys and girls waiting for you.

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THE PROBLEM

Not all synergies are created equal.

Synergies are the lifeblood of so many deals, but only some—typically those based on cost savings—are likely to be realized. Synergies that depend on revenue enhancements, from cross selling, bundling products or creating a one-stop shop, are notoriously difficult to pull off.

Realizing synergies takes up management time. They require various outlays (severance packages for laid-off workers, for instance), and often call for additional investment, such as integrating IT systems, the bane of all deals. CEOs who don't factor in these costs often end up overpaying for a target, justifying a bigger price because they've overestimated how much net value they can generate via synergies.

THE SOLUTION

Don't overestimate the benefits, and underestimate the cost, of synergies.

In assessing a deal's potential, carefully evaluate where the synergies are coming from. If a deal's success will depend on synergies to boost revenue, as opposed to synergies that cut costs, then discount, or don't count at all, potential revenue enhancements when modeling the price you can pay to close the deal.

By the same token, don't forget to factor in the true cost of realizing synergies. Some experienced acquirers estimate that cost at two times the annual savings generated. So, for example, if your deal is going to yield $200 million a year in cost reductions, expect it to cost as much as $400 million over time to make that happen.

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THE PROBLEM

Integration mistakes can be killers.

Most savvy acquirers know that integration is messy, time-consuming and potentially dangerous. Watch out for these common integration mistakes that can slow down your entire effort and cause huge amounts of damage.

◆ ***Sweating the details after the deal is done.*** Never wait for the deal to close before devising a detailed plan to make the integration work. Savvy acquirers do their homework ahead of time, sometimes even before they've made an offer. How? By carefully following a set of potential acquisition candidates long before they may be ready to make a move.

◆ ***Missing the first payroll.*** I can't think of a better way to signal to employees of the target company that you don't care about them. Start the integration process before the deal is done. Take a page out of legendary football coach Bill Walsh's playbook and get your first 20 plays organized ahead of time. And make sure getting payroll right is on the list.

◆ ***Being slow to assign roles.*** Your best talent will start getting offers as soon as reports surface about a potential acquisition. The last thing you want is an exodus of top talent, while the B and C players are content to stay put.

◆ ***Taking customers for granted.*** Many a company has suffered customer defections because it was too busy trying to get its integration plan to work. Some successful acquirers appoint two business heads—one to lead the integration effort and one to run the business as usual. Make potential customer defections a metric to watch, and act on if necessary, during integration.

Dr. Finkelstein is a professor at Tuck School of Business at Dartmouth College and author of "Superbosses: How Exceptional Leaders Master the Flow of Talent." Email him at reports@wsj.com.