

MERGERS & ACQUISITIONS | BY [THOMAS L. DOORLEY III](#)

Value creating M&A — leading practice

With the global economy in uncertain territory and the cost of capital rising, improving the odds of success in M&A deals is becoming increasingly critical. Leading practice is shifting from ever more detailed but standardised financial analysis to identifying a better financial metric, and quantifying the intangible aspects of the deal. This is where the real power resides. The best at creating successful deals adapt their pre-deal analytics by utilising the following new tools.

A better financial metric: profit per person

This performance metric was developed about two decades ago to evaluate businesses in professional services firms, for example those in advertising agencies, law and consulting firms and investment banking. Now a small number of especially astute M&A dealmakers and corporate managers are using the metric as the ultimate performance leveller. The metric decomposes performance into two parts — revenues/person (a measure of value added) and profit/revenue (margin - a measure of efficiency). Multiplying the two (revenues/person X profit/revenue) = profit/person. A business can succeed by selling high value products (high revenues/person) or doing so efficiently (high margins). A high score on one or the other aspect defines sharply different businesses by product or service type, or business model, or customer served, all of which confuses traditional financial analytics. But at the end, the enterprise will gain as profit per person rises in spite of differences. Few successful businesses are monolithic. Capturing the value of differences rather than muting them is the objective. All analyses of post-transaction expense reductions or revenues enhancements are translated in the resultant profit per person.

New metrics: quantifying the non-financial

We know that high growth companies out perform their more slowly growing counterparts by a wide margin, for example, the top 20 percent of growers generate a total shareholder return of seven times the bottom 20 percent. If a deal cannot sustain growth or rebound to higher growth post-transaction, it will not create sufficient value to justify the effort entailed to pursue and close it. Knowing these facts, the leading practitioners of candidate analysis work to understand what needs to be protected post-transaction to enable high growth to continue, or to unlock growth potential in a laggard. The former is a challenge; the later is doable if quite difficult. A good example of a growth turnaround is Hewlett Packard, who was the epitome of sustained growth for five decades until it lost its momentum in the mid-1990s. Today it is back on track, the challenge of unlocking EDS' growth notwithstanding. There are two high value arenas to search in order to identify the leverage points for ongoing or renewed growth, namely, culture/

values and organisational processes.

Cultural analysis has evolved from a 'soft, touchy feely' activity into a solid methodology with hard output. For example, since collaboration is a core value embedded in the culture of high growth/high performance enterprises, look for examples of team work and joint new product development efforts. Bureaucracy is a necessary component of all sustainable enterprises. However, the high growth/high performance enterprise limits its destructive tendencies. Culture risk assessment protocols are available from many consultancies and these can outline the positive and negative cultural elements across a set of key factors.

Organisational processes must be reviewed to assess whether or not the deal can deliver value for the buyer. It is essential to uncover core processes that drive growth and value or the lack. Two core processes that underscore success are talent management/team-building, and information sharing. High growth/high performance enterprises bring new products on line in two-thirds the time and twice as often as their slower growing competitors. Their trick is to identify talent and assemble that talent into teams on an adhoc basis. Therefore search for evidence that a talent management process exists and is utilised in practice. Growth results when talent is earmarked and can be assembled from disparate reaches of the organisation to solve problems and tackle opportunities. This ability to assemble a team, and then disband it, only to reassemble a variation again, defines an innovative organisation. Information sharing represents a second valuable growth process. Information should be easily accessed throughout the organisation, through internal blogs, open meeting spaces and an embedded cultural value of sharing. The high performers engage people at all levels in the organisation, purposely seeking contrarians in order to ferret out the best answer.

M&A procedures have become increasingly sophisticated. Every serious seller arms itself with experienced counsel in order to bid up its asking price. Every serious buyer has well honed models designed to dig into the financials and uncover expense reduction opportunities, the easiest to quantify. However, the magic that will unlock value lies elsewhere. The capability to analyse culture and values, and organisational processes in the context of how successful high growth/high performance operate marks the difference between those who close deals and those who create value while doing so. ■

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