SYNERGY AND DIS-SYNERGY EVALUATION IN MERGER & ACQUISITION PROCESS: A CASE-STUDY OF AN ACQUISITION ATTEMPT BY A MULTI-BUSINESS ‘SERIAL-ACQUIRER’ COMPANY

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Abstract

M&As are fraught with dangers of failure. Failures may happen due to misjudgments and mistakes in any of the phases of an M&A process. Over-estimation of Synergy evaluation is cited as one of the most frequent reasons for value destruction in M&A. This paper studies the M&A process of a multi-business company, with particular focus on its Synergy evaluation phase. The presented case follows an actual acquisition bid made by the company. The case-study adopts an explorative approach with data collected through participant-observation and interviews conducted during the course of Synergy evaluation. The paper proposes that big multi-business companies need to be extra careful in selecting their acquisition targets as they may face hidden dangers lurking behind the façade of attractive synergy justifications because an acquisition may have an unforeseen effect on other divisions within the company. This can be prevented as long as these companies do a thorough synergy evaluation and follow well-laid out M&A processes as analyzed in the presented case. Further, the paper also proposes to split the step of Synergy evaluation into analyzing positive synergies and negative synergies and proposes further research into systematically enumerating factors of dis-synergy in various situation sof M&A for benefit of future acquisition managers.

Key Words: Mergers & Acquisitions, Synergy, Dis-synergy, Vertical acquisition
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1. INTRODUCTION

"Growth for the sake of growth is the ideology of the cancer cell." — Edward Abbey, American Author and Environmental Advocate

What a cell turned cancerous does to the body that carries it is not very different from what an acquisition turned malicious does to the wealth of the acquirer. Business literature is strewn with examples of such cancerous Mergers & Acquisitions.

Yet, growth is necessary to increase share-holder’s value. This has been almost universally acknowledged as one of the core purposes of a firm. Hence the way out of the dilemma is not to avoid growth but rather to execute growth in a controlled, well-conceived and well-executed manner. In other words, firms should have a Strategy to grow in a healthy way. The term and the act of defining ‘Strategy’ in context of firms have been understood in several ways. Strategy may be understood as a means of defining firm’s purpose in terms of its long term objectives and action steps to achieve it. It has also been presented as definition of competitive domain of the firm. It is also seen as the path set for striving towards achievement of sustainable competitive advantage in view of several external factors like industry characteristics and competition and internal factors like available (or absent) competencies. Strategy is also viewed as an expression of the “Strategic Intent” (Hamel & Prahalad, 1989) of the firm and then there is also an internal “Resource-based-view” of the firm (Wernelfelt, Birger 1984) leading to the term Strategy being defined as means to develop resources of a firm to assure sustainable advantage. One thing that all the various definitions of Strategy have in common is the need to develop a clearly defined Business Mission statement that enshrines the purpose and scope of the firm. From this purpose and scope must emanate a growth strategy.

Mergers and acquisitions are widely used as vehicles of growth and hence are an integral part of a firm’s corporate and business strategy (Hax & Majluf, 1996)
Extensive literature exists that analyzes the phases of an M&A process and points out the critical activities that may decide the fate of an M&A. In doing so, the post-merger activity of integrating the two companies has been universally mentioned as the most delicate operation on which realization of the motives depend. However, the pre-merger-phase activities of a clear strategy and motive formulation as well as realistic synergy calculations cannot be stressed upon enough (Schweiger & Very, 2003)

This paper presents a case-study of an acquisition bid by a multi-business company to acquire another company for diversifying its business by way of a horizontal un-related acquisition. This case looks into the acquisition process of a multi-business multinational company, with focus on the Synergy evaluation. The subject of over-priced acquisitions based on ambitious Synergy evaluations is well addressed in literature (Sirower 1997, Bekier, Bogardus & Oldham 2001) where the research landscape starts getting sparse is when it comes to looking at the other side of the Synergy coin – i.e. the potential dis-synergies lurking behind takeover of a seemingly well-dressed target. This paper shows how a deep dis-synergy evaluation toppled an attractive synergy case and thereby prevented the case from joining the ranks of M&A failures.

1.1 Research question and objective

The research paper aims to examine, how a focus on dis-synergy factors, alongside Synergy evaluation, is critical for a sound Acquisition decision.

The study investigates the case of an acquisition-bid made by a multi-business company for acquiring a niche company. The scope of this study spans the Synergy evaluation process within pre-acquisition phase.

A careful analysis of the potential synergies (and dis-synergies) arising from the acquisition is done in order to assess the soundness of the acquisition.

1.2 Thesis’ Structure

The structure of the Thesis is described below.
The Theory section lays out the foundational concepts and definitions around Mergers & Acquisitions with emphasis on:

- Corporate Strategy and Mergers & Acquisitions
- Types of Mergers & Acquisitions
- Synergy Evaluation

Methodology section describes the rationale for using a case-study approach in this research and describes the tools used in data-collection.

The Data section includes the case presentation and the relevant data covering the following:

- Background information about the industry and companies involved
- The M&A process of the acquirer
- Specific events constituting the acquisition case
- Synergy valuations

The subsequent section includes the findings and analysis of the collected data.

Finally the concluding statements, along with the limitations of the study and scope for further research is presented.

2. THEORY

Mergers and Acquisitions are a part of “the market for corporate control” (Berk & DeMarzo 2007). Either a corporation acquires another (target) firm or the target firm can merge with another firm. Both these mechanisms are often, for simplicity, referred to as Takeover (Berk & DeMarzo 2007).

“A merger is a combination of two companies in which….the merged corporation goes out of existence …(and) the acquiring company assumes the assets and liabilities of the
Whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. As pointed out by Sudarsanam (2010), “(a)n acquisition resembles more of an arm’s-length deal, with one firm purchasing the assents of another’. The use of the term Merger and Acquisition has been used interchangeably in this research for the purpose of ease.

