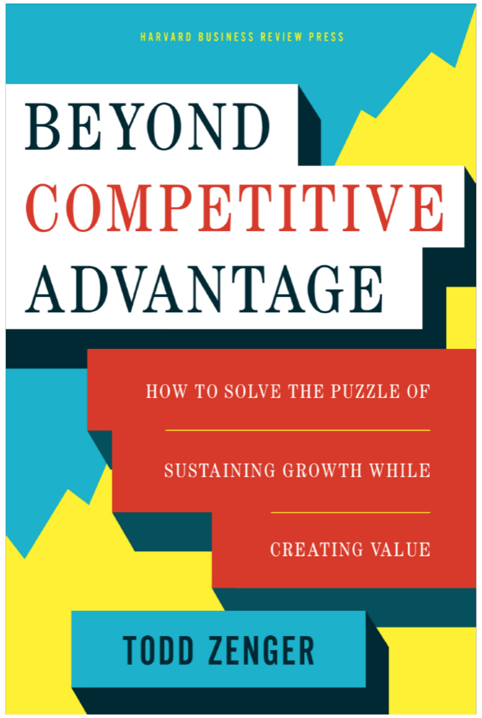
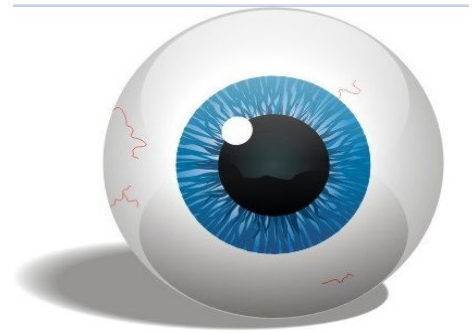
Growth, Unique Synergies, and Value Creation through Acquisitions

(Chapter 2)



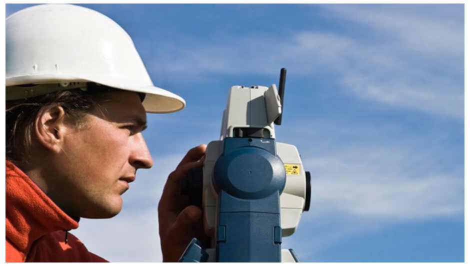
BEGIN WITH A THEORY



Foresight regarding evolution of industry, demand, technology, and customer tastes

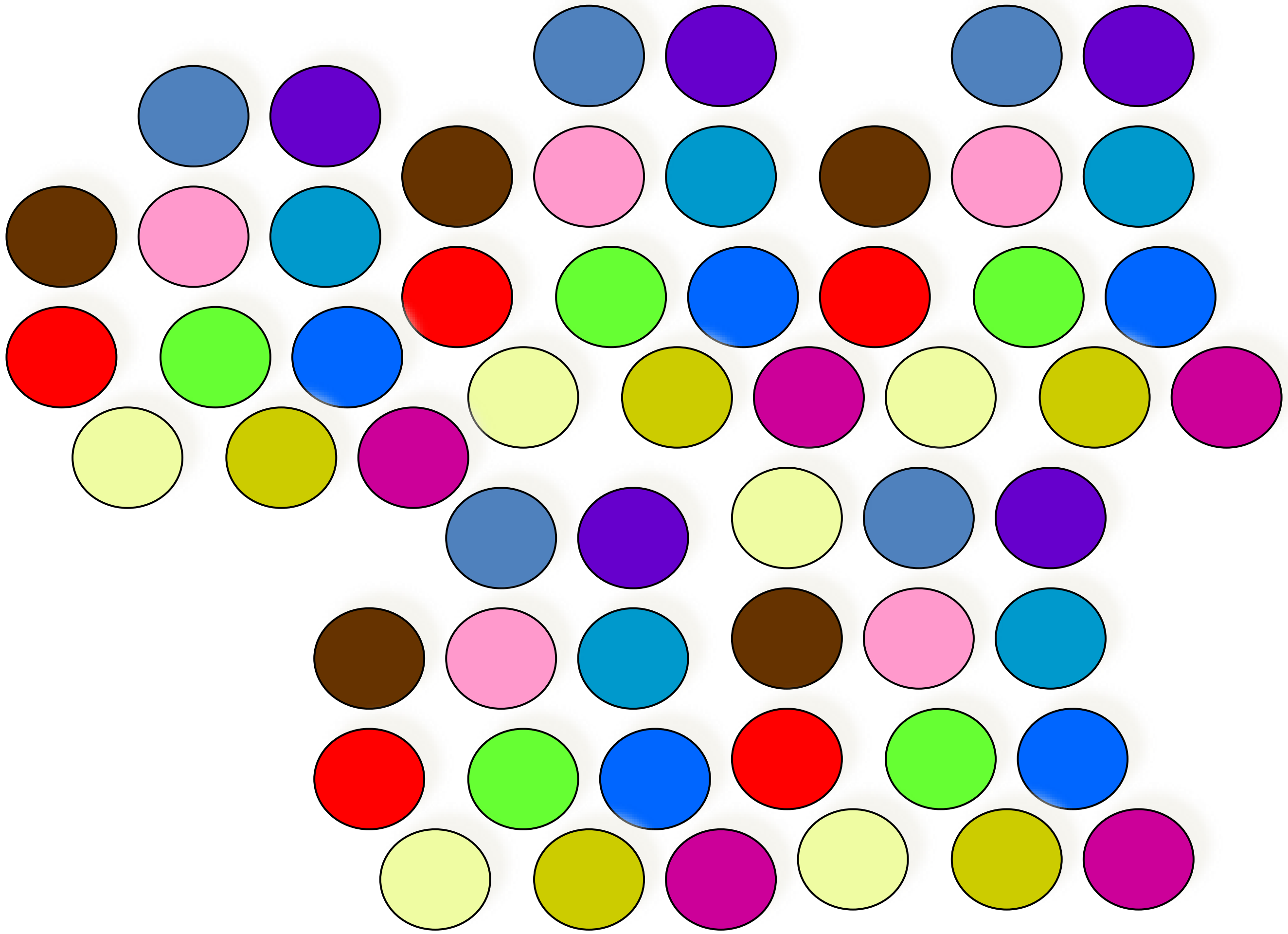
Theory of Sustained Value Creation

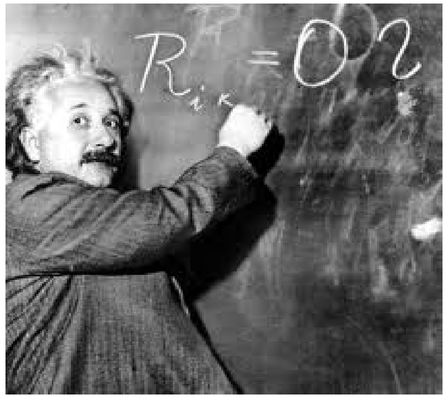
Cross-sight regarding synergies among available assets, resources, and activities



Insight regarding sustainably unique assets, resources, and activities within the firm

