

***Master of Science  
in Innovation and Entrepreneurship  
2009***

***ENT 4400***

***3rd meeting***



**UNIVERSITETET  
I OSLO**

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# Overview



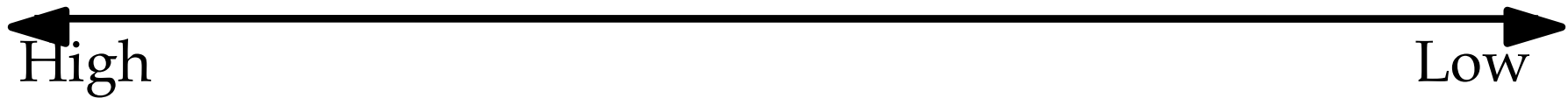
- 1st meeting:  
strategy – fundamentals and competition
- 2nd meeting:  
strategic choices – content and process
- 3rd meeting:  
extreme strategic choices – the rise and fall of businesses via M&A



# Agenda for the 3rd meeting

- **Growth alternatives**
  - Organic growth
  - Alliances
  - Mergers and acquisitions (M&A)
- **Internal preparations for alliances and M&A**
- **The M&A process**
- **Recommended reading:**
  - Technology Ventures ch. 14

# Degree of integration



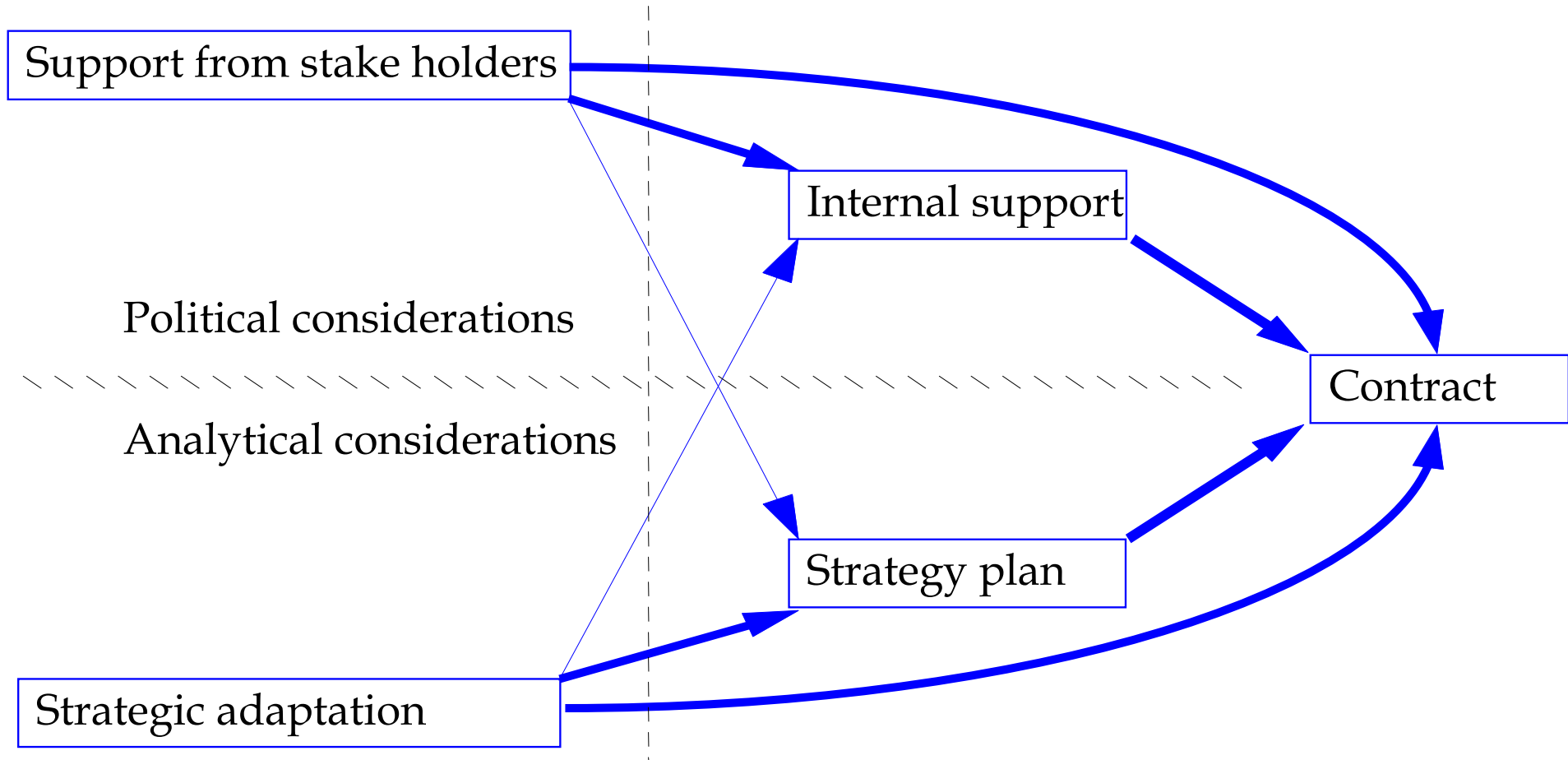
Degree of vertical integration

# Pitfalls



- Hidden strategies and motives
- Conflicting internal motives
- Lack of information and hidden assumptions
- Unrealistic belief in own strategies and motives
- Complex coordination of motives and strategies
- Lack of will to give up control

# Internal preparations for an integration process





# Strategic adaptation

- Coordination between strategic motives and potential forms of cooperation
- Cooperation related to the parties' total business portfolio
- Analyse conditions for a win-win-situation

# Support from internal stake holders

- Understand individual political behaviour and processes
  - Change of conditions in order to achieve individual objectives
  - Manipulation, negotiations and coalitions
  - Coalitions are often case by case
- How to deal with
  - Make the cases explicit
  - Predict and lead the behaviour of coalitions
