

When acquisitions go awry: pitfalls in executing corporate strategy

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However, there are instances where the loss of value makes one wonder what went wrong with the strategy of the company. This paper looks at five such cases (Table II) of significant value destruction, i.e. when acquisition was followed by divestiture at a much lower price. At the time, they were universally acclaimed in the media to be examples of acquisition failures due to bad management. A closer examination reveals several fault lines that companies frequently encounter as they execute their corporate strategy.

It is not easy to articulate a clear corporate strategy that applies equally to all the different businesses a company may be engaged in. Yet, because corporate strategy deals with visualizing the future and how the company fits into that scenario, the company's sense of identity and direction depend on a well-defined strategy.

A *business* strategy, on the other hand, deals with the present and focuses the firm on achieving and maintaining competitive advantage within a given product's marketplace. In his 2001 letter to the shareholders, for example, General Electric chairman Jack Welch explained the revision of an underlying tenet of GE's corporate strategy. He wanted his business heads to *redefine* their markets so that their businesses would have a 10 percent or less market share, instead of requiring them to be number one or two in their respective marketplaces. The objective was to view markets broadly and look for growth opportunities rather than defining markets narrowly to prove a leadership position.

Most corporate leaders consider mergers and acquisitions a vital element in the growth of the company, but mergers and acquisitions are only the means to an end and not an end in itself. They cannot be viewed in isolation and, unless the top management team shares a consensus on the company's direction, the acquisitions will be like pieces of a jigsaw puzzle that has to be completed without knowing what the picture is supposed to finally look like.

Drivers of corporate strategy

A firm seeks to address two main questions while evolving its corporate strategy: what businesses should we be in, and why? The answer defines the company's vision of the future and how successful it will be in satisfying its profit and growth objectives. The corporation could achieve its **profit maximizing** objectives through cost-reduction, where it leverages resources and generates synergies through economies of scale, or the company could maximize profits through revenue generation – widening and deepening market access. Here the firm can exploit its power in the market place by launching new products or entering new market segments and generating additional revenues.

The corporation's **growth maximizing** behavior drives its managers to seek growth opportunities when they discover a good fit between the firm and a new market opportunity. This may be very short term in outlook. In addition, the firm may seek to build a portfolio of businesses to help it reduce risk by operating in different sectors. Earning streams can be balanced as the firm achieves different rates of growth in different industries.

Acquisitions play an important role as corporations try to quickly execute their strategies. However, research is almost unanimous in criticizing acquisitions. Several empirical studies, using share prices as measures, have argued that acquisitions do not work the way they are intended to due to high premiums being paid at the time of acquisition. Apart from premiums, a clash of cultures while attempting to integrate the new acquisition causes problems of digestion. Yet M&A activity continues to be significant (Table I). Managers who see untapped niches or new ways of leveraging corporate resources have a continuing interest in pursuing opportunities in different businesses.

When an acquired unit is divested, the divestiture seems to prove that the acquisition was a mistake. But this may be a hasty conclusion since divestitures often go hand-in-hand with acquisitions as companies remake their strategy. Moreover, a fall in share value is a short term indicator and may not truly represent management's long term intent. In a survey of 118 companies taken by KPMG in 2001, about 75 percent of the respondents believed that the acquisition transaction was a success. Moreover, only 25 percent of the directors evaluated the acquisition's effect on shareholder value as a measure of success. Anecdotal success stories continue to drive managerial interest in acquisitions as a fast track to growth.

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Table I Mergers and acquisitions

	1981 to 1985	1986 to 1990	1991 to 1995	1996 to 2000	2000	2001	2002 (first half)
Total number	11,706	16,301	23,168	44,434	9,122	6,389	2,482
Average per/year	2,341	3,260	4,634	8,887	9,122	6,389	na
Total value (\$B)	511.4	1,271.2	111.7	5,944.2	1,783.3	1,149.3	267.7
Average value/deal (\$ MM)	44	78	48	134	195	180	108

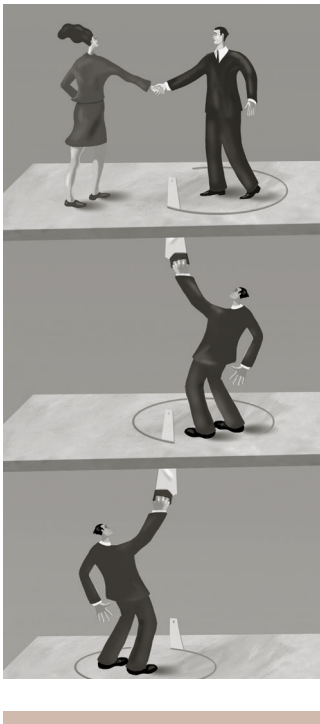
Source: Various issues of *Mergers and Acquisitions*. These represent only transactions involving at least one US firm, and with each transaction valued at least at \$5 million.