USE THEORY TO ASSEMBLE THE FIRM



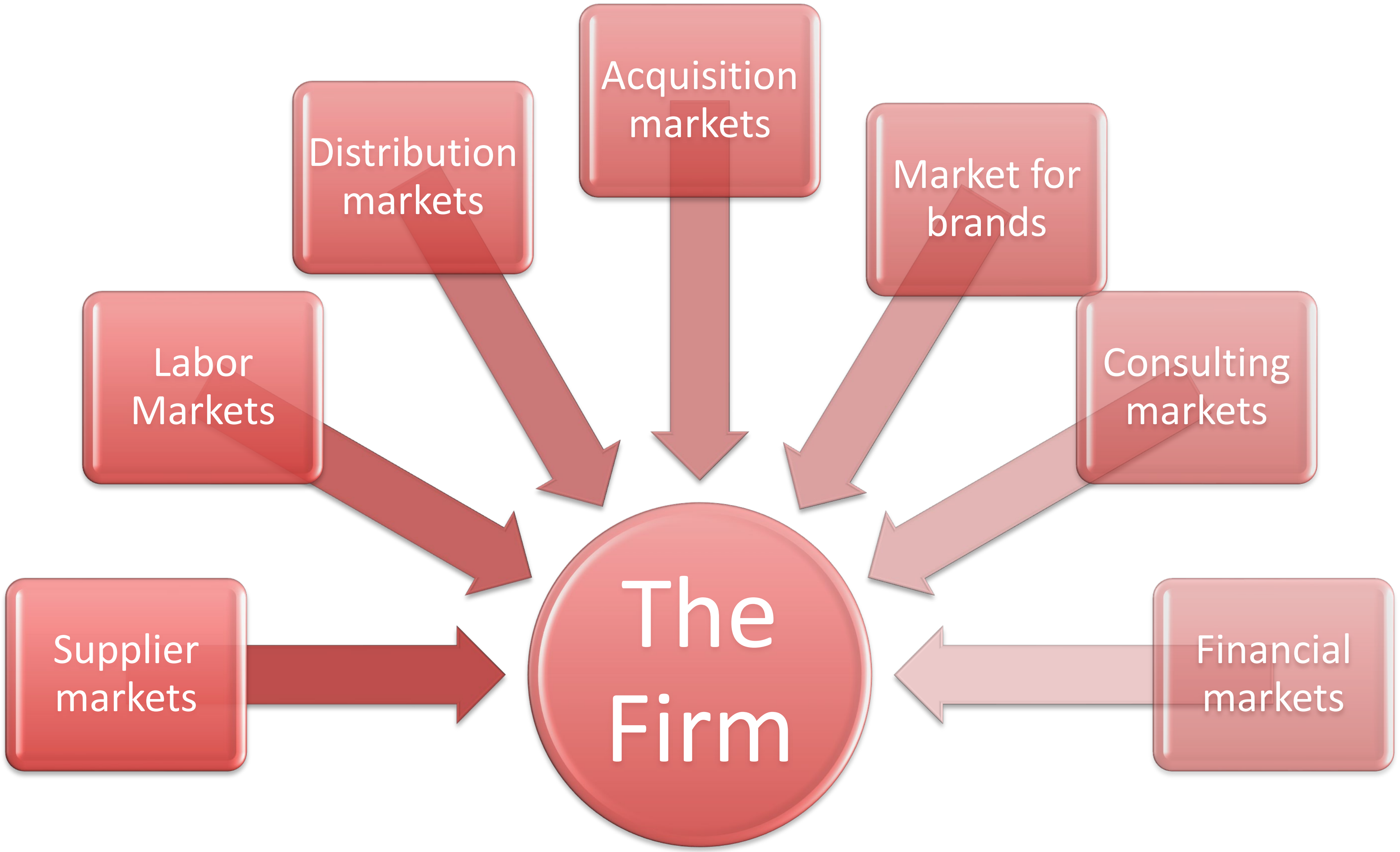


THE PATH TO SUSTAINED VALUE CREATION

"Buy low, sell high. Aren't there any other eternal truths?"

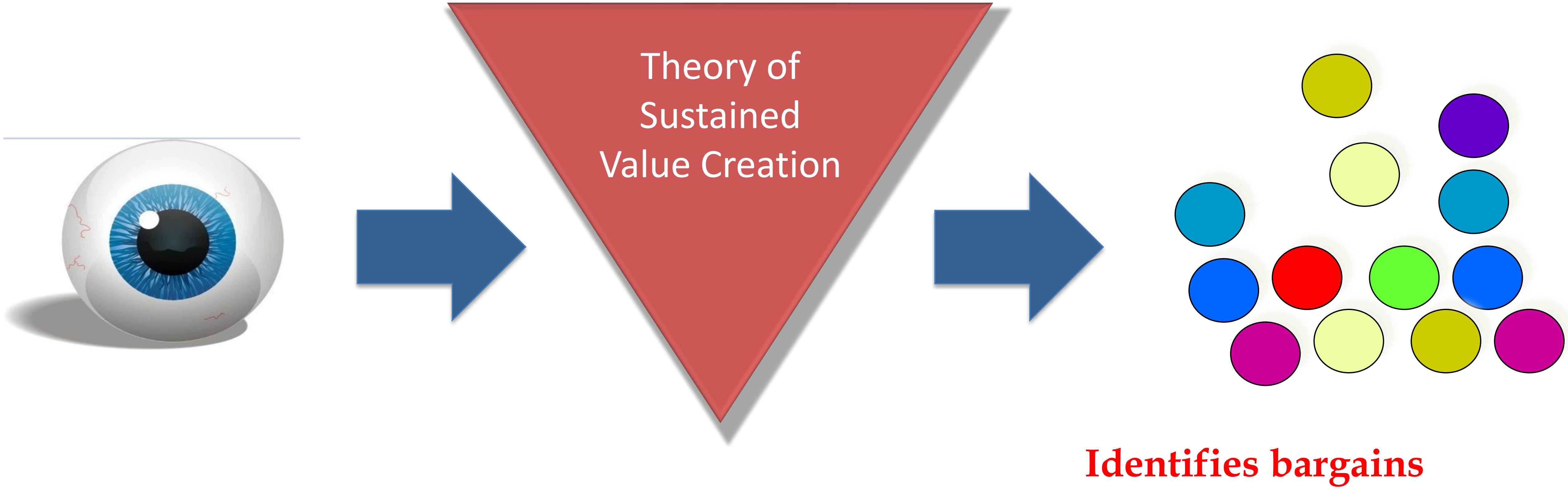
Key Question: How do you consistently discover strategic bargains?

THE FIRM AND STRATEGIC FACTOR MARKETS



Key question: how does a firm predictably acquire assets, resources, and activities to pursue strategic theories at prices below value in use?