  - Allocate time and energy base on the potential impact
  - To create a positive atmosphere is more a question of finding the right way than to win.



# Support from external stake holders

- Are major owners or groups of owners convinced?
- What will be the consequences for the company's reputation, and how will the stock market react?
- How will customers, suppliers, partners, sources of funding, and competitors react?

# Strategy plan



- The cooperation as a joint, continuous process
- Emphasise the benefits for the partners
  - Increased size
  - Speed
  - Complementary resources and competence
- Focus on competitive advantages created
- Identify and agree on common, coordinated activities
- Map the need for operational integration



# Internal support

- Is it clear who is expected to do what, and when?
- Is the cooperation well enough explained and motivated?
- Is the organisation aware of the tasks ahead and in a mode to focus on the opportunities?
- Are the questions potential reductions in staff brought up?
- Are relevant specialists motivated to do their work in a true cooperative spirit?
- Will staffs complement each other in their way of working together?



# Pitfalls in the internal preparation

- Lack of focus on the environment
- Too much politics
- Top management isolation
- Timing of response (too slow or too fast)
- Sudden need of change

# Mergers & acquisitions (M&A)

- A process approach
- Price and value
- Acquisition competition
- Over pricing and “the winner’s dilemma”
- Decision and funding

# Success or failure

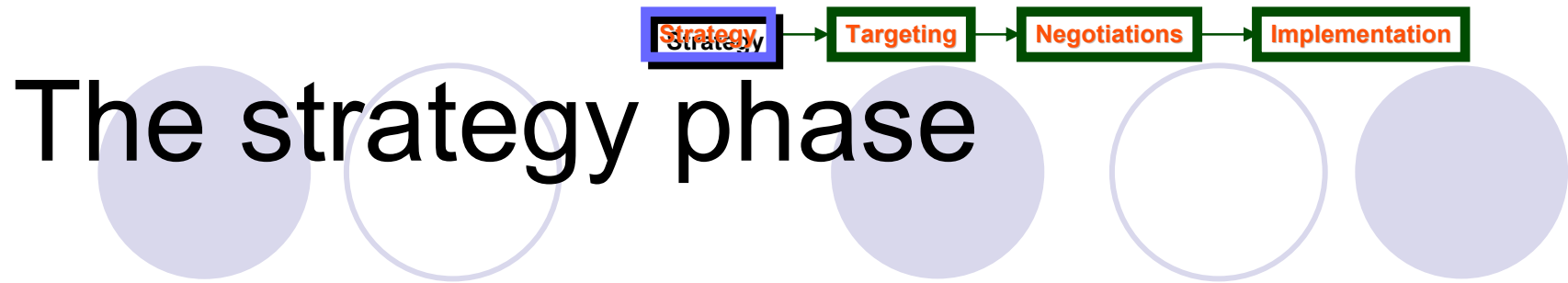


- Of what?
- When?
- Why?
- According to who?
- And to whom?

