A research study that investigated success criteria for mergers and acquisitions in the marketing communications industry revealed that an ‘ability to execute’ successfully throughout the process of a deal is critical. Anthony Mitchell and Simon Hill share insights, tools and techniques that improve execution performance.

The great M&A gamble

Successive studies\(^1\) have estimated the success rates of mergers and acquisitions at no more than 50%. This represents an evens bet - the spin of a coin. Between 2000 and 2003, accountancy firm Grant Thornton\(^2\) recently estimated that the UK spent some £44 billion per annum on buying British businesses.

Over the past 24 months we have researched M&A activity in the marketing communications sector – a hotbed of M&A activity over the past decade. The sector includes advertising, creative, media and public relations agencies and advisors. Many of these companies are small, privately owned and may seek to grow at least partly through merger and acquisition. Some of these companies subsequently become parts of larger PLCs, or simply change hands – often when the original owner or partners retire or move on to new challenges.

We were keen to seek best practice and understand the lessons learnt. Success rates in this sector mirrored UK overall performance, with only half the deals meeting their goal. The key question therefore became ‘How can we improve the chances of success? If execution at each stage of the deal was to be crucial, then what tools, techniques and approaches would we recommend?’ Further demonstrating the need for such understanding is the much publicised recent experience of Cordiant where too high a price was paid thus making it hard for investors’ expectations to be met.

Deal making experience

Our starting point was the experiences of people who had recently bought and sold businesses in the marketing communications sector. This we refer to as transaction experience.
The research: stage one
During the first stage of our research we surveyed 100 out of a total population of 300 transactions between 1997 and 2002. Face to face interviews then compared the views of acquirers and vendors. This qualitative information was supplemented by a questionnaire-based survey of 10 acquirers and 20 vendors. Marketing disciplines from advertising to sports sponsorship were represented. Similarly, the businesses ranged from owner-managed agencies to global groups such as WPP and Omnicom. For each transaction, we looked carefully at why and how the deal was managed through to completion. Attempts were also made to understand the tensions and inter-relationships between headquarters, vendors and acquirers. Our research covered the tone in which negotiations were undertaken, the degree of pre-acquisition planning, the efficacy of due diligence processes, the price paid, post acquisition communication and employee reaction.

The best deals scored four out of a maximum of five on most of the above criteria and had a particularly effective process throughout the deal – see Figure 1: Process drivers: best and worst transactions – where the latter score significantly lower on 11 out of the 12 criteria; the worst deals however, suffered from poor execution post-deal. We discovered a perception gap: acquirers evaluated their performance consistently higher than did the vendors. Interestingly, when it came to communications at senior management level both acquirers and vendors agreed on a high score. Opinions diverged however when other levels of employee were considered.

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- Retaining talent
- Structuring the deal
- Culture clashes.

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- Culture clashes.
Retaining talent is probably the most significant challenge for a recently acquired agency. The transaction is a disruption to the psychological contract that exists between the agency and its employees. Talent is the key asset of these businesses. An all too familiar story was of account directors voting with their feet closely followed by their clients. Faced with this scenario, what have you just bought?

Structuring the deal correctly is an important step not just in retaining talent but also safeguarding investments in the longer term. Earnout or deferred consideration deals dominate the transactions in the marketing communications sector. Vendors are rewarded for the post-acquisition financial performance of the business. This always focuses the mind. The problems come when profit maximising behaviour conflicts with the best long term interests of the business. This led us to consider the importance of getting the right performance measures in place. Financial measures that were historical or ‘lagging’ increasingly need to be balanced with ‘leading’ performance measures. Similarly, problems can occur when earnout targets can be achieved ahead of schedule. The HQ team of one acquirer commented that it mitigated the risk of dysfunctional earnout behaviour by closely scrutinising the management teams of the businesses it acquired. However, when we spoke to one such team, they commented that they had hit their maximum profit target after just two years of a five year deal and as such were not particularly engaged – certainly not as engaged as the corporate centre might have hoped.

Culture clashes have to be managed but are not necessarily negative. Several vendors supported the notion that tighter financial control had added rigour to their businesses in the post-acquisition era. Others were critical of oppressive paperwork, bureaucracy and control. Some employees believed radical change was needed and were disappointed when it did not materialise.

The above three concerns led us to identify further areas of required improvement. Specifically:

- The due diligence process should be ‘holistic’ rather than confined to financial and legal matters. This might include some consideration of the acquirer’s style of setting strategy and controlling its operations – referred to as ‘parenting style’

- Understand and pay particular attention to the key process drivers such as post-deal communication

- Deploy a range of performance indicators – over and above the key financial measures that would reflect the interests of stakeholders.

The next stage...

During 2003 over 20 additional meetings were held with acquirers, vendors, M&A specialists and industry commentators to assimilate more qualitative research. The idea was to develop greater insight into best practice on how M&A activity influences value, how approaches differ and the lessons for improvement.