GUIDANCE FROM A CORPORATE THEORY

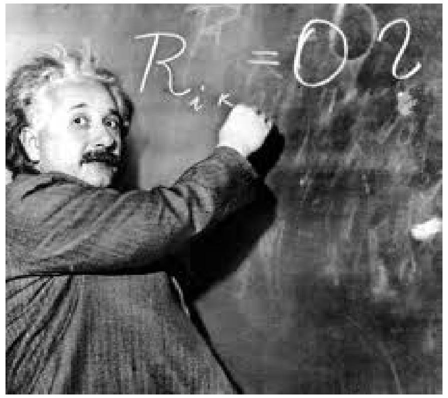


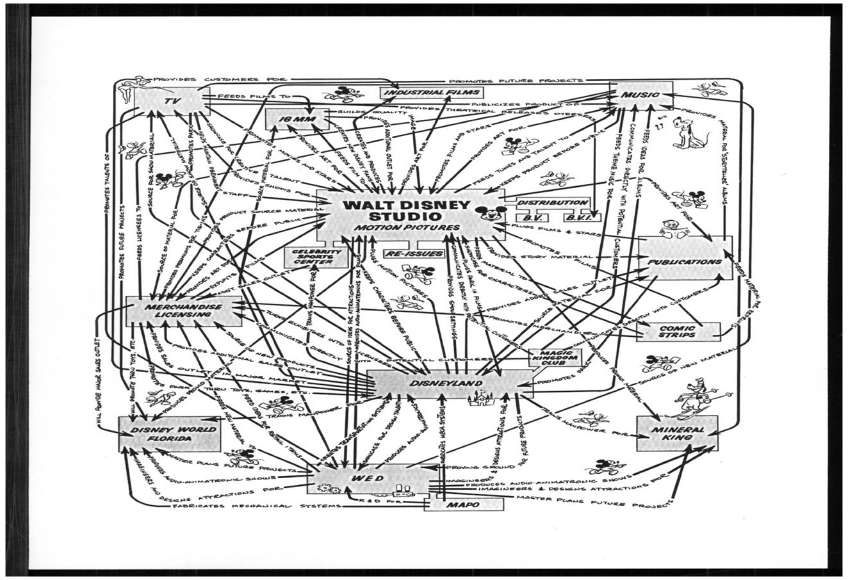
SUCCESS VS. FAILURE IN ACQUISITIONS

Causes of Failure	Sources of Success
Overpayment	Sheer luck
Overestimating synergies	Unique foresight or vision (a unique and accurate theory about value of asset combinations)
Underestimating integration costs	A common vision or theory, but the unique possession of assets critical to its execution.

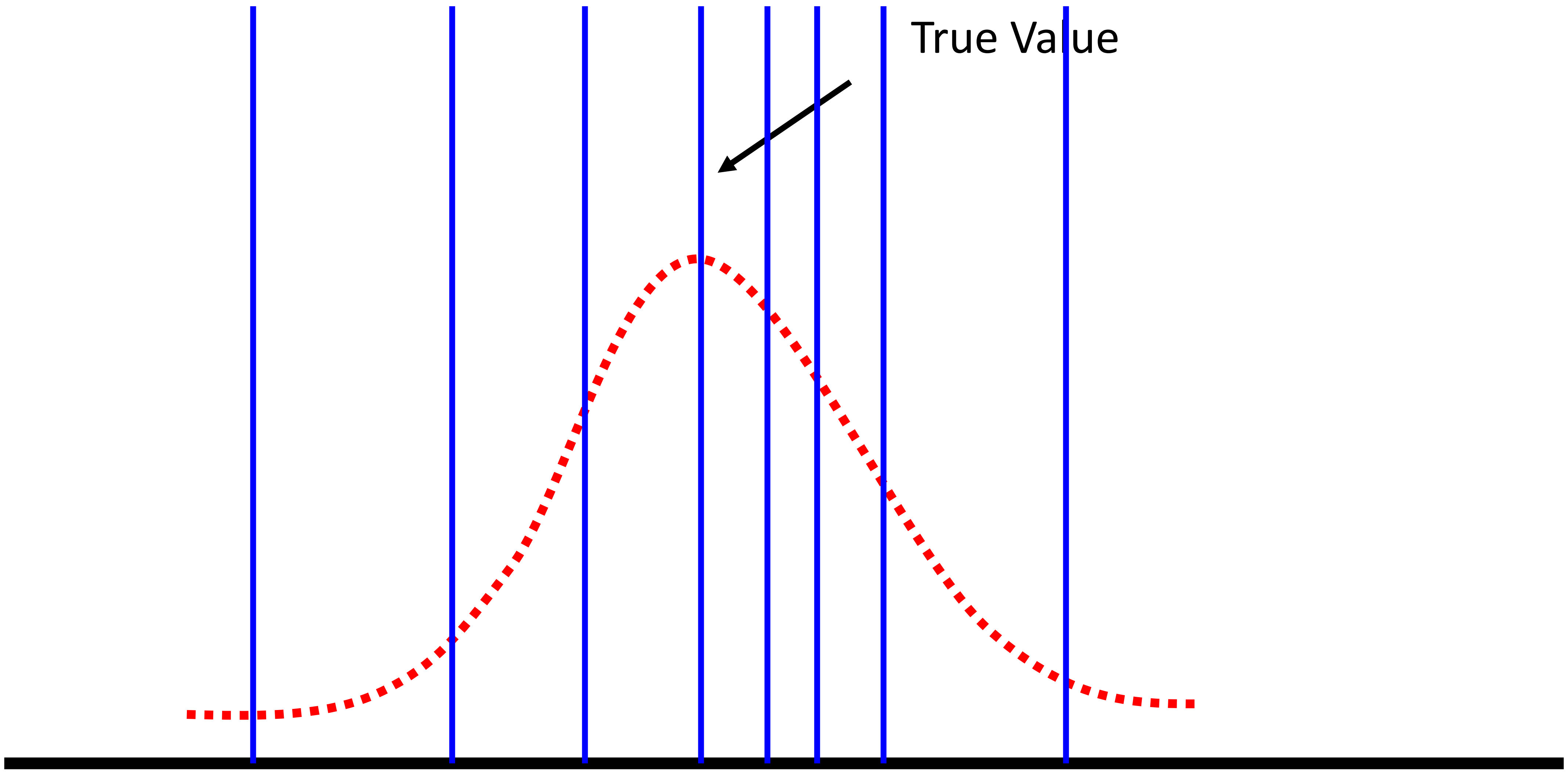
SYNERGIES?

Better Corporate Theory	Most Complementary Assets
You see value that others could obtain, but don't see.	Even though other firms recognize value in your theory, you possess assets that are more complementary with target than anyone else.





AUCTIONS AND THE WINNER'S CURSE



Overestimated value accrues to seller

AUCTIONING A COMPANY OF UNCERTAIN VALUE

- Assumption: Target company has an uncertain value to acquirers. True value is $14 million.
- Five bidders all estimate this value with error.
  - Bidder 1: $12 million
  - Bidder 2: $15 million
  - Bidder 3: $14 million
  - Bidder 4: $16 million
  - Bidder 5: $17 million
- Bidder 5 acquires the company, but overpays by $2-3 million.
- Overpayment accrues to shareholders of target.

