

Beyond the Deal Newsletter

*Mergers and Acquisitions that
Achieve Breakthrough Gains*

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August 2011

Quote of the Month

"HP has suffered through a string of 3 really lousy CEOs. Apotheker is just the latest. All had comparable failings.

- They were wedded to their personal histories (what worked for them before) and old-fashioned, out-of-date business ideas.
- Where Steve Jobs led Apple on a course to deliver what people wanted in the future, Fiorina, Hurd and now Apotheker drove HP with their eyes firmly in the rear view mirror, ignoring major trends changing markets.
- Where Steve Jobs built a company capitalizing on market shifts to introduce new products that grew sales and value, their lust to buy old businesses and enter profit-sucking gladiator wars with me-too products killed value."

Adam Hartung, Forbes Contributor, August 25, 2011

In the August Newsletter:

August has been a month filled with upheaval. This is the month that world economies took front row seats on a major economic roller coaster ride that had many of the signs of heading into a next global recession. In the midst of all of this volatility the M&A world had its greatest volume "Merger Monday" for acquisitions of all of 2011, to the surprise of many. Adding a further dimension to this extraordinary and contrary mix, HP and Bank of America announced massive corporate divestitures. Their sell offs are the outcome of ill conceived acquisitions and ineffective integrations that took place years earlier, in 2008 and 2004. At root, all of this underscores the reality that acquisition strategy and integrations are not a sprint, but instead are a marathon: a whole process, not a loosely joined series of event...This and more in the August Newsletter!

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World Economy on Roller Coaster Ride but M&A's Continue Unabated

What an August...Let's hope your seat belts stay fastened!

Turmoil in the stock market, the first ever downgrade of the United States credit rating and a debt crisis in Europe ... The market is down 600 plus points one day and up 400 points the next, and on and on. All of this wreaks havoc on valuations as well as creating a thoroughly unsettling environment.

In a normal world these stunning conditions would suck out all of the energy for undertaking acquisitions of almost any size. That is what took place starting in 2007 and continued through 2009, where only the acquisitions that took place were characterized as bottom feeding. While there might be caution and trepidation among some this time around, for others this massive market volatility was brushed aside as a cluster of \$18 billion dollars of acquisitions were announced on Merger Monday, August 15.

With its vast hoard of cash on hand, Google is acquiring, buying Motorola Mobility for \$12.5 billion. This is Google's largest acquisition by far, one in which concern over difficult markets and potential anti-trust issues are outweighed by what could be considered a remarkable need and strategic opportunity, both defensively and offensively. (Note that other technology companies are also sitting on enormous stores of cash. Apple has about \$76 billion in cash and Microsoft has \$53 billion on hand. They, and others, may well follow and join the acquisition fray.)

At the same time, major non-technology acquisitions came into play as well. Big moves included Transocean Ltd. paying \$2.2 billion in cash for Aker Drilling ASA, the \$3 billion Time Warner Cable Inc. offering for Insight Communications, and in the agricultural sector, Cargill buying Provini, an animal feed producer, held by Permira.ir for about \$2 billion. But that hardly is the end of the acquisition rush. On August 24, Express Scripts Inc and Medco Health Solutions announced their \$29 billion merger.

As Scott A Barshay, a corporate partner of the Cravath, Swaine & Moore law firm, aptly put it,

"Even intense market volatility won't get in the way of strategic deals ...Well-capitalized companies are focused on the years ahead, not the last week of trading."

So, what is going on here? Strategic opportunities are trumping market conditions. Regardless, it is well worth inquiring as to whether any of these acquisitions are being irrationally prompted by bloated balance sheets, resulting in large scale but questionable and risky deals that are not thoroughly thought through. Many of these acquisitions are not simple bolt-ons to existing organizations, but to make the most sense, will require a recasting of the acquirer as well. We shall soon enough see how capable these firms are to go "beyond the deal", with a well grounded and comprehensive integration effort. As we discussed in the July Newsletter, there is a lot more involved in these major acquisitions than "getting the trains to run again." The real promise of these major acquisitions lay in leveraging the full range of assets to create unprecedented value. Time will tell how able these firms are at realizing that promise or if they are heading into hazardous and unsupported territory.

Acquisitions and Divestitures: B of A Sells Off Credit Card Unit, HP To Shed Its PC Business

The divestitures by Bank of American and HP, also announced in August, give a cautionary reminder of how costly myopic acquisition hopes and flawed strategy can be. In these two cases poor strategic thinking undermined these transactions from the moment they were completed.

Bank of America is shedding its \$8.8 billion Canadian credit card venture to TD Banking Group to compensate for the financial instability that arose from the \$4.1 billion rescue acquisition of sub-prime mortgager, Countywide Financial in 2008. B of A is putting its remaining European card portfolio on the block, as well as selling off half its interests in the China Construction Bank (\$8.3 billion), for the same reason. B of A is struggling to regain its footing as it reels from losses in the troubled sub-prime mortgage division. What looked like a bargain acquisition has turned out to be the exact opposite. It has resulted in enormous collateral financial losses, a vast amount of distraction and extensive opportunity costs that amount to a very high price to ultimately pay for an "attractive price".

HP's decision to selling off its personal computer business is a case of controversial and flawed understanding of what was needed to grow the company, in this case a \$25 billion mistake. HP CEO Leo Apotheker is offloading a unit "the founders never liked anyway.

David Packard only reluctantly agreed to focus on PCs in the early 1990's. And Walter Hewlett, a board member and son of co-founder Bill Hewlett, undertook an unsuccessful campaign to block the 2002 acquisition of Compaq Computer Corp., a deal that vaulted Hewlett-Packard to the top of the PC industry", but fundamentally misdirected the energies of the company.