Table II The value destroyers

Acquirer	Target	Purchase		Sale		Value loss ¹ \$
		Date	Price \$	Date	Price \$	
AT&T	NCR	9/91	7.5B	1/95	3B	4.5B
Mattel	The Learning Company	12/98	3.6B	10/00	0	3.8B ²
Quaker	Snapple	12/94	1.7B	3/97	300MM	1.4B
Novell	Word Perfect	3/94	855MM	4/96	125MM	730MM
Anheuser Busch	Cape Cod Chips	12/85	7MM	5/96	5MM	2MM

¹ Value loss is the difference between purchase and sale price. Figures are as reported in the business press and are approximate.

² Does not include \$122MM the company agreed to pay in December 2002 to settle shareholder lawsuits alleging mismanagement on account of the acquisition.



they were universally acclaimed in the media to be examples of acquisition failures due to bad management. A closer examination reveals several fault lines that companies frequently encounter as they execute their corporate strategy.

Business and corporate strategies do not mix easily

Top management must be clear at the outset whether the acquisition is meant to serve the business strategy or the corporate strategy of the firm. If it is to serve the former, integration must be quickly achieved by laying out operating strategies and specific goals and setting up integration teams to make it work. Management must then focus on seeking benefits from integration in the form of additional revenues (from new sources of market advantage) or lower costs (from economies of scale and scope).

When an acquisition, on the other hand, supports corporate strategy, then management should focus on seeking benefits to the corporation through new skills and competencies that are being gained from the new acquisition. Learning, not integration, is the priority. Systems should already be in place to ensure synergistic benefits that would come from applying the new skills. But when corporate and business strategy benefits are confused in an acquisition, fragmentation often results and few actual benefits are realized.

When Mattel, the toy maker, acquired The Learning Company, an interactive software maker, it was seeking benefits at both levels of strategy. At the business level, Mattel wanted to extend its brands into software products and reach older children who were no longer interested in Mattel's core brands such as Barbie dolls. But at the same time, Mattel's corporate strategy intent was to evolve through acquisition from a traditional toy company to a global children's products company. Thus, Mattel was expecting to use the knowledge gained from the new company to revitalize its existing business while at the same time having a common distribution system. This caused several problems. In the toy industry, the retailer bears risks for unsold products while, in the software industry, returns are accepted. Distribution snafus resulting from these differences began to affect sales. Moreover, The Learning Company, with its own problems even before the acquisition, was a weak candidate on which to base a new corporate strategy. Mattel plunged into a turnaround mode.

When acquisitions serve two overlapping purposes – to reinforce an existing strategy and to change direction to a new strategy – it causes operational problems because implementation needs to be closely tied to strategy

Relatedness is not a sufficient condition for a successful acquisition

Top management often cites as a justification for a merger or acquisition that it is related to the core business. Relatedness is usually established by showing similarities between different businesses in areas of inputs, technologies, or markets. The organization believes that its existing manufacturing or marketing expertise can be leveraged with the new business. Extracting the benefits of relatedness through economies of scale or scope requires a focus on operational efficiency and offers few benefits at a strategic level.

Trying to reconcile the distribution channels of even related businesses can cause serious problems. Quaker's Gatorade, for example, sold through supermarkets and convenience stores, while Snapple initially sold through delis and corner stores. Quaker initiated efforts to reorganize the distribution systems but backed off when Snapple's distributors resisted. Quaker then altered the quirky advertising style of Snapple, diluting its special appeal.

Potential synergy vanishes in the details

Businesses are not products that add to a portfolio, but rather bundles of competencies. It must be clear where the synergies are expected to emerge in an acquisition. Anheuser Busch thought there were many complementary opportunities among beer, salty snacks, and sports markets. It was not able to derive any benefits from holding them together and, after seven years, adopted a back-to-beer strategy and liquidated the Eagle Snacks division.

