

LICENSING AND THE M&A EXECUTIVE

It's purely a coincidence, I'm sure, that mergers and acquisitions (M&A) and Marriage share the same two letters.

Unfortunately, the similarities between Marriage and M&A do not end there. The elements that drive a lasting and successful marriage are, in many respects, the same elements required for successful mergers and acquisitions.

Failed marriages in the United States result in divorce rates estimated at 50% of total marriages not counting the unsuccessful marriages that do not result in divorce in which the parties live unhappily ever after.

These statistics pale by comparison with the rate of unsuccessful mergers and acquisitions – currently estimated at 80%. The impact of these failures on shareholders, management and employees is so severe that new approaches must be developed to identify and screen potential candidates to minimize risk of failure.

Why are failure rates for M&A so high? To understand this phenomenon we need only look at the major contributing factor to failed marriages.

In a typical courtship, a handsome young man spies a beautiful young girl from a distance. He approaches her; they engage in conversation designed to present themselves in the best possible light; share a few laughs; identify some common interests; do some wining and dining; meet each other's families (all of whom are on their best behavior); and decide to get married and live happily ever after. In most cases, this level of premarital due diligence is about the same as that encountered in pre-merger/acquisition due diligence. In neither case do the parties really know their partner. Their infatuation, coupled with their grandiose plans, blinds the parties and prevents them from coolly analyzing the situation and determining whether they are sufficiently compatible to achieve a successful "marriage".

Marriages, whether between people or companies, that succeed with this level of due diligence do so only through luck.

The key to successful "marriage" is knowledge – both of yourself and your partner – to determine compatibility.

The primary causes of failed mergers and acquisitions, according to the literature, result from irreconcilable differences in cultures between the two entities; personality clashes between the two managements; and conflicting value systems.

A classic example of such failures is the well-documented 1998 acquisition of Chrysler by Daimler Benz. Daimler Benz was looking to establish a strong position in North America for cars that appealed to the mid-level segment of the market.

Chrysler, with a strong brand and excellent dealer network, suffered from a lack of capital and was perceived to have products of inferior quality that trailed GM and Ford in technical innovation. Daimler Benz, with its financial and technical prowess, believed that it could easily address Chrysler's issues and rapidly secure a strong and profitable position in the mid-level North American Market.

With great expectations, Daimler Benz acquired Chrysler for \$43 Billion. Less than ten years later, it sold Chrysler to Cerberus netting a piddling \$810 Million – a loss of more than \$42 Billion. This loss, while mind boggling, does not begin to tell the whole story. Throughout its ownership, Daimler was never able to operate Chrysler successfully as Chrysler recorded losses or minimal profits and required enormous investments in the form of capital and management resources from Daimler. When acquired by Daimler, Chrysler had a workforce of 130,000 employees – by 2005, the number of employees had dropped by 35% to 83,000 employees based primarily on reduced sales. Daimler Benz' Chairman and CEO was replaced and both Daimler and Chrysler emerged from the experience wounded and weakened.

Why did this acquisition that seemed so logical fail? To over simplify, the two parties were totally incompatible: German vs. American Culture, history and sensitivities; Daimler employed methodical, centralized decision making in a hierarchical management structure while Chrysler was focused on creativity and adaptability encouraging efficiency and empowerment of its employees; Daimler knew how to design and manufacture “high end”, “high precision” vehicles with few changes on a year-to-year basis while Chrysler served a middle to low-middle level market that required rapid response to competitive offerings. Had Daimler taken the time to understand the compatibility issues inherent in this acquisition and their impact on the probability of success, they certainly would have considered abandoning the acquisition or at the very least developing plans, in conjunction with Chrysler, to clearly address the issues and mitigate the risks.

Daimler-Chrysler is just one of many unsuccessful mergers or acquisitions: When AOL and Time Warner merged the market cap for AOL alone was \$166 Billion – the value of the combined firms is now \$28 Billion – less than 20% of AOL as a stand alone company; the merger of Merrill Lynch and BAC has not delivered – the Chairman of BAC was replaced: HP and Compaq – impossible to integrate - leadership, cultural and legacy issues (Chairman and CEO ousted); GM & EDS – moving EDS to the factory floor didn't happen – cultural issues made the deal unworkable; Quaker Oats – Snapple; BMW – Rover; Rite Aid – Thrifty Pay Less; Mattel – The Learning Company; all further examples that fill the graveyard of unsuccessful mergers/acquisition. While compatibility may not be the only cause for failure in each of these examples it is clearly a major contributing factor.

We can assume that each of the companies cited performed traditional due diligence analyses before proceeding with merger/acquisition. Clearly, these analyses did not provide management with the insight needed to sense and avoid the resulting failures.

If due diligence can't provide this data, what alternatives exist to assess compatibility of merger/acquisition candidates? As the aforementioned unsuccessful M&A transactions demonstrate, a complete understanding of a candidate is required to ensure that its culture, management and values are compatible with those of the acquiring organization. Furthermore, the evaluation process must provide an honest, accurate representation of the candidate company in its day-to-day activities and not the "best foot forward" snapshot typically obtained through due diligence.

How can a company get close enough to a prospective candidate to understand its inner workings; its values; and its attitudes toward empowerment, decision-making, honesty, quality and innovation? There are three possible options: One, look to your suppliers for potential candidates; two, look to your customers; and three, develop and assess a stable of top tier licensees (or licensors) through brand licensing as possible acquisition candidates.

Options one and two provide potential vertical acquisition candidates. Unfortunately, with rare exception the nature of customer/supplier relationships are generally "best foot forward" and may not provide accurate insight into the candidate.

Licensing, on the other hand, provides an opportunity to gain reliable insight into the licensee's/licensor's culture. Effective licensing programs demand that both parties work closely together in a "give and take" atmosphere. The parties "play in the same sandbox" and must work together to achieve common goals. If the two companies work well together and develop successful licensing programs they are likely to be compatible. Companies that have licensing relationships are not generally competitors, customers or suppliers. They instead provide real opportunities for growth through diversification.

Leading companies are pursuing this strategy as a way of testing diversification merger and acquisition opportunities that will provide new markets and gain access to new technologies. These opportunities can deliver on the M&A professional's promise that properly structured deals can achieve the new math where $1 + 1 = 3$.