Mergers & Acquisitions in a Downturn

'Buying low' can be a major driver of high performance

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By most accounts, the global economy appears to be entering a broad, deep and potentially long recession. However, a downturn doesn’t affect all companies—and their prospects—equally.

While many organisations are struggling, there are enterprises with strong balance sheets and good recent economic performance that are well positioned for exercising inorganic growth options. These companies should find the current environment highly conducive to creating value from acquisitions.

In fact, acquisitions during a recession can actually create greater value and impact for three reasons. First, the 'entry price'—the cost of gaining access to the stream of cash flows, market segment, capability and synergies from the acquired business—is often much lower, as companies' market capitalisations have dropped around the globe to levels around 40 - 70 percent below where they were just a year ago. Second, due to the lower values, organisations are able to go after targets that were formerly out of reach. This allows them to make a bolder 'strategic play', gaining market and leadership positions that they might not have had the resources to do before. Third, companies that are heavily reliant on debt and equity financing, or that have less favourable financial positions, typically must sit on the sidelines, meaning far less competition for an acquisition, and, thus, fewer companies bidding up the price.

'Cash is king' in this environment, so instead of just hunkering down, companies in a strong financial position should capitalise on 'sale-priced' acquisition opportunities to help fill strategic gaps, buttress market positions and add to organic growth. This may take some convincing for many Boards as the inclination may be to conserve cash, wait until market volatility subsides, and avoid riskier overseas forays that may test increased protectionist tendencies by governments in a downturn. Industry leaders, however, will balance the risks and capitalise on the best target opportunities.

Yet even when done at a discount, mergers and acquisitions still have inherent risks in terms of integration complexity, organisational disruption and management distraction. The keys to successful M&A during a downturn are the same as during prosperous times: make sure that the underlying valuation correctly measures realistic revenue potential; stay true to growth strategies and look at targets that increase competitive positioning by filling an identified need; properly address synergies; and effectively execute the integration of an acquisition so the enterprise can meet the operational and financial targets justifying the deal.

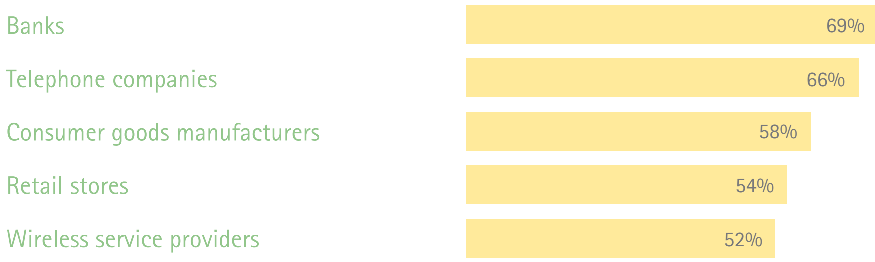
Five keys to successful M&A

Based on our experience helping clients complete more than 400 mergers or acquisitions—including six of the 10 largest—in the past six years,

Results of Consumer Opinion Survey on M&A

Survey question: Do you believe consumers benefit when companies merge or are acquired?

Percent of respondents that answered "No"



Source: Accenture M&A Survey, 2005

Accenture believes companies looking to use acquisitions as a means to gain scale and generate growth during and after a downturn should consider the following five critical actions.

1. Fine-tune M&A strategy and screening methods

A key goal of M&A should always be to fill strategic gaps. Yet many companies, especially those with corporate business development groups, do primary candidate screening based mostly on financials. Instead, the first screen should focus on whether or not an acquisition could satisfy a strategic need, such as geographic, skill or product gaps. This also helps to expand the universe of possible targets by including the acquisition of product lines (instead of entire companies) and/or orphan divisions.

2. Look for discontinuities

By discontinuities, we mean situations in which good companies have been dragged down by the overall market and/or by weaker companies in their peer group. How does one find discontinuities? Look for companies whose underlying fundamentals have not changed, or where the decline in their value drivers (such as customer growth) should not be as steep as the market valuation suggests.

3. Focus on synergy potential

While synergy valuation should always be part of M&A, a realistic expectation of synergy capture and timing is even more critical in a downturn, when cash flow and balance sheet fundamentals are key for the acquirer. Identifying and appropriately quantifying synergy potential requires a skillful blending of industry comparable benchmarks (to determine the magnitude of what's possible) and opportunities specific to the merging companies (for instance, consolidating redundant manufacturing facilities to save costs year-on-year).

By marrying the two perspectives, a company can determine whether the industry benchmarks are realistic and whether the targets specified are aggressive enough.

4. Execute to realise the potential

The ability to effectively integrate merged or acquired businesses is the single biggest determinant of whether proposed synergies can be realised. In our experience, three key steps can help companies successfully integrate. The first is to carefully focus the integration activities on those areas that really create value, rather than adopting a checklist approach that tries to integrate everything possible. The second is establishing an integration team with a well-defined charter and scope, as well as a full-time staff of experienced and knowledgeable managers. The third is determining the requirements to minimise the gap between the day the merger is approved by the government and the day the merging companies are expected to begin operating as one integrated enterprise.

5. Maintain customers focus

Even at the best of times, the majority of customers feel they do not benefit from mergers or acquisitions (see figure above). During an economic downturn it can turn into a real challenge. Companies fighting for survival will take aggressive measures to stay afloat and maintain cash flows by targeting new customers with price cuts and other incentives. So it is important to take a proactive approach to customer retention. Clearly communicate the intended benefits of the merger to customers. And act with speed during integration to get the combined organisation back to 'business as usual' as soon as possible.

Conclusion

The current economic situation is challenging for companies, and the level of uncertainty is likely to continue. That's why it's important for executives to avoid adopting a bunker mentality as the only possible strategic option. We know that well-executed acquisitions—buying the right company at the right price and integrating successfully—can create tremendous value, and that the potential for value creation is even higher if targets can be acquired at lower prices. By capitalising on the buying opportunities in a downturn, strong companies can become even stronger and position themselves to achieve high performance—both in the near term as well as when the recovery ultimately comes.

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About Accenture

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