# A process approach to M&A

Mergers and acquisitions are complex processes:



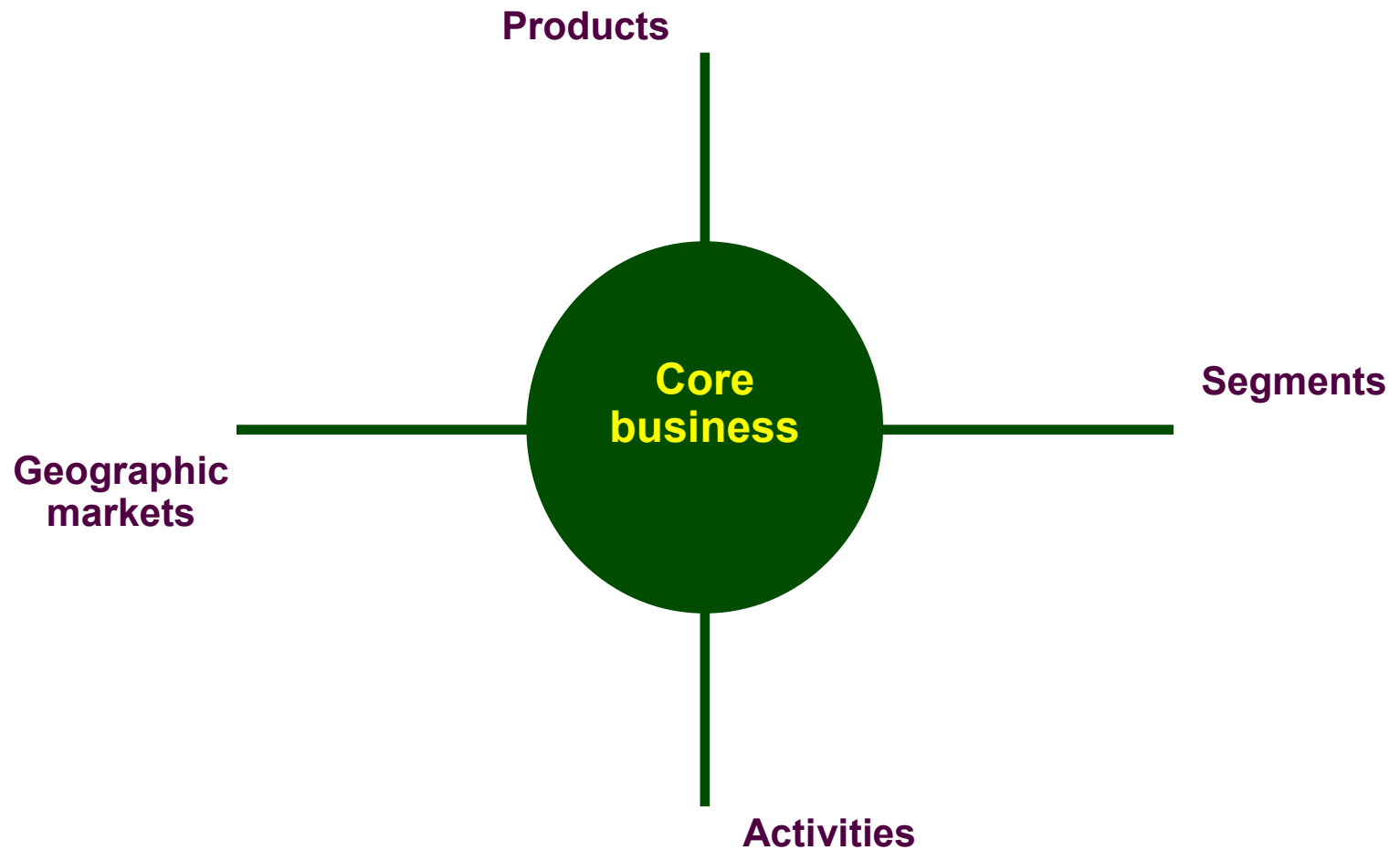


- Map the environment
  - Predict major changes
  - Focus on critical parts of the industry
  