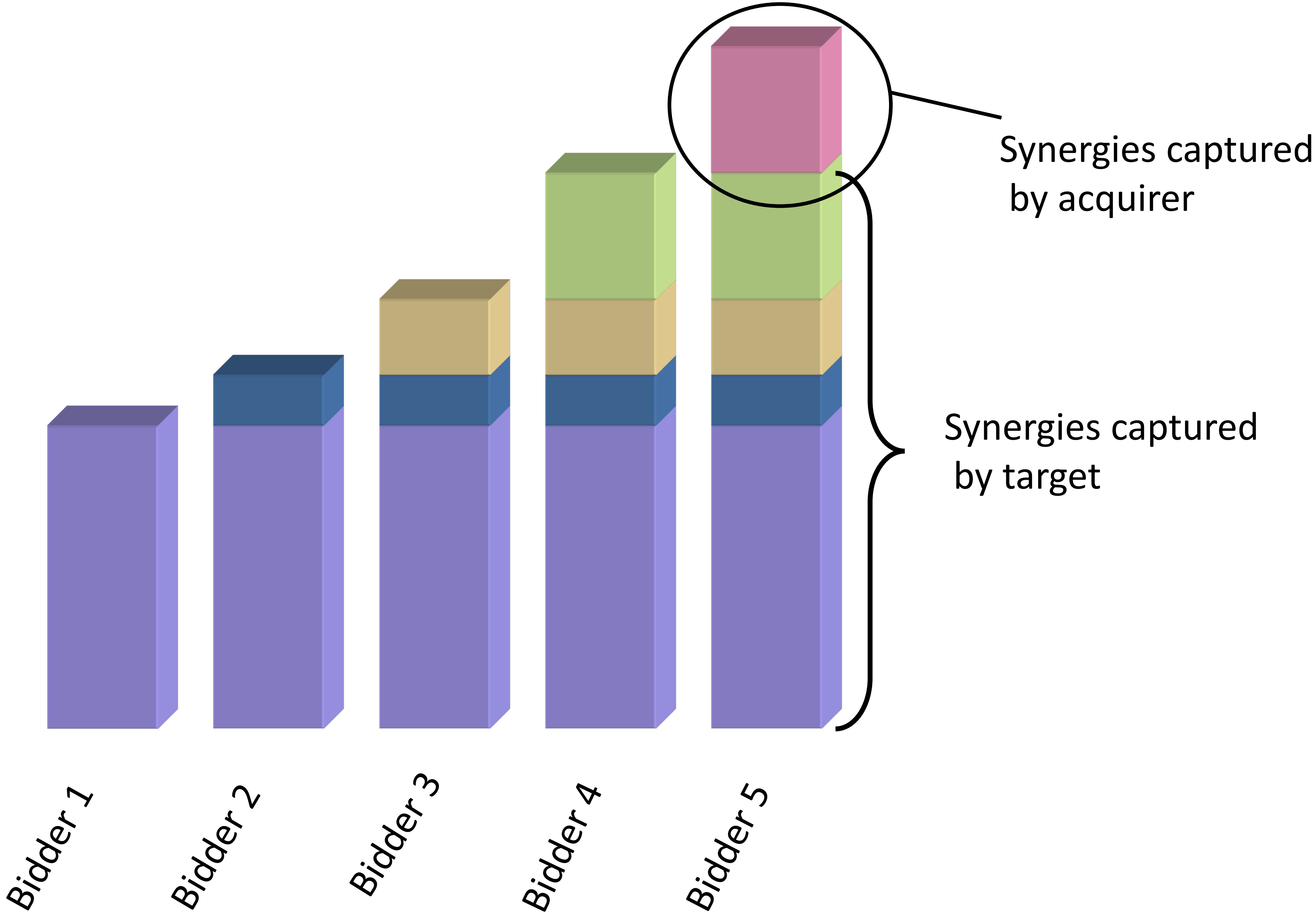
SYNERGIES AND UNIQUE VALUE IN ACQUISITIONS

- Value of target independently is $14 million
- Value of bidding firm's synergies/economies of scope are:

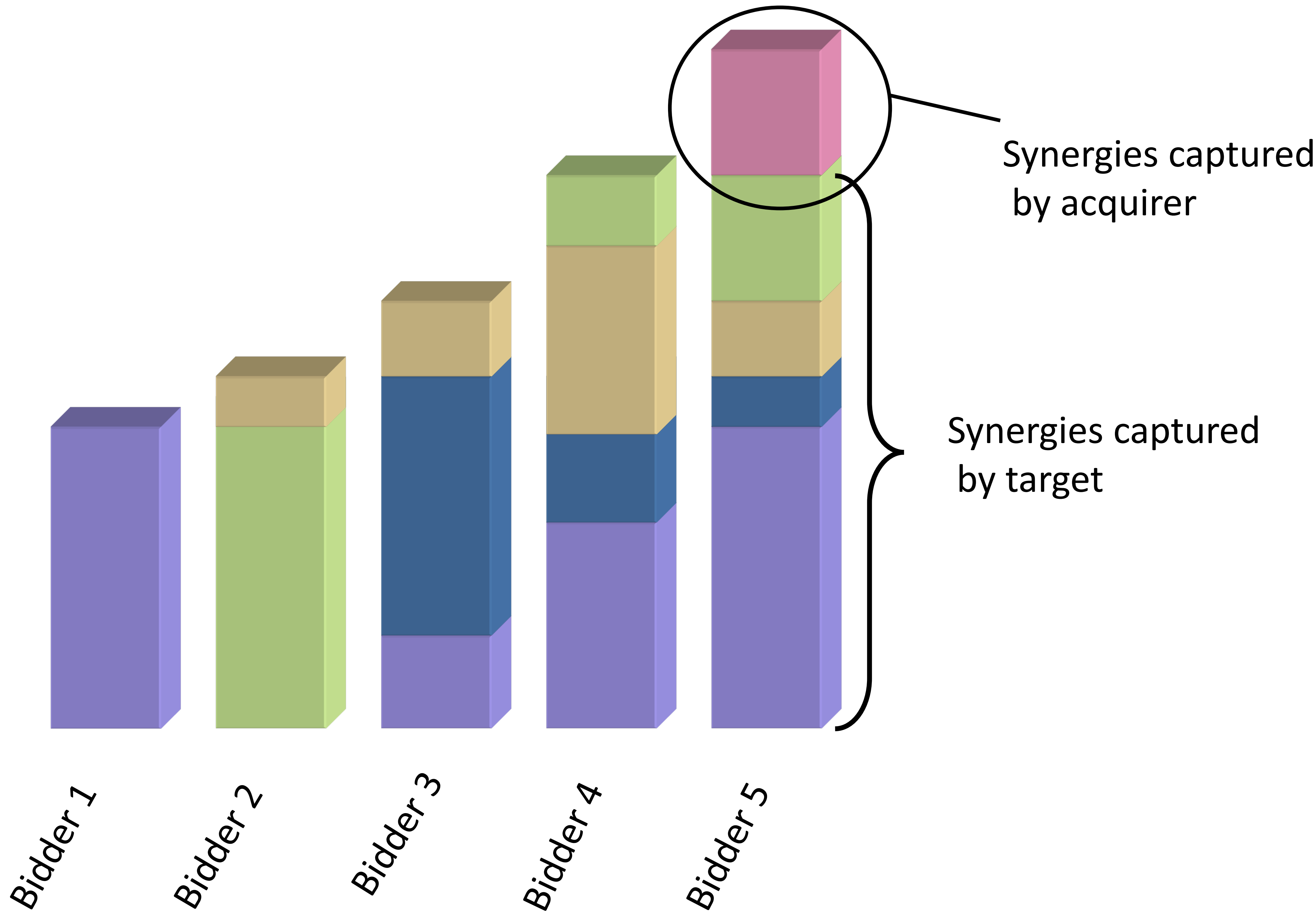
  Values of companies combined - Value of independent companies
- Assume five bidders with varying levels of synergies:
  - Bidder A: $2 million (shared distrib.)
  - Bidder B: $4 million (shared distrib., R&D)
  - Bidder C: $5 million (shared distrib., R&D, mgmt skills)
  - Bidder D: $6 million (distrib., R&D, mgmt, brand name)
  - Bidder E: $7 million (distrib., R&D, mgmt, name, prod)