Findings fell into two broad categories:

- The question of which deals are appropriate (usually regarded as ‘fit’)

- How the overall project or ‘process’ is managed – this considers the controllable elements of executing the transaction that then have significant impact upon ultimate success or failure.

Good deal / bad deal - planning and executing

This we refer to as transaction strategy. At this stage we also stepped back a little from the marketing communications sector in
the UK to explore several broader issues and to determine whether wider trends were supported by our sample.

**Focus on what you are buying and why**

Judgments on ‘fit’ - organisational, strategic, cultural can seem to be largely instinctive, borne out of deal experience and business acumen. There are ways to deconstruct this process into a couple of key principles. The first should be the ruthless pursuit of value. Our definition of success centres on value creation. It has been suggested that 80% of acquisitions fail as they do not create wealth for the acquiring shareholders. Vendor shareholders appear to be the only consistent winners. Most achieve the direct opposite - they destroy wealth. In our research only 50% of buyers rated their transaction success as ‘good or better’ against their set objectives.

**Figure 2: Transaction strategy** depicts possible synergies and maps them onto a timeline. The earliest/easiest to achieve are to the left. Many transactions only payback if the acquirer can achieve the real value-add which comes from a greater clarity of management focus, integration and cross-selling (the Holy Grail of Synergy)\(^5\).

The second key factor is measuring customer profitability. (See **Figure 3**, opposite.) Selden and Colvin suggested splitting the customer base into quartiles from high to low based on profitability\(^6\). We know from our research that it is not unknown for value creation from the ‘Darlings’ to be wiped out by losses from the ‘Disasters’. Net shareholder value therefore results from the ‘Dependables and Duds’, ie the middle ground only. This inevitably leads to mediocre rather than outstanding performance.
This analysis pinpoints possible synergies. Can the acquirer turn customers who potentially destroy value into profitable ones? Or close them down? Or perhaps, more devious still, sell them to less knowledgeable competitors? From a vendor perspective, these insights are crucial to assessing and hence maximising the full value of what is being sold, also to the policy regarding encouragement of key account directors and employees.

**Parenting style**
The combination of how Head Office works with its business units, subsidiaries and divisions led Campbell and Goold to identify three distinctive styles of setting strategy and controlling the business (now also referred to as parenting style – and parenting advantage, ie how is value created?) These were referred to as strategic planning, strategic control and financial control. For larger multi-business groups within the marketing communications sector, eg WPP and Omnicom; these organisations seem to share strategic control as a common parenting style; and as a consequence:

- Do they achieve the best of both worlds and occupy the middle ground? In practice tensions in control and decentralisation often create ambiguity and make this style of management the hardest to execute particularly where the ‘fit’ is not close.

- At best, the strategic control style accommodates the need to build a business and have tight financial performance. The business is responsible for strategy but it must be agreed with HQ, often leading to elaborate planning reviews where HQ subsequently ‘tests’ business managers, and may suddenly ‘pull the plug’ when short term finances deteriorate – and then key executives (and their clients) may become the ‘casualties’.

- Financial targets may be set separately – often the budget and the strategic plan are contrary. Risky investments drop out of the strategic plan as the budget is prepared, or periodic results emerge.

- Companies may display less internal growth but improved profitability. They sacrifice long-term development for short-term financial gain. Arguments slow down decisions – eg disposing of loss making business.

- Such conditions can make it difficult to undergo radical change when perhaps it is most needed in post-deal implementation, or simply in day to day operations.

**How to improve the chances of success?**
This we have called process excellence. From a process perspective, here are some important aspects to consider:

**Experience of making deals**
Rovit and Lemire argue that some companies (generic, not specifically marketing communications) are constantly seeking growth through acquisition, irrespective of market cycles, the economy, stock prices etc. They seem to generate above average returns on the deal. In contrast, companies that only seek acquisitions in a recession, or in a growth stage of the business growth cycle, or when the market is in the doldrums, do less well. The
inference is that deal making experience and knowledge are invaluable - the more practice, the better businesses seem to get at mergers and acquisitions.

**Performance measures**

You would not choose to drive a car with a blindfold. But that is what some executives are effectively doing. Holistic approaches to due diligence should encourage the continued use of non-financial measures especially customer and employee satisfaction based after the deal. There also seems to be a need for linking such measures to ‘earnout’ targets. In particular, for those deals which do indeed trigger the earnout targets quicker than envisaged, there is a need to retain key stakeholders and continue to motivate the new acquirer team. Successful acquirers such as Noel Penrose at Omnicom understand this - but unfortunately it is not true across the marketing communications sector, nor more generally where an obsession with legal and financial due diligence causes ‘so called’ softer issues to be sidelined. Vendors need alternative offers to be sure that they are getting the most attractive deal and to understand the buyer’s propositions. This means meeting a range of suitable buyers. ‘Marry in haste and repent at leisure’ seems to be the consequence.