M&A is believed to increase the net value of the combined entity formed (Gupta & Gerchak, 2002). However, history of Mergers & Acquisitions is strewn with glowing examples of astounding value destruction (Grundy 1996).

2.1 Corporate Strategy and Mergers & Acquisitions

Hax & Majluf (1996) have described the Mission of a Firm in detail. It contains the business scope of a firm and its unique competencies. Defining a mission statement is a major corporate task for the management. Changes in mission statement are driven by Growth objectives. Alternatives for growth are presented by possibilities to penetrate further in existing markets, expansion in new geographical areas, vertical integration and diversification. Each of these strategies need to be carefully evaluated for its merits, possible negative consequences and costs involved. Companies may chose to develop growth-drivers in-house, for example, development of new products & technologies, setup of distribution network in new areas etc. Alternatively, they may choose to considerable shorten the cycle of strategy execution through leveraging its buying power to acquire or merge with those other firms which have the capabilities that the firm may otherwise need to develop on its own. Hence M&A is not an end in itself, it is rather a means to an end. It is the vehicle that carries the growth strategy of a firm. The M&A process starts not with the selection of a target company. In fact, it starts much before that, even before any M&A opportunity even presents itself to the company. M&A is closely linked to a firm’s mission, its strategy and is in fact a result of it.
Very & Schweiger (2003) have developed a model linking the Strategic objectives of a firm with how it executes its M&A strategy. M&A strategy has two distinct parts, on one hand the pre-merger phase strategy of motivating careful selection of target firms by linking it to the firms’ mission and growth strategy and on the other hand the post-acquisition integration phase to make sure that the motives listed and synergies evaluated during pre-merger phase are realized.

2.2 Types of Mergers & Acquisitions

The following types of M&As have been often cited by researchers and text-books in order to categorize and study them (Ghauri & Buckley, 2003):

*Horizontal Integration* – This type of merger occurs when two competitors combine, this type of integration causes an increase in the market power of the combined company that generally has an anti-competitive effect.

*Vertical Integration* – These are combinations of companies that have a buyer-seller equation, for example, merger of two companies in the same industry that make products required at different stages of production cycle, Berk & DeMarzo, 2007. Such mergers mainly help in terms of coordination, however may have an adverse effect of changing existing relationships with its suppliers and customers. A forward integration may jeopardize relations with existing customers and a backward integration with its suppliers (Hax & Majluf 1996).

*Conglomerate merger* – This type of merger occurs when the companies are not competitors and do not have a buyer-seller relationship. Such companies have a diverse portfolio of companies in a way that creates shareholder wealth, one successful example of such mergers is General Electric, which is a serial acquirer.
2.3 Synergy evaluation

When companies bid to buy (takeover) other companies, they usually pay a premium over the premerger price of the target company. An average of 38% premium was reported by Andrade, Mitchell and Stafford (2001). The readiness to pay premium is based upon the expectation by the acquiring company to add economic value beyond that what could be added by the two companies separately on their own before acquisition. Main justification for this expectation is synergy valuation foreseen and calculated by acquisition managers.

Synergy refers to the ability of a corporate combination to be more profitable than the individual parts of the firm that were combined (Gaughan, 2007). The anticipation of synergy results in a seemingly positive net acquisition value (NAV). The synergistic effect is expected to be more than the sum of the premium paid for the acquired firm and the expenses in the acquisition process. Schweiger & Very (2003) have explained the concept of Synergy as value creation achieved as a result of acquisition in terms of improvement in cash flow of either of the two parties involved or the combined entity. The most common sources of Synergy are cost, revenue, market power and intangibles (Schweiger & Very, 2003). But in effect these fall in two broad categories (Berk & De Marzo, 2008) of motives behind M&As – Cost and Revenue synergies.

Cost synergies are achieved due to economies of scale, consolidation of administrative functions and utilization of existing setup for new revenue streams. Some of the most common examples for reasons behind cost synergies are layoff of employees due to combining of overlapping functions, elimination of other redundant resources, achieving better economy of scale in production and procurement, economy of scope in activities like marketing & distribution, vertical integration (see next section for more details), etc. are some of the common ways of achieving cost synergies. Such synergies are are comparatively easier to achieve and are most often calculated in Synergy evaluation.
Revenue synergies are supposed to occur due to the expectation that merged entity will be able to have the best of both worlds. Some examples of reasons cited to support revenue synergy calculations are cross-selling of products by each other’s sales forces, gaining of new customer base, leveraging of brand name, increased extraction from existing customers etc. Schweiger & Very (2003) mention that Revenue Synergies rarely materialize despite the fact that these are often anticipated in acquisitions.

Market Power Synergies are caused due to consolidation of competing firms. This has an impact on available supply in the market as an acquiring company gains better control on it. It can thereby control prices. There is however the danger of running into anti-competitive and monopoly laws.

Intangible synergies include brand names leverage, knowhow exchange etc. These cannot be directly and provably calculated, but Acquisition managers may often cite these as strategic reasons in favor of acquisition and as basis for estimating synergistic revenue growth of the combined entity.

There may however be another hidden and not so rational motive as pointed out by Ghauri & Buckley (2003) as being “fashion” for managers to pursue an M&A strategy fuelled by top manager’s “ego & hubris” (Gupta & Gerchak, 2002). Seth et al. (2000) have suggested that managers undertake acquisitions laying great faith in their own synergy calculations even though these may actually be faulty over-estimations.

