

M&A Backers Must Beware of “Deal Fever”

Agencies must taking into account quality of the target and integration considerations

BY TIMOTHY J. CUNNINGHAM

Both 2007 and 2008 played host to terrific activity in the agent-broker merger and acquisition arena. It remains to be seen, however, whether 2009 will follow suit. Given the troubling uncertainty of the insurance market and the domestic economy, prudence is in order this year for those firms considering and undertaking acquisitions.

A common downfall amongst acquirers is to become smitten with “deal fever.” When this happens, a critical fact may be lost in all the M&A hype, namely that an acquisition’s ultimate quality stems from two conditions: the quality of the target and the quality of integration following the closing of a transaction. These issues may seem incredibly basic, but unless they’re accorded sufficient attention by acquirers, the results of an expensive and time-consuming acquisition can be disastrous.

When discussing the issue of quality of the target, the measure should be by the target’s ability to deliver projected financial results and earnings on a go-forward basis that are in line with the purchase price. Prudent acquirers will recall that many business-school studies indicate that from 50 percent to 75 percent of acquisitions in the public-company sector do not deliver their intended results. Thus, wise acquirers know that any financial modeling and projections they use must be realistic.

To that end, the purchase price or value of the target should never be based on a multiple of top-line revenues or commissions. Such multiples can be used as check-point metrics, but should never function as valuation equations. Instead, the purchase price or value should always be based on the target’s actual deliverable earnings or cash flow. Deal terms and structure cannot magically convert a poor target into a good acquisition. An apparently creative pricing and earn-out structure rarely will compensate for the intrinsic weaknesses of the target. Lost in an overly optimistic belief that terms and structure creativity will overcome weakness is the additional intellectual capital and staff cost that is required to integrate the weak target into the acquirer. Junk is junk, and some deals should not be completed at any price.

Two other common pitfalls in M&A are overly optimistic expense reductions and illusory economies of scale. Such savings are finite and usually fleeting. Even when an acquirer has excess infrastructure and excess staff capacity, these assets are soon absorbed by normal needs and growth thereby negating any such benefit. Even if this is not the case, a seller should rarely if ever be accorded the financial benefit of the acquirer’s economy of scale.

Components that should additionally be considered are the target’s culture and fit with the acquirer. Although hard to measure, these components are critical to the quality of an acquisition. An acquirer must unequivocally trust the target and feel confident that its management, staff, business operations and book of business will align with those of its own. This is not to suggest that a nirvana-like aura should surround

the deal. It is to say, however, that a lack of trust and alignment of interest should generally be deal breakers amongst other issues. Due diligence and purchase agreement language will never overcome a lack of suitable culture or trust in the target.

Planning for the integration of a target into an acquirer should be part and parcel to the number-crunching, analytics, deal terms, structure and negotiations. An acquirer should be mindful from the time of initial contact with a prospective target of the challenges that will be faced during the integration process. The old adage that “the devil is in the details” could not be more apropos than in acquisition integration.

The success of the integration process is predicated on two critical and inextricably linked pieces: the planning structure prior to the closing and its implementation after the closing. During both, communication among and between the acquiring firm and the target is absolutely key. The planning process should embrace all operational and related areas, from human resources, training and development, systems and procedures, to information technology. A member of the acquisition team should be tasked with responsibility for the integration plan, and the plan should be in its formative stage as terms are agreed to between the parties. The actual plan should be segmented by topical area and include:

- A list of tasks and sub-tasks.
- The point person at the acquirer.
- The point person at target.
- The target completion date.
- The actual completion date.

As soon as possible after deal terms are agreed to, the integration czar should roll out the plan. A person with similar but subordinated responsibility for the plan should also be designated at the target company. No detail is too small to be overlooked in achieving adherence to all completion dates.

Communication with the target’s staff is critical to manage expectations and minimize as much angst as possible with the transaction. There will always be some shock and uncertainty, and some individuals will carry a level of fear past closing, regardless of the quality of communication. Even so, it is important to be absolutely forthright at all levels. Any negative ramifications affecting the organization or to certain staff members should be communicated directly and without equivocation.

Experienced and wise acquirers embrace the concept that, on balance, the best deal may be the one that is never made. Management guru Peter Drucker opined many years ago that deal-making beats working. “Deal-making is exciting and fun, and working is grubby,” he said. “Deal-making is sexy. That’s why you have deals that don’t make sense.”

Properly executed, acquisitions can be an important part of an agency’s long-term growth strategy. But any such transaction done without proper attention to the quality of the target, and to the quality of integration after the deal is closed, could cause irreparable damage to the acquiring firm.



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