Acquirer receives < $1 million

BIDDING WITH SYNERGIES



BIDDING WITH SYNERGIES



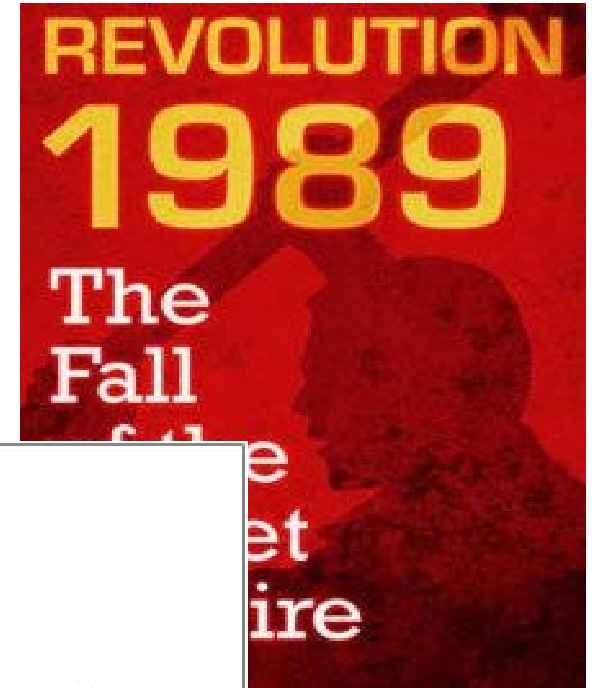
WHAT VALUE DOES THE ACQUIRER KEEP?

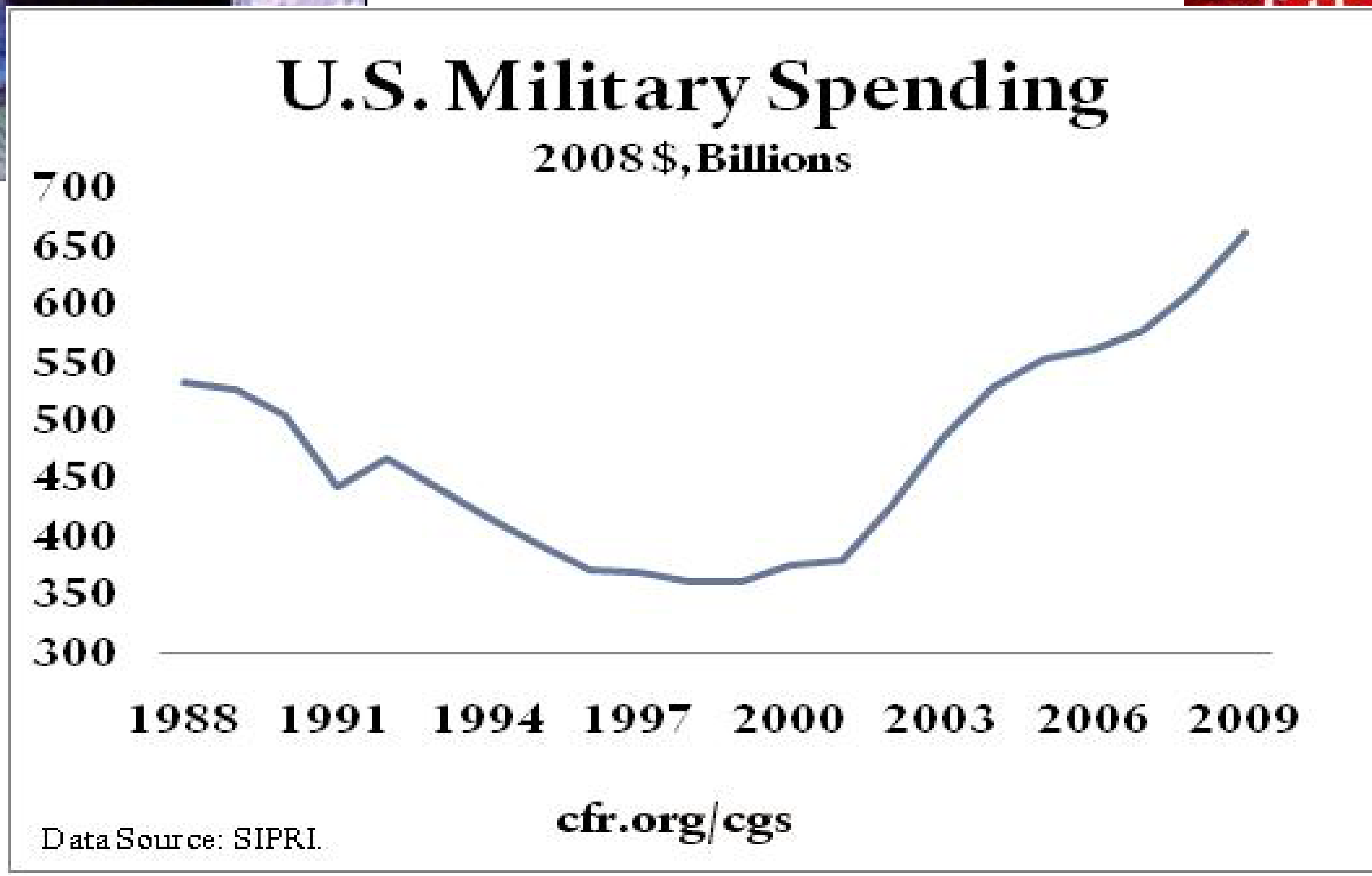
- ….in a certain world (i.e. a world of correct valuations), only the value of those "synergies" with the target that are UNIQUE (i.e. synergies not shared by other bidders, or potential bidders).