Sirower (1997) has coined a very evocative term for the dangers lurking behind the tendency to over-estimate Synergies – “The Synergy Trap”. As will be later seen in the presented case, the revenue synergy calculated in the initial phase of the acquisition process was too optimistic and suffered from a myopic view. Some negative synergy factors were not considered in the initial evaluation of Synergy, which, had these not been discovered and the acquisition plan not dropped, would have led to significant erosion of value for the acquiring company as a whole (though not for the acquiring division). Schweiger & Very (2003) have described negative synergy as destruction of intrinsic value of a firm due to the process of merger & acquisition. The nature and types of negative synergies have not been mentioned or described, except that these are
caused during M&A due to “…interventions in organizations that can create disruptions…”.

The post-acquisition phase cost of achieving synergy is a topic not postponed for future, rather already calculated within overall synergy evaluation. Synergy is not just a positive influence of acquisition, but its achievement involves certain costs too (Berk & DeMarzo 2006). In multi-business (or multi-divisional) companies there is an additional challenge of managing multiple divisions (Fulghieri & Hodrick 2006). This cost however is different from the concept of dis-synergy mentioned above. Costs are encountered in implementing steps leading to achievement of synergies. The factors of dis-synergy are quite distinct influences that may lead to post-acquisition diminishing of firm’s value due to changes in its interaction with its suppliers, customers, employees and other stakeholders.

3. METHOD

3.1 Research approach
To assess a micro level process in M&A within multi-business companies and understand the nitty-gritties of the steps in an acquisition deal, a Case-study method has been used for investigation in this research. Additionally, the scope provided by a case study method, to go into a relative depth and be able to look at the phenomena incisively does justice to the complexity of the real-life scenarios in multi-business companies. Yin (1994) defines Case-study as study of events within their real-life context and recognizes it as a widely used research method for Thesis and dissertations in Management studies.

The present research seeks to critically examine the importance of an accurate and impartial Synergy evaluation in an Acquisition process within a multi-business company. Through an intensive examination of the cross-section of the synergy evaluation process, it purports to investigate the potential lags during the pre-acquisition analysis phase for a complex M&A situation. Such incisive focus of the research proposition
lends well to use of a Case-study method (Yin, 1994). To this end, the present study engages intensively with an actual case of a proposed acquisition by a multi-business company, analyses the results of synergy evaluation in the pre-acquisition phase and assess the impact of this analysis on the acquisition decision by the management.

3.2 Data collection

Access to the investigated case was enabled through a participant-observation, in other words, being a participant-observer enabled access to the otherwise impossible-to-access data (and insights) that was essential to an in-depth examination of synergy evaluation and for an exhaustive validation of the results within the available time-frame and resources.

Additionally, in order to supplement the data for the case-study, interviews with key-players involved in the synergy evaluation were conducted and cross-case questioning was done.

3.3 Generalization, Reliability and Validity

As with most case study researches, the findings of the present study are aimed at generalizations towards theoretical propositions, rather than to the populations or universes (Yin, 1994). This study does not propose to develop a rigorous model to identify and quantify an exhaustive list of dis-synergy sources. Rather, the focus is on identifying and describing a source of dis-synergy in the particular context of this case in order to demonstrate the significance of such factors, without attempts at generalizations at this stage. These circumstances make the present case revelatory and unique (Yin, 1994) manifestation of a particular source of dis-synergy in acquisition of a small niche-technology company by a large multi-business corporation. Interviews with key-players involved in the synergy evaluation ensured certain amount of objectivity in the data collection and hence lends to internal validity.
3.4 Measures
The case-study involves comparing overall synergy calculation with dis-synergy calculation. In doing so, emphasis is on outlining how the factor of dis-synergy came to the attention of acquisition team and how it significantly altered the impact of overall synergy calculations (synergy + dis-synergy) and as a result the acquisition decision itself.

Dis-synergy factors are those that will have a negative effect on overall Synergy evaluation. For example, in the presented case, acquisition of the target company would have resulted in the acquiring company losing some of its existing customers. The resulting loss in revenue is taken as a measure of dis-synergy.

The names and actual businesses of the bidding company (acquiring company) and of the target company have been substituted with imaginary names to maintain confidentiality.

4. Data

4.1 Case Context

This case looks into the acquisition process of a multi-business multinational company, with focus on the Synergy evaluation. The names and actual businesses of the bidding company (acquiring company) and of the target company have been substituted with imaginary names to maintain confidentiality.

A typical value chain for oil & gas installation projects is shown in diagram 4.1a below.
End-users, the companies (typically a joint-holding of several companies, including the process technology provider, land-use owner, operator) who hold the rights to exploration or extraction or processing of oil & gas facility, have an important influence in pre-selection of suppliers in the supply-chain down from EPCs. EPCs are directly and solely selected by the owning company. EPCs select the suppliers after a techno-commercial evaluation process from the list of approved vendors supplied by owning company.

Solutions offered by engineered-solution companies generally include products sourced from other divisions within the company. These products are either standard products, standardized and adapted to oil & gas industry specifications are engineered products, designed and manufactured to fulfill project specifications.
Both the companies in the context of this case offer their own different engineered solutions required in Oil & Gas projects. The solutions are sold mostly directly to contractors in Oil & Gas industry. Some examples of engineered-solutions are site-construction activity, compressor-trains, piping system, water and waste-water handling, pumping solutions, electrical installations, etc. The supplier selection and decision-making throughout the value-chain is based on long-standing references, stringent specifications-compliance and impeccable project-management experience. It is difficult for new entrants without past experience and references to enter the market and win projects. Already existing customer-supplier relationships are therefore difficult to modify. The two companies are not competitors. Hence acquisition of one company by another will lead to the acquiring company diversifying its solution portfolio.

4.2. Description & data of the Companies involved in acquisition

4.2.1. About GS

The information presented below about GS, GS-S and GS-P are based upon observations as direct-participant, several internal and external documents as well as interviews with several persons directly and indirectly involved / affected by the presented acquisition case.