- Industry analysis
  - Critical success factors
  - Key competence
  
- Analysis of the business
  - Compare strategy and vision
  - SWOT
  
- Strategic alternatives
  - Organic growth
  - M&A
  - Alliance
  - Wait and see





# NB! Realism in growth alternatives



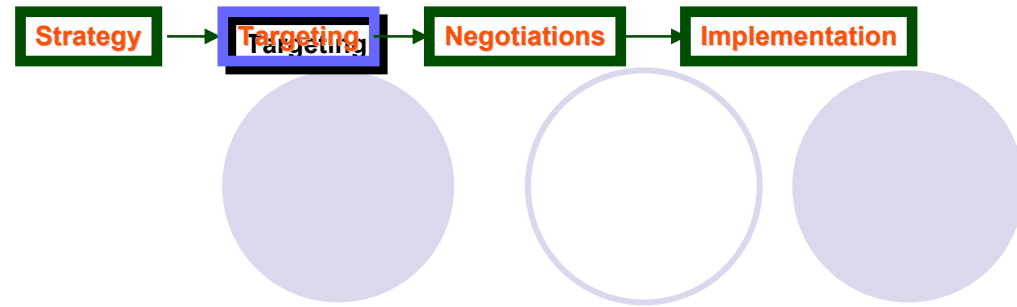


# Growth and risk

Risk increases in line with complexity:

- Attempts to grow along several dimensions at the same time
- M&A to "win time"

# Targeting



## Critical issues:

- Selection criteria and ideal candidate profile
- Search for potential candidates
- Choice of target
- Approach
- Initial contact
- Initiate negotiations



# Potential candidates

- Updated overview of strengths and weaknesses in key areas
- Evaluate with emphasis on
  - Activities that add maximum value at minimum cost
  - Key resources
  - Critical competence
  - Future challenges in the industry
  - Necessary competence to be able to exploit opportunities
- Personal contact with key personnel



# Ideal candidates

Look for strong and compatible companies who can:

- Help acquirer overcome complexity
- Create two-way synergies
- Avoid being dominated by acquirer
- Demonstrate a market position
- Improve acquirer's image
- Build mutual trust and respect
- Contribute to smooth and fast integration

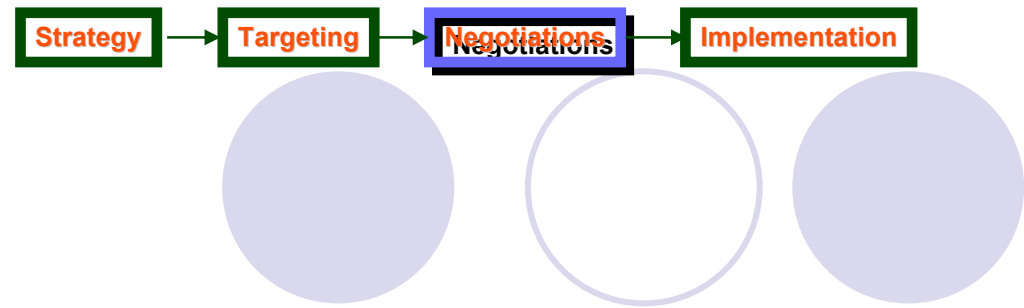


# Ranking of candidates

Ranking based on value for acquirer :

- Net present value of future cash flow
- Synergies
- Dependencies
- Total cost of the M&A process
- Price

# Negotiations



## Key issues:

- Initial contact
- Stepwise mapping of opponent's position
- Estimate of value
- Negotiation meetings
- Deal



# Negotiation issues

- Upgrade focus from two different pasts
- ..to a common future
  
- Create a positive atmosphere
  - Start with “simple” issues
  - Continue based on achieved results
  - Delegate to experts between negotiation sessions
  - Sum up and emphasise achieved results
  
- Documentation
  - Oral confirmation on achieved understanding
  - Start next session with a written summary of achieved results





# Key implementation issues

- Implementation should start in the strategy phase
- Maintain a balance of people from both companies, but make sure that the right person is in the right position
- Continue the surveillance of the environment
- Start early with communication of achieved results
- Control realism in synergy effects on both sides
- Take the lead!
- Create attitudes for one company
- Listen and communicate!
- Deal with conflicts immediately



# The post merger integration process

- Secure operations in target
  - Keep key management as long as possible
  - Give strong incentives to increase performance
  - Maintain basic systems
  - Allow management to focus on current business
- Treat those who will lose their jobs with generosity and respect
- Maintain and strengthen relations in the organisation



# Decision and funding

- Go/no go decision  
(with internal and/or external funding)
- An offer to the seller
- Board approval
- Announcement to stake holders
- Legally binding contract



**NB!!**

Always be prepared and willing to call off the process – if necessary with a loss,

i.e. avoid escalation of irrational engagements.