  Unique synergies = value of synergies in excess of synergies of next highest valuing bidder

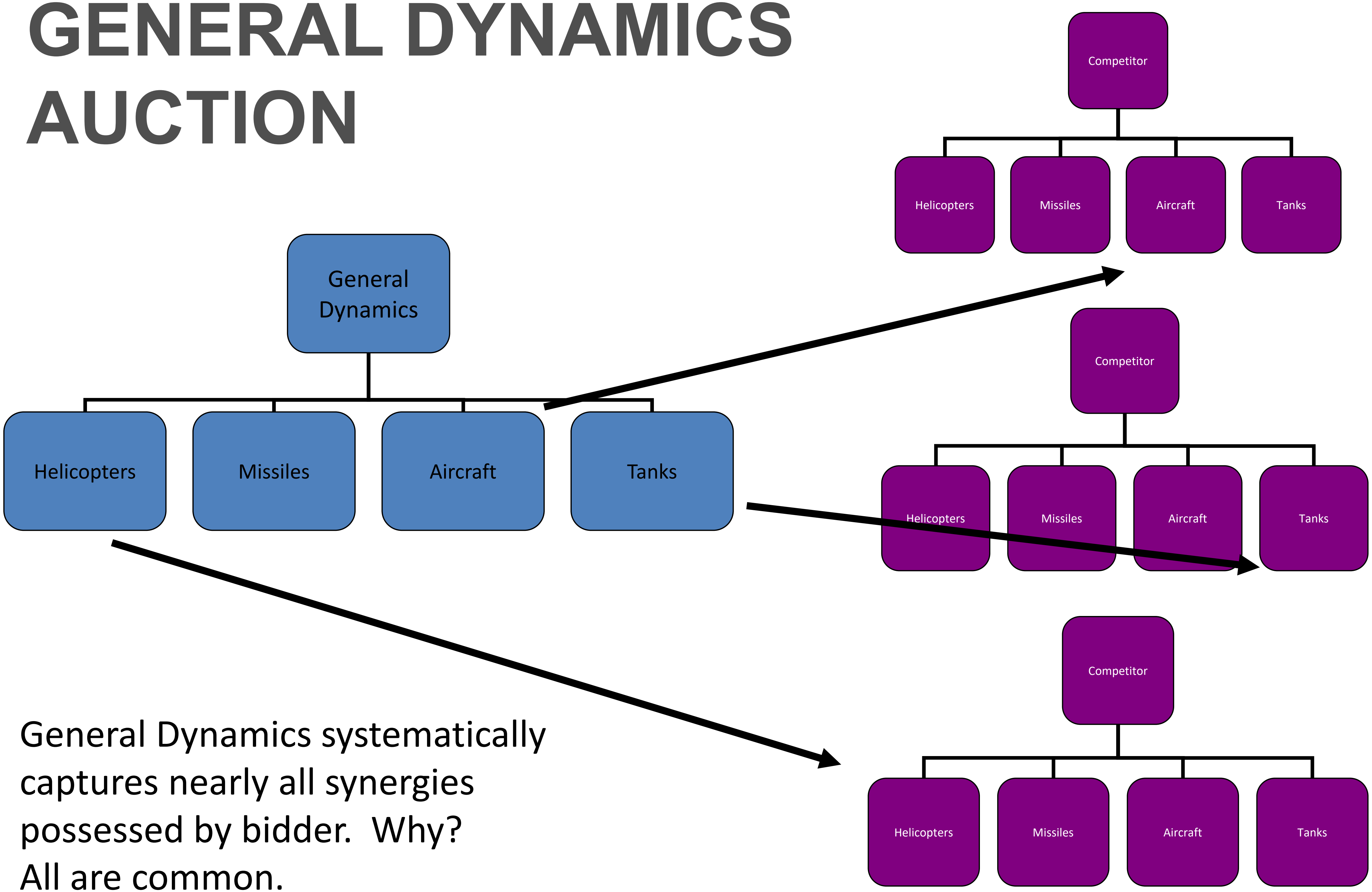
- …in an uncertain world, only the value of UNIQUE synergies beyond the *perceived synergies* of the next highest valuing bidder

DECLINE IN MILITARY SPENDING IN 1990S



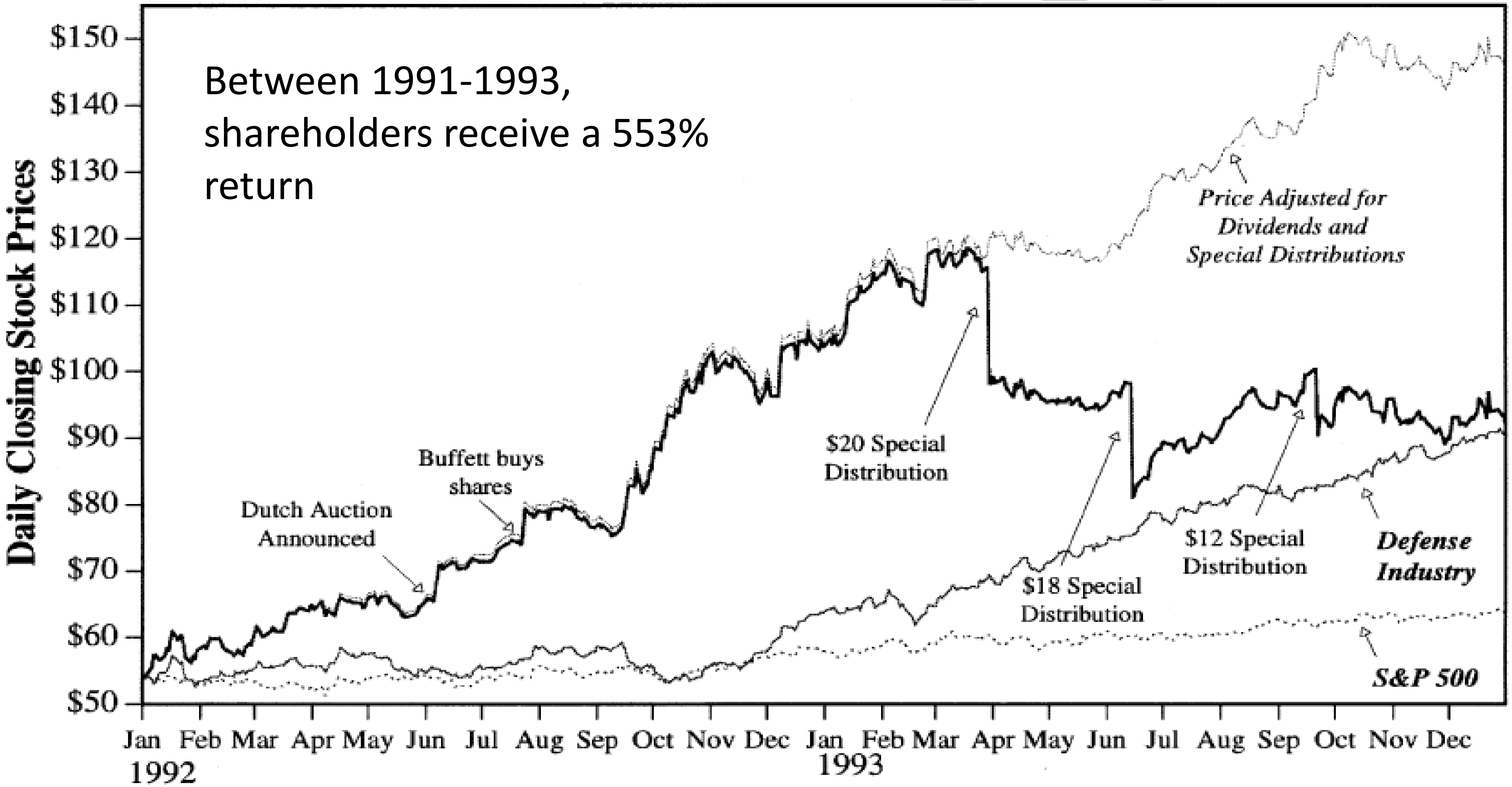


GENERAL DYNAMICS AUCTION



General Dynamics systematically captures nearly all synergies possessed by bidder. Why? All are common.

