How to avoid failing in Big Deal M&A by asking some simple questions

The track record of those doing Big Deals is not convincing

Why do so many big M&A deals fail? Business literature consistently reports that more than half of all deals do not deliver their planned business case. Quite a few of these big deals result end in downright misery. For this, explanations range from deal fever to groupthink[1]. Fortunately, methodological solutions are available for operating better M&A processes[2]. This article, however, is not about a better M&A process as such. This blog just shares an insight I recently got and that I believe may contribute to your next deal's success. This insight came to me when I attended a lecture at the history faculty of Leyden University. Historical research, summarized by professor Sir Lawrence Freedman from King's College, London, suggests that **'(military) alliances are a precursor to war'**. Let me explain why I believe this observation, perhaps rather improbably, matters to the business of doing Big Deals.

You make friends before you need them

Military alliances have been numerous in the past. During World War I, T.E. Lawrence, better known as Lawrence of Arabia, united various Arab peoples in an alliance to push back the Ottomans from the Arab peninsula and the Levant. United and allied the Arabs stood a chance against the Ottomans – divided they wouldn't. The alliance was a preparation for war. Similarly, the World War I 'Triple Alliance' of France, Britain and Russia prepared for a war nobody wanted, but most of all nobody wanted to lose. When wars are fought between symmetric, equally capable parties, numbers matter. When closing an alliance offers you the larger numbers, these larger numbers enable you to take a chance and try your luck. Closing alliances is making friends before and because you need them. What is true in war suddenly seemed true to me in business as well. When companies close an alliance or do a Big Deal, the key words mentioned to justify such deals are often 'increased joint market shares' and 'economies of scale' that deliver synergies. Numbers matter – just as much in business competition as they do on the battlefield.

A business environment is rarely static

Realizing business scale through big deals necessitates one or more deals to materialize. Rarely can corporate leaders simply decide for themselves. In most companies there are checks and balances. Hence, a plan for a big deal requires authorization. To get such authorization, a plan needs to show the superior value of doing the deal versus not doing the deal. The question now is: how to calculate such value? Prior to closing the deal, the competition in an industry may be transparent. The top-five in a global industry may together have 70% global market share. Now the global no. 2 and no. 4 plan to join. In doing so, they plan to become the new global leader. When no. 2 and no. 4 join, they must calculate the value they create against an industry environment that they need to predict.

The easiest and most common forecast of an uncertain future is to predict 'all other things to remain equal'. When you have no idea about tomorrow's weather, the best guess is that it is the same as today's weather. For forecasting the value creation of Big Deals there is an inherent benefit in doing this. The first benefit is that it is compelling. Forecasting anything but today's situation is speculative. For every speculation a counter argument is available. That is an endless road. This is especially true in the feverish, time-constraint climate in which Big Deals are being planned. A second benefit is that 'all other things being equal' is usually favoring a business case. Post-deal markets rarely are equal to pre-deal markets. Usually it is not the deal-making companies that benefit from changes in the market climate.

This is where I believe the insight from history kicks in. An alliance is a precursor to war. War often results. The war, however, does not need to be started by the deal-making parties… Germany started World War I when it felt increasingly anxious about the potential future effectiveness of the Triple Alliance. The earlier it started the war, the less time the Triple Alliance would have to align and operate together. In business terms one would say, the less time the Triple Alliance would have had time to harvest its obvious synergies.

Wars neither in the military nor in business have a natural tendency to create value for those involved. When the business case for a Big Deal rests on stable product market prices before and after the deal, the question is whether the other market players allow the newly allied parties that luxury. When prices change in business war, the usual direction is down, not up… How resilient is the Big Deal business case to such hard-to-predict but potentially highly impactful effects? The better question of course is: how to make a business case more resilient. Let's look what can be done.

Open questions that need to be answered

The last thing I want to suggest is that because Big Deals are signed without the right questions having been asked. Firstly, I don't have the empirical or other evidence to proof such postulate. Secondly, even when the right questions have been asked, things may still go wrong for unanticipated and sometimes truly unimaginable reasons. Despite this disclaimer I still have the audacity to suggest some questions that I believe are better answered before signing a Big Deal. Another disclaimer: lists like this are never exhaustive.

- What competitor war moves would your alliance (Big Deal) possibly trigger? How can you think the unthinkable? What product price / value implications could such moves have? How does your business case look when assuming a worst-case scenario?

- How will your customers respond to the Big Deal? Everyone calculates potential post-transaction dis-synergies: how can you prevent these calculations to be too optimistic?

- How may regulatory authorities in the home countries of your competitors respond? How could regulators hurt you most? How likely will they act and why? How can you pacify them before they hurt you? How could your deal trigger protectionist measures by Government supporting your competitors against your increased market presence?

- What is your most valuable and vulnerable business position post-transaction? How can you pre-empt future competitor attacks on that position?

- Consider yourself to be living five years later. The deal has failed. Now execute a pre-mortem analysis. What pathways can you define to reach that undesirable end-state? How probable are the events in such pathways to lead to the undesirable end-state? What early warning indicators do you identify that things go off-track? How do you in your post-transaction execution ensure you monitor these early warning indicators timely – in order to correct things before they go wrong?

- The ultimate question: what if you don't act and ally, but your competitor does?

Asking questions is easier than answering them. Looking with hindsight at lost wars and failed deals is easier than pre-empting bad outcomes. But worst, I believe still, is not using insights when they are free and out in the open, shared in a history lecture at Leyden University!

Notes

.1. Elgersma, E. (2017), The Strategic Analysis Cycle – Handbook, LID Publishing London, pp. 461-475.

.2. Zink Secher, P., Horley, I. (2018), The M&A Formula – proven tactics and tools to accelerate your business growth, Wiley, Chicester.