# Bidding contests



A market for corporate control is regulated by the following factors:

- The total number of potential acquisition candidates
- The total number of acquirers



# “The winner’s dilemma”

- When there are several potential acquirers bidding for a target, the winner is too often the one who has over-estimated the value of the target.
- The purpose of bidding is not to win, but to make a profit.



This raises some intriguing questions:  
(1) When does information become opinion?

- When everybody thinks so?
- When the CEO has made her decision?
- When the board has agreed?
- When the advisor says so?
- When it is too late to turn around?

## (2) What drives transactions?

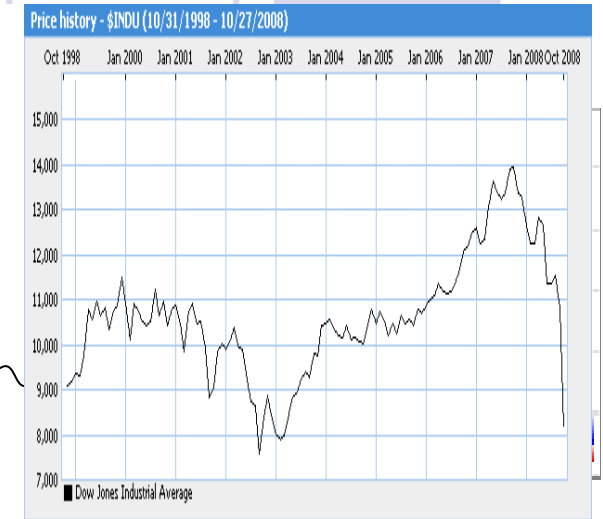
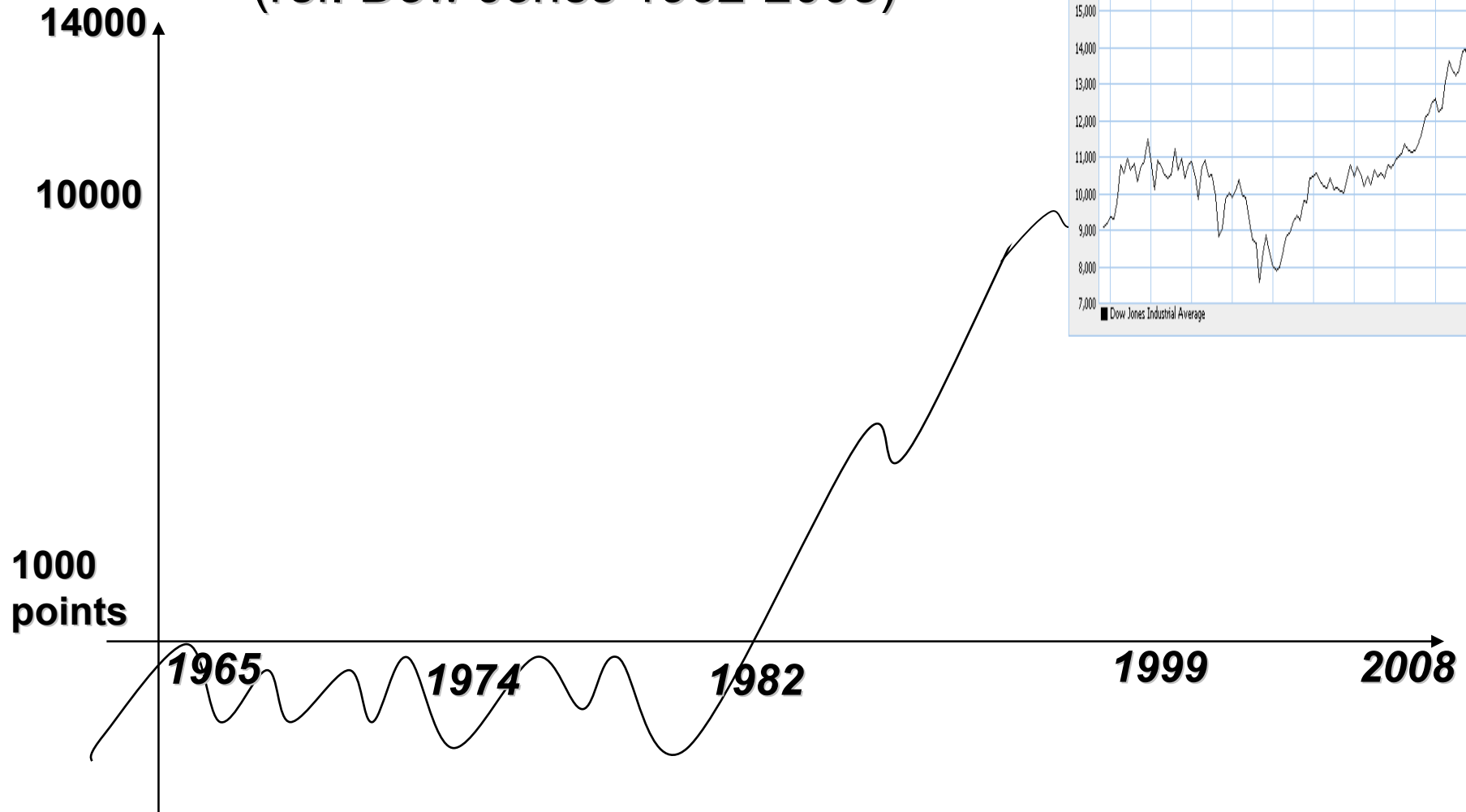