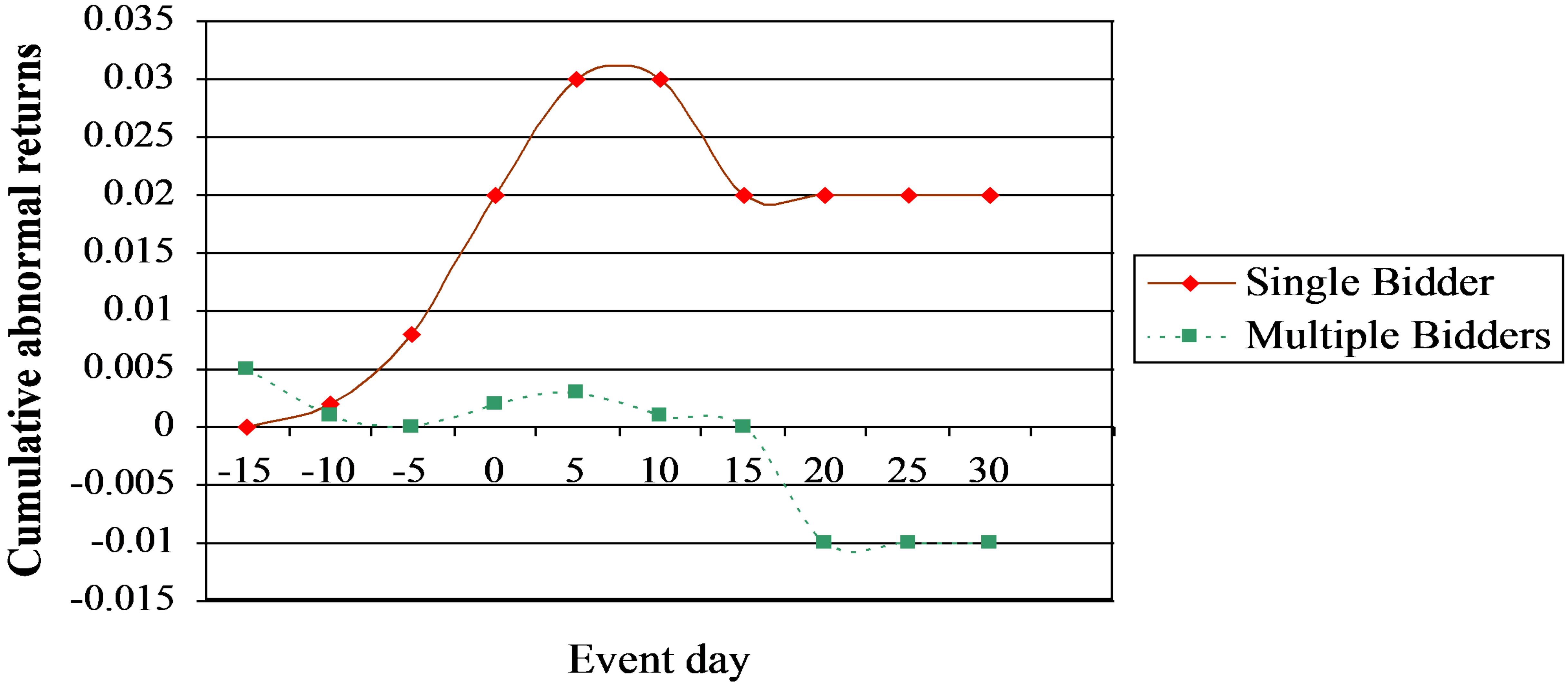
RESULTS


Between 1991-1993, shareholders receive a 553% return
Daily Closing Stock Prices
$150
$140
$130
$120
$110
$100
$90
$80
$70
$60
$50
Price Adjusted for Dividends and Special Distributions
Dutch Auction Announced
Buffett buys shares
$20 Special Distribution
$18 Special Distribution
$12 Special Distribution
Defense Industry
S&P 500
Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec
1992
1993

GENERAL DYNAMICS CONCLUSIONS

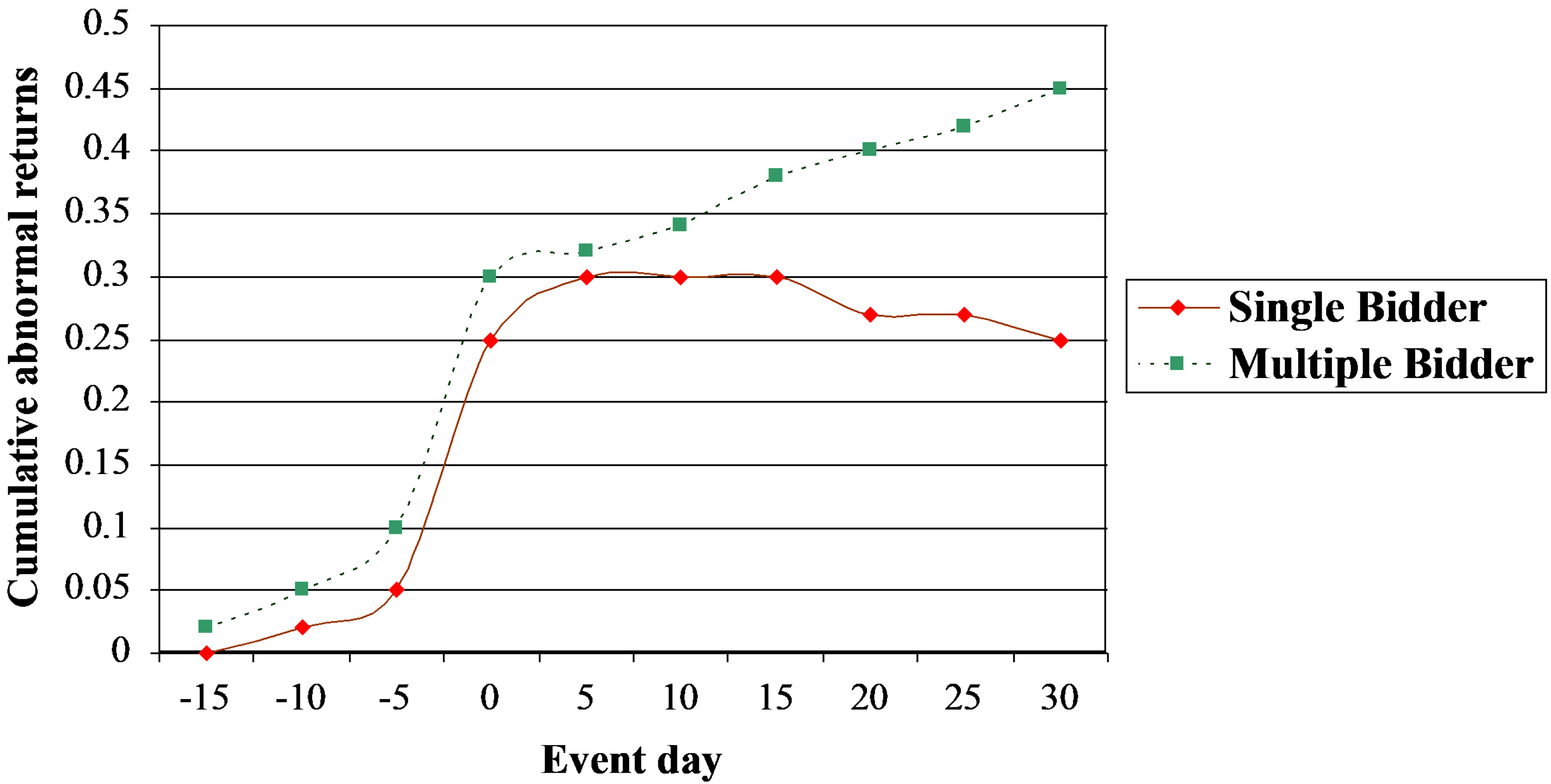
1. In settings where substantial synergies are present from recombining, re-sorting, or orchestrating assets, managers must decide whether to buy or sell.
2. Selling has clear advantages when synergies are common
3. Buying has advantages when synergies are unique.