GS is a multinational giant with several business divisions supplying products, solutions and services in several industrial and consumer segments. For the purpose of this case study it is sufficient to focus on one of the solutions divisions (GS-S) focused in oil & gas segment and on one of the product manufacturing divisions (GS-P) supplying its products to a broad spectrum of industries, including oil & gas among several others. The diagram 4.2a below shows representative structure of GS and its value chain.
There are several functional groups at corporate level, including a Strategy and M&A group. In addition there each individual business unit has its own strategy group too, reporting directly to the respective Business unit’s CEO. There is a ‘dotted-line’ relationship with the corporate Strategy group.

4.2.2 M&A process at GS

The acquisition process and teams are setup in accordance with the guideline available from the corporate M&A group.

The M&A process has been clearly defined at corporate level at GS and all its business divisions are encouraged to follow this harmonized process. Diagram 4.2b below shows the M&A process at GS which provides a kind of roadmap for the overall process. Starting with the need for external growth the process begins with a clarification of the strategic goals for external growth and the candidate screening and selection. After the target company has been selected the acquisition project itself begins. The overview
shows the Strategy, Transaction and Implementation phases, together with the major steps, with the project focus shifting from strategic planning to deal-making to integration. The main deliverables to the business at the end of the project (at “1Year”) are a new, combined organization and a value creation program which should jointly enable the business to deliver the expected value and results.

GS wanted to achieve following objectives with a well-defined M&A process:

- Increase speed and quality of M&A projects by providing a framework developed from the best practices of past projects
- Foster reusability and accessibility of corporate know-how, especially in terms of process, tools and templates
- Raise awareness of the importance of professionally executed M&A projects with clear responsibilities, time schedule, budget and outcome to maximize value creation.
- Enhance sharing of resources and expert development within GS
GS distinguishes three phases of the M&A process:

**Strategy**
This phase starts with identifying a strategic gap and deciding to explore the opportunity for external growth. It comprises the definition of the acquisition strategy, the screening and the selection of an appropriate target company. Having identified a target, this phase also includes the gathering and evaluation of as much additional information as possible. This is followed by a review of the strategic fit and the preparation and approval of the project proposal (Acquisition Proposal) by the executive management to proceed with this target company. Mainly Business managers and the strategic planner are predominantly involved in this phase.

**Transaction**
This phase runs from project proposal to closing. It requires special expertise to handle legal issues (company, contract, antitrust, authorities, etc), M&A valuation, negotiation and deal environment (investment banker, etc). Corporate M&A department takes the lead and provides guidance on each project during this phase. They work in conjunction with the M&A departments in the business divisions with respect to the preparation of the business plan and the development of plans to leverage synergies and value creation and to conduct due diligence. Preparation for the implementation phase also begins during this phase.

**Implementation**
Implementation starts immediately after Closing – on Day One of the new combined entity, when everything is new (ownership, governance, rules, people). The goal of this phase is the implementation of the project to achieve the original strategic goals. This involves the hallenges of integration and value creation, including the establishment of the new organization, the alignment of the offering portfolio, people and processes to strategic goals, controlling achievements, risks and opportunities and measures, following-up on contract claims, etc.
Overlapping Areas of Expertise

In addition to the time-oriented phases, GS has identified three major areas of expertise in M&A projects, which are overlapping the phases. Each of them requires special expertise and focuses on different deliverables. The key success factor for each project lies in managing the cooperation between these areas and the respective experts involved in order to realize the maximum benefit:

- **Strategic expertise** defines clearly the road to success for the respective business. It includes the definition of the criteria for evaluation and screening for target company selection. It also involves an assessment of the strategic fit of the selected company, a definition of the strategic priorities and goals for a particular project and a checks that all other activities are aligned with the defined strategy.

- **Deal Execution expertise** ensures the deal optimization for GS – not paying too much, winning the deal against competing bidders, excluding as many risks as possible in the negotiated Sale and Purchase Agreement, obtaining as much information as possible to be able to take the correct decisions and prepare for integration, retaining the acquired top management, the employees and customers, not violating any laws, obtaining the necessary approvals for the deal and ensuring that the correct payment is made at Closing. After closing, following up on the Post Closing Contract Management (PCCM) claims.

- **Integration expertise** comprises all the work that needs to be done to make the acquired entity a part of GS, supports our business strategy and adds value. Derived from the strategic goals, it is essential that integration activities are thoroughly planned from the very beginning. This involves detailing the strategy and defining measures for strategy implementation. It comprises: the need to ensure that people from different environments work together to ensure the success of the combined entity, retaining the existing and winning new customers, shaping the new, combined organization to manage growth, leveraging synergies, improving value and market position and achieving strategic goals.
Milestones

Project Start
The project starts when the strategic planning exercises of the business divisions results in the conclusion, that external growth in the specific business field is required, potential candidates have been screened and a target company has been selected. The “Deal Entrepreneur” (= business owner = head of the acquiring business unit) initiates the project and sets up a small team of business experts, M&A experts and strategists to further analyze the selected target company.

Acquisition-Proposal
At Acquisition-Proposal approval is received from the Managing Board (MB) to begin negotiations with the selected target company. Typically a detailed internal review and approval process takes place before submission to the GS Management. Corporate Strategy department evaluates the effects on corporate strategy, gives advice for the project set up and provides a commentary on the project.

Decision-Application
By the time the Decision-Application milestone is reached, the negotiations and valuation of the target company are at a mature stage. The amount of the investment, the contract conditions and further proceedings are submitted to the Management for approval.