**Relationships, communication and the management of expectations**

Each transaction serves up a unique cocktail of factors to consider. The relationship perspective is well worth considering. Who are the key stakeholders? How are they likely to be affected? How might they react? How should we be communicating with them and hence managing their expectations? Nowhere is this more true than in the marketing communications sector where client and employee relationships are the economic engine of the business.

It is not possible to be too prescriptive in this area. There is always an exception to the rule. The message is to dedicate sufficient time and resources to considering it adequately.

**Paved with good intentions**

Whilst few argue against the thoughts put forward on transaction strategy and process excellence these good intentions may be common sense but are by no means common practice.

Put another way, no-one sets out to do a ‘bad deal’, which will destroy shareholder value. Furthermore, there is no shortage of knowledge on best practice within corporations, published by academics or experienced by practitioners. Yet deal success rates remain largely unaltered and are unimpressive. The knowledge and theory are well researched and at least partially understood: why then is it so difficult to successfully put into practice?

Perhaps we know what to do, but are not very good at the ‘how’ or - as is often the case - lack the time, resources, and leadership to implement properly.

This is an execution issue and the implications are that:

- Ill-conceived deals proceed and are doomed from the outset - there has been a failure to execute transaction strategy.
The following checklist is offered as a start to improving the chances for success.

- **Avoid being too adversarial** - even in transactions between willing partners, a spirit of confrontation often follows hard on the heels of the initial courtship. Why? There should be a clear and common goal to which everything else is subordinate. Although at times you’ll need to be stubborn and stick to your guns, don’t let this dominate. The ideal is collaboration rather than competition with partners, colleagues and associates. The style of leadership we would advocate is essentially forthright, but willing to learn and to listen, able to provoke rather than force change.

- **Post-acquisition changes** - focus on where the value-added potential arises, when change is required - then ‘go for it’; the staff are likely to anticipate change. Typically, employees anticipate...
rather more change and at a faster rate then is often the case. Ensure that the deal structure does not overly restrict the opportunity for change. For example, some earnouts require the vendor business to be ‘ring-fenced’ to ensure fair dealing in the calculation of deferred consideration.

• **Consistent communication** - align what is said with what is done in practice, and beware of one message in private and another in public. Managing messages should be a core competence in the marketing communications sector yet in our experience this is not always done well. Consider ‘need to know’ and timing carefully and look beyond the boundaries of the business to address the wider stakeholder community.

• **Improving on earnout** - review ways to sustain performance over and above earnout targets. Imaginative incentives for key fee earners are crucial for sustainability.

• **Measurement insights** - go beyond the financials, link to categories of client and influential members of staff. We suggest a mixture of lead
and lag indicators using the now familiar ‘Balanced Scorecard’ format and approach.

**Employee impacts** - plan, target and assess the reactions of key staff. Involve people. The better resourced, trained and motivated the staff, then the more likely they are to satisfy the clients, who will remain loyal - and the company then earns profit and stable growth in the medium to longer term. This is known as the service profit chain.

**Codifying chemistry** - the success map (see Figure 5) highlights the interrelationships between the business drivers. It pinpoints explicitly what needs to happen to make the transaction a success. This has to be an improvement over the ‘black box’ approach where all the talk is of chemistry, yet detail on ‘how’ results are to be achieved is in short supply. We see this as an important tool in working towards nurturing a collaborative approach.

**Conclusions - improving chances for success**

When assessing transaction strategy, proposed mergers and acquisitions are best analysed from several perspectives as a ‘complex whole’. In other words, traditional due diligence should go beyond financial and legal considerations to include stakeholder relationships (market reputation, clients, employees, suppliers).

Culture and parenting style/fit should be managed as a constructive process, based on mutually aligned goals.

Ability to execute should be a key focus and responsibility for both acquirers and vendors. Operationally, adopt a laser focus on synergies, direct client profitability, and effective communications.

Improving M&A performance will include a more rigorous and holistic approach to leading as well as more traditional lag indicators of business performance management. Consider earnout structures based on sustainable measurement criteria.

Pay attention to detail - too often it is many months post-deal before signage and stationery are changed. Understand client satisfaction surveys as part of the due diligence, understand which clients are profitable - and which are not. Clients are the lifeblood of an agency - so why do they only know when they read about a merger in the press?

...and for a sector which focuses upon communications - then the message on M&A must get across to all relevant parties in a far more timely, clear and coherent manner.

If you intend to take the M&A gamble, focus on excellent execution and drive the chances of success far higher than 50:50 - a far more attractive game to play.

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### References


### Look further

- Bruce R. Non Financial Measures just don’t add up, Financial Times 29/03/04.