There are, perhaps, greater chances of synergy when the businesses are related, but, as noted above, concerted effort is required for synergies to emerge. This requires designing proper operational strategies. If there is no integration, the firm is just like a holding company.

AT&T was hoping that the expertise of NCR would help in fixing its own computer division, which was in trouble. NCR had a free hand. After a promising start, AT&T found the process was not working well and it integrated the two operations. AT&T Global Information Solutions, the resulting business, was headed by AT&T people. The problems compounded as the expected synergies between NCR's computer systems and AT&T's Unix and networking technologies never materialized. Culture clashes also created obstacles. The potential for synergy vanished when AT&T realized that telecom equipment and computer technologies were similar but not the same.

There is more to post-acquisition care than mere integration

When an acquisition is in the same line of business, close integration is necessary to achieve the desired economies of scale and make inroads into new market segments. But the process of integration must take into account the uniqueness of the strategy of the unit that has been acquired. As part of its push into snack foods Anheuser Busch built its Eagle division through an array of acquisitions. Cape Cod Potato Chips (CCPC) was one of them. In the process of integration, CCPC's brand management and distribution was also integrated. CCPC was a niche premium brand vaunting its kettle-cooked process and priced higher than other brands. In the fight with Frito Lay for market share price wars erupted and CCPC's specialty needs were ignored. It was treated and positioned like the other brands of Eagle. When finally Eagle lost the battle in the market place, and discontinued operations, CCPC was sold back to its original owner.

Quaker Oats saw strong similarities between its Gatorade sports drinks and Snapple Teas. Having made a success of the former, it wanted to expand its position within a "beverages" industry that it thought both products belonged. But they occupied very unique positions in different segments of the industry and Quaker could not extract any benefits through leveraging its advertising, and distribution expertise.

Re-evaluate the vision and retreat early when necessary

Companies tend to subsidize activities to support a vision, rather than check frequently to see if the vision is realistic. AT&T put up with losses in NCR almost from the start because it was generating sufficient revenues from its long-distance telephony. It was determined to make the marriage of computers and telecommunications work. Every futurist was subscribing to an integration of voice and data processing capabilities at that time, so one cannot blame AT&T. Where the company can be faulted is in not cutting its losses earlier when it found that its implementation of that strategy was value destroying.

We began by referring to these five cases as those of value destruction. They were failed acquisitions in the sense that they were sold at a price significantly lower than the cost. But the cost of not making a bold decision is that of a failed opportunity and a desire for above-average profitability requires bold decisions. What is important is to learn from the wrong decision and retrace steps, through a costly divestiture if necessary. When Novell acquired Word Perfect and QuattroPro spread sheet to build an applications suite to rival Microsoft, it was hoping to use its networking skills to launch a complete office suite that would work on a network. Networks were the rage and Novell was leveraging its resources. Unfortunately, network-enabled applications were not at the top of the customers' wish list. But if it did, Novell would have had a winner. AT&T continued to cling too long to the vision that communications and computing could be integrated for customers' benefit.

Was value really destroyed in these acquisitions? Yes, going by the figures in Table II. Of course, although these cases are glaring we must also bear in mind that the unit that was divested is most probably not identical to the unit that was acquired. During the time it was under the care of the acquirer, several efforts at integration or transfer of resources to the parent would have altered the value of the unit without the price reflecting the benefit that had been extracted.

Although these units were divested at significant losses to their parent, some of the new owners built value out of them. Triarc bought Snapple from Quaker for \$300 million, rebuilt the brand and sold it to Cadbury Schweppes in 2000 for \$910 million. Stephen Bernard, the founder, bought Cape Cod Potato Chips back from Anheuser Busch, fixed it, and then sold to Lance Inc. in 1999 for about \$30 million. NCR continues as an independent company with improving performance.

Success or failure of an acquisition is the result of a combination of several factors rather than being unidimensional. Thus, *Business Week's* study, reported in October 2002, concluded that 61 percent of buyers in M&A deals destroyed their own shareholders wealth. Even a well conceived acquisition can fail if the post acquisition process is not paid sufficient attention to. Acquisitions will continue to be popular since they are a rapid means of crafting the corporation as it attempts to continually fit with a changing environment. What is important to remember is that the acquisition is only one piece of a larger corporate strategy. That vision of a corporate strategy must be constantly evaluated and divestiture decisions made before it is too late.

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**Corporate strategy,
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