Below is diagram 4.2c showing the detailed steps within the whole M&A process at GS.
The parts circled in the diagram above highlight the stages of Synergy calculations and their incorporation in the overall Business plan for the acquisition case. It can be seen that if the process is followed, there are two stages at which Synergy evaluation takes place – once during the strategy phase and finally during the transaction phase. In the detailed description for these steps, it has been specified to “Analyze impact on acquiring unit”. Any guideline to analyze impact on other divisions / units is conspicuously absent!

4.2.3 About GS-S

The solutions division provides engineered solutions to EPCs. A solution is composed of several ‘in-house’ products sourced from internal product divisions as well as engineering knowhow available within the GS-S division itself. The products of GS-P are however not needed as part of GS-S’s solution package.
GS-S has its own management (CEO and CFO) and several other functional units, including strategy group.

4.2.4 About GS-P

GS-P is a global market-leader in its range of products, with several manufacturing locations worldwide, conforming to almost all regional standards and specifications and supplying into almost all industry segments. It is however known as a high-quality and high-price supplier, specializing in applications with demanding specifications. Hence it has a high market share in Oil & Gas industry, which has demanding specifications due to explosive working environments, as against a low share in Water industry, where specifications are not as demanding.

GS-P sells through several channels, with its strongest support being from end-users, who value product quality and total cost of ownership. GS-P is one of the few suppliers accepted and even preferred by most end-users. Many times GS-P is the only specified make in projects.

GS-P works closely with a few global OEMs especially in the high-demanding industries like Oil & Gas. In general OEM channel is not a strong one for GS-P due to its comparatively high prices, but O&G is an exception. This is especially true for the OEMs like NP and all of its competitors. This is because the product-package of these OEMs can have as much as 50% component of its production cost contributed by procurement of GS-P’s products. This makes suppliers of GS-P type products a very important part of the strategic supplier development program for NP and all its competitors and critical for their success in O&G market. There are strategic supplier agreements between GS-P and some of its key OEM customers and GS-P enjoys a high share in total spend of these OEMs. Business with some of these OEMs is already at a high level and is growing steadily with others as shown in diagram 4.2d.
It should especially be noted that GS-P had a high share of almost 50% in NP’s spend on those products.

4.2.5 About NP

Most of the following information about the company has been drawn from the Teaser document provided by BM. Teaser contains a wide range of information about the company including its history, changes in ownership structure over the years, technology, subsidiaries, customers, competitors, suppliers, strategy, financial information, motivations for the offer to sell etc. Information relevant for the scope of this case study has been summarized below.

The target company (Niche Products - NP) is a market-leader in its particular sub-segment of oil & gas industry. However, looking at the broad class of products that it
manufactures, the company can be called a small niche player because of its small size (assumed in proportion of spend) relative to its conventional-technology-based competitors for this class of products and also on the basis of the narrow slice of the market that it addresses within the oil & gas market. See the diagram 4.2d for relative spend of NP on GS-P’s products and diagram 4.2e for a realistic perspective on the relative market-size addressed by NP.

![Diagram 4.2e](image)

Majority shareholding of NP was held by its founding family and the rest owned by an investor company. NP indicated its intention to sell 100% of its shares to a multinational blue-chip company operating in oil & gas industry. NP expressed its intention to select an investor that would secure the company’s main production facility and strengthen its core business. NP’s main motivations in looking for an investor were the need to expand its global presence to cover the strategic growth markets worldwide, need to strengthen its technical competence in being able to deliver and install its products & solutions in the remote and harsh locations of oil & gas exploration sites and to get access to financial strength of the investor in order to retain its leadership in an increasingly competitive market.
75% of NP’s sales were in oil & gas and most of the balance part in food & pharmaceutical.

Among NP’s strengths are its market leadership in the products they manufacture, being in a niche sub-segment of the oil & gas industry which was growing at twice the rate of overall oil & gas industry, increasing number of applications where the technology-type of NP’s product-range is seen as better fit than the conventional technology-type, engineering and project-management capabilities and probably the most important being its close and ‘symbiotic’ customer-relationship to some of the global giants of Oil & Gas industry. ‘Symbiotic’ is used to emphasize that NP’s products and solutions are critical for successful execution of its customers’ projects.

NP was optimistic and bullish about its growth potential. It forecast a growth rate of about 18% from 2011 to 2014 as against 4% from 2009 to 2011. The main reasons cited for this situation were:

1. The industry sub-segment it operated in is forecast to grow at twice the rate of overall oil & gas segment.
2. Increasing substitution of conventional technology by the technology on which NP’s products are based.

NP has a core manufacturing location. Besides manufacturing its core product, this location also has an assembly capability which combines NP’s own products with some bought-out finished products to produce a complete functioning ‘product-package’. This product-package is a custom-designed and custom-manufactured product which can be directly sold to contractors for relatively small applications or projects. However, typically the contractors need a complete solution based on these product-packages, other system components and substantial engineering knowhow.

NP has no direct relation with the acquiring division of GS (GS-S). But a products division of GS (GS-P) is one of the key-suppliers to NP. The products manufactured by GS-P form an integral part of the NP’s own ‘product-package’. Diagram 4.2f below shows this value-chain.
4.2f. Value Chain for NP

GS-P has a total share of about 50% in the spend (purchase volume) of NP on these products. GS-P’s products represent second-highest category of NP’s purchases. GS-P is the second-biggest supplier of NP by volume.

4.3. Case description

The acquiring company (Global Solutions- GS) was approached by the financial advisor company (Bid Management – BM) retained by the target company (Niche Products - NP) to organize its sale, to participate in auction of Niche Products. Niche Products sent an ‘Information Memorandum’ to GS, inviting GS (and other selected potential investors) to evaluate the investment opportunity. The Memorandum also described the sales process and most importantly, the Memorandum provided ‘Teaser information’ about NP.

