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LIKELY M/A SHOW STOPPERS

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Quick Summary: Identify issues that could stymie an M/A transaction as early as possible in the discussions.

Abstract:

Many more merger or acquisition discussions start than end up closing. Although there are almost countless reasons for the transaction failure, a small number probably accounts for the majority of discussion terminations. Openly discussing and evaluating the most obvious show-stoppers early in the process can save time and effort on everyone's part. If it is decided to proceed, proactive plans can be developed to mitigate the risk of most show stoppers.

What are the odds of a first date resulting in a marriage? What are the odds of an initial discussion resulting in a merger or acquisition? These rhetorical questions are examples of the simple fact that more activities start than successfully finish. Just like a first date, initial M/A discussions can end up going nowhere for many reasons. There are a few reasons for M/A discussion terminations that bubble to the top of the list. Identifying their signs during the M/A dialogue early can either help to avoid the unwinding of the discussion or be indicators that terminating the discussion quickly is in everyone's best interest. Below is a list of the most common transaction failures.

Extreme Differences in Valuations: This issue was discussed in the previous article, "*What It's Worth*." As pointed out, company valuations are nothing more than opinions that are sometimes backed up with calculations. Those calculations are usually based on some gross, overall assumptions. Once an "unreasonable" value is presented, one party may never get over the shock and may simply walk away.

Missed Forecasts: The article "Why Mergers Fail" points to missed financial performance as the major reason M/A transactions are labeled failures. The underlying root cause is a lack of productivity, measured by lower-than-expected sales or higher-than-expected costs (less reductions). Although "failure" refers to post-merger results, the seeds of the failure can occur during the merging process in the form of missing revenue forecasts or the resignation of key personnel. In either case, one party may simply get "cold feet" and decide that the risk is too great to pursue the transaction.

Incompatible Company DNA: As discussions continue, it may surface that the culture of the two organizations is simply too great to allow a smooth transition and ongoing operation. The articles 5.050205, "*Incompatible DNA,*" and 9.020103, "*DNA Match*," discuss this subject for business partners and job candidates. This issue is equally applicable to merging companies. There is no right or wrong set of DNA characteristics. All that matters is that there are fundamental differences that may not be able to be overcome within a reasonable time frame or, perhaps, ever.

Personnel Integration: Companies of all sizes often share the same titles. However, roles, responsibilities, and span of control can vary widely. For example, a VP of Sales in a small company may be responsible for $500,00 in sales and manage two sales reps. Their counterpart at a large company may be responsible for one billion dollars in sales and 200 sales reps. Individual egos will become a factor as the differences are discussed. The result is often the resignation of key employees who are the true value-creators in the organization. Their departures will jeopardize the entire successful post-merger performance.

Business Partner and Customer Pushback: Existing business partner or customer relationships may be strained once others hear about the potential transaction. For a variety of reasons, some contractual and some emotional, key partners or customers may attempt to stop the transaction. One of the merging companies may find these issues too risky to continue pursuing the transaction. For example, a business partner that is a reseller of one of the companies may be a direct competitor of the other company involved in the merger and may no longer be interested in the reselling arrangement.

Differing Financial Norms: Many large companies assign significant costs to a product or service offering to offset their administrative cost structure. Assigning those standards (unwavering cost allocations) to a smaller company's products may dramatically change the profitability of the company, making the transaction less attractive. The same factor applies to large company customer support activities.

Competitive Mischief: Competitors, through a variety of sources, will find out about the proposed transaction. They will logically search for ways to create fear, uncertainty, and doubt ("FUD") in the marketplace. The result could be lost sales to one or both of the merging companies or the delay in sales as prospects take a "wait and see" attitude. For example, a competitor could suggest to a prospect that they receive a written guarantee from both companies involved in the transaction discussion that no changes will be made to the product/service offering after the transaction is complete. Those guarantees cannot be legally made in many instances.

Negative Public Reaction: Bloggers and social media junkies can quickly spread gloom and doom predictions or issues about the proposed merger as all of us have witnessed their impact. The truth has nothing to do with the "information" that spreads like wildfire almost instantaneously. A company involved in the merger discussions may decide that the bad public relations implications are too great to pursue the merger.

Regulatory Hurdles: When most common when publicly traded companies are involved, regulatory requirements and delays may slow or totally stop the transaction. Those delays may change the overall economics of the deal to make it unattractive.

Customer Mandates: Similar to the regulatory hurdle issues, current customers may not be able to continue their relationship due to internal or external restrictions. For example, a company that sells products to the Department of Defense may no longer be able to continue its relationship if it purchases them from a foreign entity.

Litigation: Actual or potential litigation can quickly cause merger discussions to terminate. For example, a large company may decide not to pursue a potential patent violation by a small, new competitor until that company enters into discussions with a larger company that represents a larger competitive threat.

As another example, a disgruntled employee may threaten legal action after they hear about the merger discussions to leverage their grievance. It is common that both companies need to disclose all actual and potential legal issues through a Representations and Warrants document prior to closing.

Far more potential show-stoppers can emerge than those issues listed above. The article, 7.030204, "*Staring the M/A Process*, " suggests that senior officials from both companies independently develop a list of potential show-stoppers that could occur and then share their lists with the other party. This exercise should be completed at the earliest stages of the discussions. With this open dialogue, both companies can collectively consider the risks and likelihood of occurrence of the identified issues. A mutually agreeable decision can then be made on whether to pursue the transaction or not. If the risks and likelihoods appear too great, it is far better to acknowledge them early, save time and energy, and avoid any repercussions before they occur. If it is decided to pursue the discussions, the potential show-stoppers can be taken into account, and plans to mitigate them before they occur can be made.