M&A RETURNS-ACQUIRING FIRMS



Source: Bradley, Desai, & Kim, 1988

M&A RETURNS-TARGETS



Source: Bradley, Desai, & Kim, 1988

EMPIRICAL EVIDENCE ON ACQUISITIONS AND VALUE CREATION

- How do we reconcile? Acquisitions on average create value, but acquisitions on average fail.
- Answer:
  - The combined value is often greater than the sum of the separate values
  - BUT, more than the value created through the addition is paid to the shareholders of the target firm.
  - Thus, while the combination makes economic sense, it often does not make sense at the prices paid.
  - Reflects ABSENCE of unique synergies or ABSENCE of unique (and valuable) strategic theory

KEY MISTAKES IN THEORY-GUIDED ACQUISITIONS

- Confusing similarity for synergy
- Overstating uniqueness of synergies

GENERAL MILLS

Kenner®

Talbots

MONET

General Mills

LACOSTE

KIMBERLY KNITS

CASA GALLARDO
MEXICAN RESTAURANT

Red Lobster®

Eddie Bauer®
EST. 1920

GENERAL MILLS CORPORATE THEORY

Kenner®

Talbots

MONET

- GM has Foresight about industry growth
- GM has Deep understanding of consumer
- GM has Skills in consumer marketing
- There is Value in consolidation

LACOSTE

KIMBERLY KNITS

CASA GALLARDO
MEXICAN RESTAURANT

Red Lobster®

Eddie Bauer®
EST. 1920

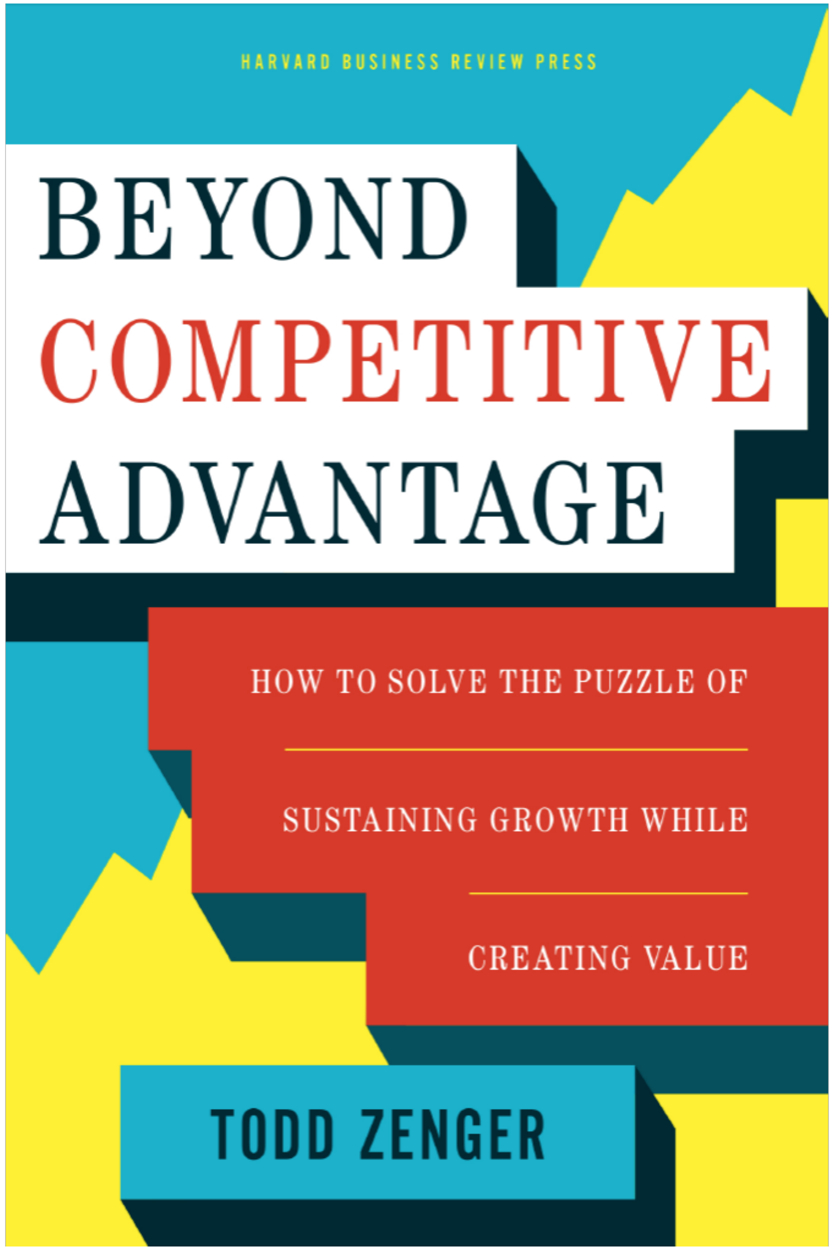
RESULTS

- From 1974-1984 underperformed the market.
- In 1984, value of consumer foods on its own was nearly worth the total market capitalization.
- After selling or spinning off non-core assets and refocusing on consumer foods, firm increases more than 4 fold in value in six years.

SAP BUYS QUALTRICS FOR $8 BILLION

KEY TAKEAWAYS

- Identifying synergies in an acquisition does not guarantee value creation.
- Value creation through acquisitions requires identifying unique synergies, or identifying synergies that others do not see, due to possessing a better theory.
- Value creation through divestitures involves exploiting unique synergies (or perceived unique synergies) that others possess with the assets of your firm.


HARVARD BUSINESS REVIEW PRESS
BEYOND
COMPETITIVE
ADVANTAGE
HOW TO SOLVE THE PUZZLE OF
SUSTAINING GROWTH WHILE
CREATING VALUE
TODD ZENGER