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M/A MOTIVATION

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Quick Summary: Understanding each party's motivation for pursuing a transaction is critical.

Abstract:

Just as in sales to a prospect, there is usually only one overriding and compelling reason for each organization to consider an M/A transaction. There can be many additional justifications used to support the single compelling reason. Each party needs to understand their compelling reason and the other party's compelling reason for pursuing the deal. Sharing these motivations, which will always surface later, will save both parties significant time and energy in pursuing the transaction.

Virtually all M/A transaction discussions are motivated by financial considerations that can take on many forms. It is easy to list several apparent advantages that the combined ownership or operations of two companies will provide that may not be available to either company individually. This notion is referred to as synergy and, in presentations and announcements, is often "mathematically" represented as "1 + 1 = 3." It is, of course, necessary to look far deeper and not take this commonly held belief at its face value.

The owners, board of directors, or others with a controlling interest in both companies need to thoughtfully and openly discuss this issue. Key managers will also need to be brought into the discussion to share their intimate tactical knowledge that may not be apparent to the owners.

In an M/A transaction, understanding THE single underlying reason behind the deal is critical. This is very similar to any sales situation in which understanding "the single compelling reason to buy now from you" as discussed in article 5.010301, "*One Question: Multiple Parts,*" needs to be determined. In sales, there is usually one compelling reason that can vary from person to person in an organization based on their roles or responsibilities. Once a person has decided, a litany of features and benefits can be used to justify the decision. The same principle applies to an M/A transaction. The following is a list of the most common reasons used to justify a transaction. It is not uncommon for the two parties to selectively use some of them based on the audience they are addressing. However, there is usually one and only one driving motivating force behind the decision.

Increased Revenue

It is difficult for a company to continuously increase revenue at a high rate through generic growth by offering more of the same products and services or variances of their current offerings. Acquiring another company serving a different market segment or operating in a different region can provide instant growth through consolidated reporting. The pressure by industry analysts and short-term traders on public companies for increases in revenue in each successive quarter is one of the major factors in stock price.

Increased Market Share

Similar to increased revenue, assuming that both companies serve the same markets, combined operations allows the new company to have increased market share vis-à-vis their competitors.

Increased Margins (reduced costs)

Increased margins or profitability through combined operations is often the single reason used to justify an M/A transaction. It is easy to calculate savings based on spreadsheet calculations of existing costs. The increased profitability usually comes through economies of scale (ex., high volume materials purchasing power) or the consolidation of redundant functions (ex., combining sales teams, customer service, purchasing, accounting, or manufacturing). Unfortunately, it often takes time for those cost savings to be realized. Impatient analysts and short-term stock purchasers may expect immediate benefits, which seldom occur.

Broadened Offering

The combination of two companies may increase either the breadth of their combined product offerings to be more attractive to customers or may increase their depth of offerings, allowing them to be more vertically integrated. The advantage of increasing the breadth of the offering allow sales reps to have more products or services to sell to their existing customers. With vertical integration, it may be possible to streamline the new integrated offering and reduce costs or increase performance.

Transition to a New Business

Many larger, more mature companies serving existing markets have a difficult time innovating for a variety of reasons. Commonly, their cost structure and/or “bureaucratic” processes may make purchasing innovative products and services from a smaller, more agile company less expensive and more timely. The new offerings may allow them to transition to a new business or update their current portfolio. This arrangement is probably the largest driving force behind startup acquisitions.

Market Perception

Similar to transitioning to a new business, some larger, more established companies may be interested in changing their public image. An excellent example are the companies that first embraced the Internet as a method for reaching customers. In many cases, their images were changed from being “old school” to being “new and progressive.” More recently, companies that embraced social media accomplished the same thing.

Staving Off Competition

Similar to transitioning to a new business, a larger, more mature company may acquire a smaller company before one of its competitors does. The acquirer may be interested in the company’s products, customer base, or perhaps only their intellectual property. They may also be interested in the other company, only to keep its products out of the market and protect their offerings.

Need for Capital or Resources

A smaller company may seek to merge with a larger company to fund its growth or operations. A small company may not have the funds, management bandwidth, reputation, or time to dramatically scale their business. Probably the best example of this is for a small company to merge with a larger company with a mature distribution channel that can offer the smaller company's products or services to their existing customer base. Many smaller companies experience severe cash flow problems as they grow. A larger, cash-rich company can ease that burden overnight by providing the required cash infusion.

Tax Benefits

Companies also use M&A for tax purposes, although this may be an implicit rather than an explicit motive. For instance, since the U.S. has one of the highest corporate tax rates in the world, some of the best-known American companies have resorted to corporate "inversions." This technique involves a U.S. company buying a smaller foreign company and moving the merged entity's tax home overseas to a lower-tax jurisdiction. This may substantially reduce its tax liability. In some cases, the purchased company may not even serve similar customers or offer related products.

Compliance Benefits

Sarbanes Oxley and other government compliance requirements can easily overwhelm a small company. Merging with a larger company that already has the staff and expertise necessary to meet these requirements can significantly reduce costs and access to the market. One very common and graphical example is a small company's difficulties in meeting Department of Defense procurement hurdles. A multi-billion dollar existing defense contractor could shorten that cycle from years to weeks.

Reverse Merger

In a reverse merger, a private company can short-circuit the expensive and time-consuming efforts to become a publicly listed company. In this type of transaction, the private company buys a publicly traded company with limited success or is in another distressed situation. After the transition, the resulting company has access to public markets and can raise capital by issuing tradable shares of stock.

"Just Plain Tired"

This category is not often discussed in the literature as the primary motivating factor for many small companies. It can be part of a business succession plan or relieve the principal players of their responsibilities and provide them a method to exit the business.

As discussed at the beginning of this article, it is easy to assume "all of the above" as the reasons to justify an M/A transaction. All may be true, but there is, most likely, one overreaching factor. Each party in the transaction should strive to determine their primary motivation and then share it with their counterpart. This is not a time to keep one's cards close to their vest. Open dialogue at the earliest stage is essential in the development of mutually acceptable arrangement.