- External factors
  - Economic growth
  - "Bull" market
  - Access to funding
  - Political and financial liberalisation
  - Consolidation in an industry
  - ...and the role played by financial advisors
- Internal factors
  - Total concepts
    - "Control with value chain"
    - "Focus on strategic core"
  - Growth
    - "Time to market"
    - Synergies
    - New technology



# (3) When is something expensive?

(ref. Dow Jones 1962-2008)



## (4) Who wins – seller or buyer?

Acquisition	Buyer	Seller (target)
Related to strategic core	+5%	+17%
Related, but not to strategic core	0	+24%
Not related	-3%	+26%

Note: buyer typically 5x larger than target

Source: Gretland & Reve (1992)



## (4) Post M&A strategic management

- Have objectives been met?
  - typical objectives
  - value creation and synergies
- Turnover and organisational resistance
- Organisation culture

# Profit and synergies



- Since value is based on profit, and since profit is the difference between costs and revenues, the "magic arithmetic" in M&As takes place by:
  - Cost reductions
  - Increased revenues
  
- But remember
  - Paper synergies  $\neq$  actual synergies
  - Synergy is dynamic
  - Synergy as an attitude rather than a financial formula

# Watch up for implicit costs

Direct costs are quite easily identified, and are typically called: "*restructuring costs*"

- Compensation packages for laid offs
- Consultancy fees
- Adaptation of IT systems
- Closing of facilities
- Introduction of new brands
- Moving to new locations
- Etc.

# Implicit costs (ctd.)



Implicit costs are too often ignored

## In the entry phase

- Reduced effort
  - De-motivation
  - Key staff resigns
- Reallocation of effort
  - Queue of internal decisions
  - Lobby activity

## In the growth

- Negative economies of scale
  - Longer communication channels
  - Strangled creativity
  - Incentive problems
  - Increased wage costs
- Cost related to complexity
  - Time and attention
  - Sub-optimal compromises
  - Reduced responsibility

# Dangers and pit falls related to post M&A strategic management

- When strategy and motives are not coordinated
- Management develops “gigantomania”
- Analyses of the establishment process comes too late
- Too impatient
- Lack of attitude for change and innovation
- Can not give away “black box”
- Support from owner to board to management
- Employees’ interests are ignored
- Other market development than assumed
- Changes in ownership

# Summary



- Merges and acquisitions seldom create value
- Disposal of targets is more profitable than acquisitions
- Few companies and managers develop patterns
- Be conscious about the role of external, financial advisors



The image features seven light purple circles arranged in two rows. The top row contains three circles: the first is an outline, and the second and third are solid. The bottom row contains three circles: the first and second are solid, and the third is an outline. The text "Examples: M&A as a project" is centered horizontally between the two rows.