Sales process was divided in three phases:
**Phase 1:** Indicative offer

**Phase 2:** Due diligence and binding offer for investment

**Phase 3:** Final negotiation with selected investors

GS successfully submitted its indicative offer, which included, among other details, the offered price, strategic reasons for interest in buying NP, integration plan and corporate governance plan post-acquisition.

The scope of this case-study spans the Phase 2 – due diligence, with specific focus on Synergy evaluation.

The target selection, as mentioned in the process above, was guided by GS-S’s own strategy. This strategy is informed but not actively synchronized with that of any other Business unit within the company GS. In the Project Proposal report submitted to Managing Board, the following strategic reasons were cited for the acquisition:

- Strengthen GS-S position in O&G through portfolio expansion.
- Technology on which NP’s products are based, is considered necessary or preferred in some of the (expected) fastest-growing sub-segments (niche areas) of O&G industry.
- The application areas that NP’s products & solutions can address complement some other application areas already addressed by GS-S (within any given O&G project) using existing solutions based on products available from other product divisions of GS.
- Because NP needs GS-P’s products to produce its product-package, thereby a strong Synergy due to potential internal purchase of GS-P’s products.
- NP’s strong business relationships with and reference list containing some of the well-known blue-chip endusers and significant EPCs will help GS-S to strengthen business with these customers.
• Increase GS-S’s recognition as a player in O&G market.

• NP already identified as a potential acquisition target in GS-S’s strategy plan.

### 4.4 Synergy evaluation

This paper focuses on Synergy evaluation. However, in order to get the perspective of the Synergy figures, the Market valuation and financial figures of the target company have also been presented without analyzing it any further.

In order to maintain confidentiality, the figures presented here are a multiple of original figures. However, for the purpose of this paper, it is suffices to see the relative magnitudes between some key business data and synergy calculation even if the figures have been scaled by using a random multiple. The random multiple used is the same for all figures.

Key figures of acquisition proposal are shown in the diagram 4.4a
Key figures of acquisition proposal

- Current revenues of NP: 113
- Synergies calculated by GS-S: 163 (45) (180)
- Current initial bid-price

Diag.4.4a
GS-S calculated synergies as shown in the diagram 4.4b below

**Overview of Synergies**

![Diagram showing synergies](image)

A total initial Synergy calculated by the project team during the Strategy phase was on following accounts:

Sales Synergy comprised of four components:

1. Leveraging of the global setup of GS-S and references of NP:
   a) Increased market reach for NP through GS-S’s global sales & sourcing network
   b) Localization of sales and solution-content, very important (as examples) for remote markets like Russian oil & gas field or protected markets like in Brazil.
   c) Access of GS-S to certain key customers of NP. GS-S was so far unable to win significant business from these resource-wealthy owners of huge oil & gas reserves.

2. Pull-through effect on other in-house business divisions:
   As mentioned earlier, GS has several business divisions and many of these are market leaders in various products. NP and its competitors are typical OEM customers for these divisions, including for GS-P. GS-S expected that once NP gets
acquired by GS-S there will be a preference to source products from ‘in-house’ divisions of GS and this will bring add to the revenue of GS. This was estimated at €34 mio.

Cost synergies comprised of two components:

3. Cost synergies (Savings): These were attributed to cost savings for target due to riding on GS-S’s global sales network, economy of scale and consolidation of R&D.

4. Cost synergies (Integration costs): This, according to GS-S, is a negative synergy

The initial valuation and Business-plan incorporating a total initial Synergy calculation was presented to the Managing Board during the Strategy phase. The presented Project-Report (P-Report) was approved and the project thus moved on to the Transaction phase. The approval was made subject to some further detailing and checks recommended by Corporate Strategy group to the Project Manager. Some of these points included:

- Elaboration on how the existing sales setup of GS-S will be able to acquire competence in acquired products /solutions. These products/solutions are unrelated with the existing solutions of GS-S.
- How will the planned profitability be met considering that over-head costs of GS-S are much higher than that of NP
- Review NP’s capacity to follow the enhanced sales ramp-up plan of the project team
- Re-analysis and review of ‘pull-through’ sales synergies by the involved product divisions.
- Concept for maintaining and growing the 25% non-O&G business (mainly Food and Pharma)

The Corporate M&A too made several comments for consideration of the Project team during the due-diligence process within the Transaction phase. The most notable being: “Entire case and thus the buffer depends on sales synergy realization. Therefore sales synergies should be thoroughly verified and underpinned in due diligence.”
Keeping the focus of this paper on Synergy evaluation, from the above points, only the review of pull-through analysis will now be presented in detail. As it turned out later, it had a significant impact upon the initial Synergy evaluation.

It was at this stage that GS-P was officially requested to participate in the project team with the sole purpose of verifying pull-through sales synergy.

GS-P evaluated the impact on current and future business with NP and its competitors (customers of GS-P). The evaluation had following steps:

1. Determining current and forecast revenues from NP if there is no acquisition: GS-P already enjoyed a high share of about 50% in NP’s spend on those products. Since there are few suppliers who can match the demanding specifications in O&G industry and because some end-users tend to have a preference for certain suppliers, OEMs (like NP) try not to let one supplier (even a strategic and preferred supplier) not have a share of more than 30-40% in their spend. Hence in the forecast calculation, the share was assumed constant at about 50%, which was already high.

2. Determining increase in business of GS-P from NP in case GS-P becomes an in-house and hence a preferred supplier. It was assumed by the project team that this will lead to an increased share of GS-P in NP’s total spend. However, since the current share was already a high 50%, projected increase from 50% to 70% was substantially lower than what the project team had optimistically calculated during the initial synergy phase (from 0% to 70%!). It should be noted that 100% share possibility was ruled out as firstly the customers do not allow this situation to prevent over-dependence upon one supplier, and secondly, due to end-user preferences and need for customized engineering, not all suppliers fit all the specifications all the time.