"From Hewlett-Packard's beginnings in 1939, the company's founders set out to invent one-of-a-kind products and tools for engineers. They never intended to become the biggest provider of a commodity product," said Michael Cusumano, a professor at the Massachusetts Institute of Technology's Sloan School of Management. As PC profits deteriorate as competition from Asia producers and other platforms emerge (tablets, etc.), Apotheker is seeking to return to that philosophy.

"Their DNA never included being a commodity consumer products manufacturer, which is what the PC has become," Cusumano said. "It's certainly not where the action and innovation is in the business these days. They can reinvent themselves. They may have the capability to do it." Some have said that HP would have been better off selling its computer business to Compaq in 2001 and returning to its core business, instead of acquiring Compaq for \$25 billion. Now it is selling off that business while it is simultaneously acquiring British software firm Autonomy for \$11.6 billion. Is HP making a new strategic blunder? There are those who are saying that is exactly what is happening.

Both of these divestitures make the case that the whole strategic acquisition and integration process needs to be under continuing review to insure they are in accord with principles of soundness and alignment. Mistakes and misjudgements are just going to happen in this imperfect world. But, a sound acquisition/integration process tends to improve the quality of decision making in the first place, significantly mitigates the prospects for risk and enhances the ability to make necessary course corrections as the company moves forward.

Google Chairman Communicates to Its UK Stakeholders

Shortly after Google agreed to acquire Motorola Mobility for \$12.6 billion, Google Chairman Eric Schmidt gave a keynote speech at the Edinburgh TV festival on August 26 on how Google will launch its Internet TV in Britain within six months.

This is an excellent example of how a company manages the execution of its integration communication strategy to key stakeholders, in this instance, British TV executives. The Motorola Mobility acquisition gives Google another chance to build a successful Internet TV platform. Google's previous effort in this area failed and Google is now gearing up for a second and more auspicious launch.

For Google, integrating Motorola Mobility is not purely an internal integration matter. Effective integration is comprehensive integration. It entails continuously communicating the value of the new Google to its critical external stakeholders. This involves engaging with stakeholders to support its move or at least to neutralize their opposition. Google clearly signaled the significance of its intent by committing its most senior leadership to carry out this outreach. It chose the

Edinburgh venue to deliver an unprecedented keynote lecture in a highly prized public setting. Schmidt's address is even more newsworthy in that he is the first person from outside the TV industry to make the keynote lecture in the thirty-five history of the event. This is not an isolated or chance occurrence, but part of executing a broad ranged stakeholder communication strategy. Expect to see many more instances of its communication strategy as Google continues to systematically go out to its broad range of global stakeholders.

Aligning the Values of Legacy Companies into a Single Company

How does an acquiring company operate in this volatile landscape? Perhaps the most essential element is for decision-makers and all the other actors who are involved to reground themselves in the acquirer's core organizational values.

An emerging company's underlying values will either support or disrupt your effectiveness in achieving your goals. Working in a single company where the leadership acts on one set of values, the middle management acts on the basis on another, and the line workers act on the basis of a third set of values is difficult enough. This dissonance is compounded during a large scale acquisition where multiple value sets coexist after two major, complex companies combine. If you don't manage this situation well, these conflicting sets of values will undermine the best intentioned and best financed acquisition. The extent to which the core values align and are commonly held in an emerging company will play a key role in determining whether that company will achieve the necessary level of employee engagement and commitment. Shared values create a trusting environment where knowledge is not seen as a source of personal power, but rather as a common resource.

Managers and leaders often overlook and under-appreciate the role of values in knowledge generation and transfer, yet it is not difficult to identify the values that drive individual and organizational behavior. Those values support, or disrupt, the company as it moves forward toward quantum leap gains.

In our rapidly changing world, command-and-control leadership is losing its ability to mobilize for rapid response to the wide variety of complex demands that a company faces. Values-based organizational networks, coupled with a set of compatible partners, are more able to provide viable responses to customers. This difference is especially important in a world where diverse global customers have come to expect high performance regardless of their location, their needs and when they require a response.

This does not mean that companies can take a shortcut by establishing a hard-and-fast set of rigid, uniform values. What may be considered to be a core value in one company may not be

valued in the same way in another company, or even a different part of the same company that is operating in another culture or another part of the world. The goal of alignment is to create the capability to leverage the diversity of positive values of the two legacy companies in your newly emerging company, not to drive everyone to march in a lockstep fashion or to have cookie-cutter sameness. Diversity has to be seen as an opportunity to get beyond a too-limited viewpoint, not something to be squelched for efficiency's sake. What is needed is to find a core group of values that are among the overlapping values between one legacy company and the other. If this core group includes such values as integrity, respect and responsiveness, the the other particular values can be seen as complementary.

What is key is to have a minimum set of commonly held values that will serve as the foundation for collaboration and interdependence across the new organization. Beyond these few values that must be held in common, all other values can be held in the the full diversity that is needed to serve a wide base of very different customers.

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All the best,

Jay Chatzkel

Progressive Practices

Jay L. Chatzkel is coauthor of the [Beyond the Deal](#), and editor of the Newsletter. He is Principal of [Progressive Practices](#) where he assists organizations in transforming themselves into knowledge-based, intelligent enterprises. This includes working with organizations to develop skills and practices in the areas of merger and acquisition integration, intellectual capital, knowledge management, leadership and collaboration, business process management and performance measurement.

He is also author of *Knowledge Capital: How Knowledge-Based Enterprises Really Get Built* (Oxford University Press, 2003) and *Intellectual Capital* (John Wiley & Sons, 2002).