**Examples: M&A as a project**

# 1. Transaction overview

## Transaction overview

- The shareholders of Voyager Group are currently seeking offers for the component parts of the Voyager Group
- Tiger declined to make a bid for the whole of Voyager Group earlier in the year
- Tiger has been invited to submit a bid for the Business/Provider segments in Norway and/or the residential business – Propose to submit bid for Business/Provider
- Voyager Business Norway is the number 2 player in the market (after Telenor) servicing c.27,800 corporate and public customers
- Voyager Provider Norway offers white label services to around 45 customers who in turn sell on these services to in excess of 46,000 end users
- Voyager has unbundled 324 of Telenor's exchanges in 75 cities and installed a total of 445 DSLAMs, providing coverage of c.63% of Norwegian businesses
- Indicative offers are due on Thursday 11 October

## Business & Provider summary financials

Dec y/e (NOKm)	Business		Provider	
	2008E	2009E	2008E	2009E
Mobile	969	1,113	159	161
Fixed voice (incl.VOIP)	574	630	103	105
Internet access	192	204	22	22
Datacom	153	160	101	98
Professional services	77	79		
<b>Total revenue</b>	<b>1,964</b>	<b>2,186</b>	<b>384</b>	<b>385</b>
Mobile	212	242	15	15
Fixed voice (incl.VOIP)	152	177	8	8
Internet access	157	169	15	15
Datacom	100	105	64	61
Professional services	50	51		
<b>Gross margin</b>	<b>621</b>	<b>694</b>	<b>102</b>	<b>98</b>

## Breakdown of customers

<b>Business</b>	<b>27,736</b>
Public authorities	38
Municipalities	129
Corporates	27,569
SOHOs/low -end SMEs	25,778
High-end SMEs	1,573
Large corporates	218
<b>Provider</b>	<b>45</b>

Source **Voyager Information memorandum & addendum**

# 2. Timetable to Indicative Bid

Month		September							October													
Date		24	25	26	27	28	29	30	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Week	Responsibility	W/c 24 September							W/c 1 October							W/c 8 October						
Day		Mon	Tue	Wed	Thu	Fri	Sat	Sun	Mon	Tue	Wed	Thu	Fri	Sat	Sun	Mon	Tue	Wed	Thu	Fri	Sat	Sun
Tiger kickoff meeting	Tiger / NMR (dial-in)			■																		
Provide updated Voyager WACC	Tiger			■																		
Provide first view on synergies for model	SAGA				■																	
Provide comments on inputs to model	SAGA / Tiger				■																	
Tiger Treasury to confirm strategy for funding for IO letter	Tiger					■																
First draft of CMT paper circulated	NMR / Tiger					■																
Circulate draft IO letter highlighted where input required	NMR							■														
First draft of valuation, incl. Business Plan DCF, multiples, benchmarking and synergised case	NMR							■														
Conference call to discuss draft valuation	Tiger / NMR / SAGA									■												
Tiger Legal to confirm anti-trust position and strategy	Tiger									■												
Revised draft of Indicative valuation	NMR										■											
Circulate draft CMT paper to Claus (by close)	Tiger										■											
Circulate second draft of IO letter	NMR											■										
Financial secretary review of valuation?	Tiger												■									
Tax review of loss utilisation and other tax assumptions	Tiger												■									
Final CMT paper circulated to committee members	Tiger												■									
Circulate IO letter to legal, tax and financing teams	NMR														■							
Circulate final draft of IO letter	NMR																		■			
CMT meeting	Tiger																		■			
Submit IO letter by 1700 CET to UBS	Tiger / NMR / SAGA																			■		

# 3. Project management

## 3.1 Key workstreams

Steering group	
<b>Key tasks</b>	Overall direction and ownership of process Key strategic decisions Final signoff on key documents

Valuation	Synergies	Integration	Financing	Legal & documentation	Tactics, structuring	Due diligence
Build model based on Voyager BP (IO stage), DCF, multiples based valuations Develop Tiger case (FB stage) Incorporate financing assumptions Assess valuation and returns and impact analysis	Compute synergies between Tiger and target businesses  Provide outputs to valuation team for incorporation in the model	Develop plan for integrating target businesses eg. <ul style="list-style-type: none"> <li>- Branding</li> <li>- Key personnel</li> <li>- Assets/IT</li> <li>- Timing</li> </ul>	Identify and advise on best financing solution  Documentation for Indicative Offer  Financing documentation	Indicative and final offer letters SPA TSA Internal papers Anti-trust analysis and submission	Develop tactics and approach strategy Transaction structuring/considerations Bid documentation Liaise with vendor's advisors	Legal Accounting Tax HR Insurance Environmental