3. GS-P also recognized the strong likelihood of change in its customer base as a result of acquisition of NP by GS-S. It was argued that the present competitors of NP, who are also customers of GS-P, will no longer view GS-P as a neutral supplier to be trusted with sensitive project-specific and future-innovations-
related technical information. It was feared that these customers will shy away from GS-P and abandon strategic-supplier agreements with GS-P, in favor of other suppliers (competitors of GS-P). It was proposed by other members of the due diligence team that the loss in business will be seen only to for the overlapping application-portfolio of NP and its competitors. And since NP operates in some niche application areas only, the argument was extended that the loss of revenue will be limited to these niche areas only. However, GS-P members rejected this proposal based on following reasons:

a. NP (and GS-S) had projected a substantial growth opportunity for NP’s products & solutions because of gaining popularity of its technology-type and its encroachment into conventional application areas. GS-P argued that this strategy will bring NP into direct competition with its ‘conventional-technology’ competitors and hence it will no longer be limited to niche application areas.

b. Most of the biggest global OEMs of conventional-technology based solutions have invested in development of the ‘niche-technology’ based solutions because of the high-growth rate projected for its applications. However due to GS-P losing its preferred-supplier status, it was thought unlikely that these customers will engage in joint-technical innovations with it. This was thought to likely have a cross-influence on existing business as well.

As a result of these influences, NS-P examined the current and projected business with all its customers who are in direct and in-direct competition with NP and calculated the projected loss in business in case GS-S successfully acquired NP.

The calculations were based on following facts and assumptions:

i. The growth rate of business of indirect competitors was assumed same as that of the overall Oil & Gas industry (which is almost half that of OEMs in fast-growing niche application areas, i.e. direct competitors of NP)

ii. Growth rate of direct competitors was assumed same as that of NP
iii. Growth of GS-P’s share in OEMs spend was assumed much higher (15% - 20%) for its key and focus OEMs than for others (only 4%). Share was assumed to reach a terminal value of about 35 to 40% with focus customers and about 10% - 15% with others.

iv. It was assumed that post-acquisition, GS-P will lose completely that Oil & Gas-related business from its customers, but business related to other segments (e.g. Water, Mining etc.) will remain unchanged.

v. With some mitigation efforts, like continuing focus-account management despite low share or management efforts to re-gain confidence etc., it was assumed that the share in lost O&G business will climb back to about 15% level. This figure was based on the level earlier experienced with same customers before GS-P had started a focus-account management with these customers.

vi. Finally, it was assumed that the lost business in niche-application areas will never recover.

The calculation of net change in business (gain from NP’s spend and loss from its competitors) is summarized in diagram 4.2i -4.4d
As against a positive pull-through synergy of € 42.5 mio calculated by GS-S in initial valuation, GS-P calculated a negative synergy (or dis-synergy) of € 35 mio appx., thus almost wiping out this element of synergy calculations.

The significant change in the Synergy calculation led to a negative answer from the managing board regarding decision to bid for NP and GS dropped out of the bidders list. The case triggered a discussion within GS about the need to synchronize strategies of different business units, related or un-related, with the goal to discover overlapping and / or contra-productive growth strategies of different business units, more sound selection of acquisition targets and avoidance of unnecessary acquisition-expenses incurred through false-starts as in this case.

5. Analysis
The above presented case presents an opportunity to not only verify several existing theories and research findings, but also to make a proposition (which may need to be verified in further research).

Within the scope of this research, focus has been narrowed down to Synergy evaluation in an acquisition bid, even though, the amount and richness of available data lends itself to a deep look into several other sub-processes and industry-practices of M&A.

Even a very casual analysis of this case, based on just qualitative assessment, as against a technical (meaning financial) and quantitative analysis, is enough to throw up some interesting insights.

The initial Synergy calculation made in the Strategy phase was approved through several decision-making levels up to the level of Managing Board. As it turned out later, the Synergy calculations lacked the rigor that they deserve, given the huge investments at stake. Several researchers (Sorower 1997, Schweiger & Very 2003, Walker & Price...
have stressed upon the importance of pragmatic and well-researched synergy evaluation as an important step in avoiding over-whelming M&A failures. Sirower (1997) has cautioned against this in very evocative phrase ‘The Synergy Trap’.

In this case, the ‘Synergy Trap’ (Sirower, 1997, Sirower & Sahni, 2006) was avoided thanks to a necessary deep look in the next Transaction phase before the decision point. This shows the importance and effectiveness of a well-defined and executed M&A process, especially in huge conglomerates like GS, which are in any case difficult to govern due to their size and complexity.

What was especially effective in this case was the fact that GS had corporate level Strategy and M&A departments; the effectiveness and value of a corporate level strategy has been enough emphasized by researchers like Sudarsanam (2010). The SG corporate M&A department was involved in initial design and implementation of an M&A process guideline to be used as a framework by individual business units for their own M&A activities. In addition, the M&A department was able to identify the high sensitivity of the initial business case to Synergy evaluation and hence could raise a well-founded caution to review the synergy in greater detail. This is quite in line with the emphasis laid on a sound Synergy calculation by several researchers in the field, as mentioned earlier. The Corporate Strategy department had a good assessment of how the various business units and their individual strategies may have been linked to each other. Hence this group was able to advice right in the initial phase to subject the synergy calculation to a review by the product group (GS-P). It must also be noted that presence of these corporate departments helped to learn from the case and feed the learning back into the experience pool in order to further fine-tune and strengthen the processes. This is especially valuable for companies like GS, termed ‘serial acquirers’ by Sudarsanam (2010).

This acquisition is in-effect the acquirer acquiring its own customer. The case started out as a diversification from GS-S’s viewpoint, but viewed from GS-P’s view, it would actually have been an upward vertical integration, even without GS-S’s intention to do
so. It is a pit-fall of vertical integrations that the pre-integration supplier / customer relationships get altered (Hax & Majluf 1996). This is clearly to be seen in the dis-synergy evaluation done by the project team.

Diagrams 5.1a and 5.1b below compare the pre-acquisition relationship between various stake-holders with the post-acquisition impact on the relationships.

![Diagram 5.1a: Pre-acquisition relationships]
This case may be a unique case in that, the size of the target was relatively small as compared to several of its competitors. NP addresses niche applications within the O&G segment on account its strategy to focus juts on the ‘new’ technology based products and applications. But these products have the potential to replace conventional-technology based products due to its several advantages in today’s hard-to-extract oil wells and push for off-shore exploration and extraction. This brings NP into direct competition with the established global giants, who are also pushing the innovation limits. Was NP then an ideal acquisition target for a company like GS, which is a global conglomerate present across almost all industries, segments and applications (and moreover has strengths of production, sales and distribution to address markets spanning a whole spectrum from mass-markets to niche applications)? Would the Synergy scenario have been different if the target were not NP but one of its giant competitors? Let us assume tentatively that the target was the Competitor OEM 2 as in the diagram 4.2i. This would have altered the positive pull-through sales synergy to a significantly higher number of approximately Euro 75 million (assuming increase in share from current 10% to 70%) This is because OEM 2 has a substantially higher
revenue and (hence) spend on procurement of products produced by GS-P and GS-P currently has a low share in that spend. The figure for negative synergy due to loss of customers and hence revenue for GS-P would however have remained more or less unchanged. In fact it would have still been better than in the actual scenario as GS-P’s revenue from NP is much smaller than that from B. Thus despite the presence of negative synergy factor, the positive synergies would still have remained high. It indicates that a bigger target is likely to present a stronger business case than a small target.

Another notable point thrown up by this case, which becomes apparent on extending the analysis on the above mentioned two points is that a conglomerate or a multi-business company is likely to have a huge base of external interfaces – both suppliers and customers. And it is more likely than not that several of these external interfaces interact with the company in different roles. Customers for one division may be suppliers to another and vice-versa. It may thus be quite likely that an acquisition target for one division has interactions with another. Conglomerates must therefore bear the burden of an even more careful scrutiny at all stages of M&A process, especially in Synergy evaluation. The above reasoning indicates that it may be difficult for such companies to find suitable targets that really add considerable acquisition value to its shareholders.

In addition, to above it may also be inferred that the cross interfaces with external entities must be well understood and should be totally transparent through appropriate database design. IT tools should provide the necessary reports to pull up data related to a target company in all its roles and interactions with the acquiring company. And this may be limited not just to the target company, but also for its competitors.

Finally, it may serve well to critically assess the concept of ‘Synergy’ itself, for instance, isn’t the term synergy a misleading misnomer! Several well-defined M&A processes and several researches emphasize the importance of realistic Synergy evaluation, caution about over-enthusiastic and egoistic synergy scenarios, stress on inclusion of costs of achieving projected synergies (Ghauri & Buckley, 2003; Gupta & Gerchak, 2002; Seth
et al., 2000). As this case shows that just like there are positive Synergies that come into life as soon as acquisition happens, there may also be negative Synergies (dis-synergies) that may be born immediately on an acquisition happening. The term dis-synergy as used here is different from 'cost of synergies' and different from the dis-synergies like cultural differences. What the term indicates here is really those factors that may cause the sum of acquirer’s and target’s value to be less than value of their combined entity just based on fundamental changes in the internal and external environment caused by the acquisition and not because of frictional issues caused post-acquisition. In this case the gain of one business unit would have been a loss for another, unwittingly and unknowingly. Whether this is just a unique case and an only point of dis-synergy, cannot be examined within the scope of this paper. However, it is felt that a research into several cases past, present and future may throw up a check-list of more such factors. Probably ‘Sources of dis-synergy’ deserves a place of its own within the concept of ‘Sources of Synergy’ and probably even the term ‘Synergy’ should be split into its two forms ‘Synergy’ to mean positive synergies only and ‘Dis-synergy’ to mean negative synergy factors.

6. CONCLUSIONS
To conclude, the case-study has demonstrated how a focus on dis-synergy factors, alongside Synergy evaluation, is critical for a sound Acquisition decision, especially for multi-business companies. There may be a tendency not to look for factors of dis-synergy as most of the current literature and industry-practices imply Synergies to mean positive, and costs of achieving Synergies to imply negative Synergies or dis-synergies. The factors of dis-synergies must be viewed as seen and unforeseen influences on the whole organizations, which are different from, and independent of, factors of positive synergies or costs of achieving synergies. In the present study one such dis-synergy factor has been found – possible revenue-loss for other non-acquiring division of a multi-business company. It can also be concluded that only a sound and well-thought through M&A process gives the chance for Synergy calculations and Business plan to be reliable. Further, having a well-defined process
and a feedback-loop helps the organization to learn from past mistakes and strengthen the process further.

7. LIMITATIONS AND FURTHER RESEARCH
This study does not propose to develop a rigorous model to identify and quantify an exhaustive list of dis-synergy sources. Rather, the focus is on identifying and describing sources of dis-synergy in the particular context of this case. Within the scope of this Thesis it is seen that the presented source of dis-synergy has a significant magnitude that cannot be ignored in decision-making. However no further attempt is made to define and generalize the threshold of ‘significant’. Future research of several acquisition cases may likely be able to develop a sound model for synergy and dis-synergy evaluation.

8. REFERENCES


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