# 3. Project management

## 3.2 Workstream actions

Area	Responsibility	Deadline
<ul style="list-style-type: none"> <li>● Valuation           <ul style="list-style-type: none"> <li>▪ Confirm updated WACC analysis</li> <li>▪ Comments on draft model structure and inputs</li> <li>▪ Circulate first draft valuation</li> <li>▪ Conference call to discuss valuation</li> <li>▪ Circulate revised draft valuation</li> <li>▪ Conference call to discuss valuation &amp; price for CMT paper</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>[Tiger]</li> <li>SAGA, [Tiger]</li> <li>NMR</li> <li>NMR / Tiger / SAGA</li> <li>NMR</li> <li>Tiger / NMR / SAGA</li> </ul>	<ul style="list-style-type: none"> <li>26 Sept</li> <li>27 Sept</li> <li>1 Oct</li> <li>2 Oct</li> <li>2 Oct</li> <li>3 Oct</li> </ul>
<ul style="list-style-type: none"> <li>● Synergies           <ul style="list-style-type: none"> <li>▪ Provide synergy data for synergised case</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>SAGA</li> </ul>	<ul style="list-style-type: none"> <li>27 Sept</li> </ul>
<ul style="list-style-type: none"> <li>● Financing           <ul style="list-style-type: none"> <li>▪ Confirm funding strategy and documentation for IO letter</li> <li>▪ Provide documentation for IO letter</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>[Tiger]</li> <li>[Tiger]</li> </ul>	<ul style="list-style-type: none"> <li>28 Sept</li> <li>8 Oct</li> </ul>
<ul style="list-style-type: none"> <li>● Tactics &amp; structure           <ul style="list-style-type: none"> <li>▪ Call UBS for Q2 actuals and 2007 budget</li> <li>▪ Summary of key target management</li> <li>▪ Interloper analysis for CMT paper</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>NMR</li> <li>SAGA</li> <li>SAGA</li> </ul>	<ul style="list-style-type: none"> <li>26 Sept</li> <li>28 Sept</li> <li>28 Sept (am)</li> </ul>

# 3. Project management

## 3.2 Workstream actions (cont.)

Area	Responsibility	Deadline
<ul style="list-style-type: none"> <li>● Legal &amp; documentation           <ul style="list-style-type: none"> <li>▪ Circulate CMT letter draft1</li> <li>▪ Circulate IO letter draft1</li> <li>▪ Comments on CMT paper draft1</li> <li>▪ Tiger Legal to confirm anti-trust position and strategy</li> <li>▪ Circulate CMT paper draft2 to Claus</li> <li>▪ Comments on IO letter draft1</li> <li>▪ Comments back from Claus on CMT draft2</li> <li>▪ Circulate IO letter draft2</li> <li>▪ Circulate final CMT paper to Committee</li> <li>▪ Comments back on IO letter draft2</li> <li>▪ Circulate IO letter draft3 to legal, tax, financing</li> <li>▪ Legal comments on IO letter draft3</li> <li>▪ Tax comments on IO letter draft3</li> <li>▪ Circulate IO final draft IO letter draft4</li> <li>▪ Submit IO letter to UBS by 1700 CET</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>NMR</li> <li>NMR</li> <li>Tiger / SAGA</li> <li>Tiger</li> <li>Tiger</li> <li>Tiger / SAGA</li> <li>Tiger</li> <li>NMR</li> <li>Tiger</li> <li>Tiger</li> <li>NMR</li> <li>Tiger</li> <li>Tiger</li> <li>NMR</li> <li>Tiger</li> </ul>	<ul style="list-style-type: none"> <li>28 Sept</li> <li>1 Oct</li> <li>2 Oct</li> <li>2 Oct</li> <li>3 Oct</li> <li>3 Oct</li> <li>4 Oct</li> <li>4 Oct</li> <li>5 Oct</li> <li>5 Oct</li> <li>[8 Oct am]</li> <li>[9 Oct]</li> <li>[9 Oct]</li> <li>10 Oct</li> <li>11 Oct</li> </ul>