

## CONSOLIDATE FOR COOL

In 1997, I was at Dell headquarters in Round Rock, Texas, leading a seminar with Michael Dell, Kevin Rollins and other Dell managers, when rival Compaq announced its intention to acquire Tandem for \$3 billion. The following year Compaq's \$9.6-billion acquisition of Digital Equipment Corporation made it the world's second-largest computer company. One industry analyst at the time congratulated Compaq for moving up to the major leagues and not "screwing around with the Dells and Gateways" of the world anymore. Although analysts and observers were predicting catastrophe for Dell, I can tell you the reaction at Dell headquarters to both of Compaq's acquisitions: They cheered the news!

The Dell people expected Compaq to be consumed for several years with integrating both DEC and Tandem. They expected Compaq to be bleeding cash, focusing on its internal tribulations, and becoming distracted from growth opportunities that Dell would jump on. Dell would stay lean and profitable, and Compaq would remain a large, costly patchwork of quasi-aligned systems and corporate cultures.

The predictions came true: Compaq's performance and financials dropped after the merger and stayed that way for the next four years. But what Dell didn't anticipate was that, incredibly, Compaq would

be rescued from its acquisition follies by a company willing to overlook trivial matters like Compaq's lousy performance and the commoditization of the entire PC business. In 2002, HP paid \$19 billion for Compaq, even though Compaq was still digesting Tandem and DEC. As a result of buying another company, HP did indeed become the number one seller of PCs, but the newly consolidated company had two little problems. As noted in Chapter 5, one problem was that, while Dell was posting quarterly profits on its PC business and sharpening its ability to create cheaper built-to-order machines, HP was bleeding red ink on its investment and struggling just to maintain its market share—not by innovating, but by reflexively cutting prices to match Dell's, thereby accelerating the bleeding because its costs were so much higher than Dell's.

The second problem went even deeper. Here's how the *Economist* critiqued HP's defense of the acquisition:

HP is trying to be all things to all kinds of customers, and is leaving more and more of them plain confused. HP dominates in the market for printers, both laser and inkjet, and both for consumers and companies...[but HP's] public relations minions regularly circulate long and tedious lists of obscure sub-segments of the market in which HP has the largest market share—"fault tolerant systems," "external storage systems," "tape drives," "virtualization technology" and so on. Being big in so many different areas, they argue, means that HP is the "leader" and vindicates the merger.

Investors didn't buy it. HP's stock and reputation continued to plummet until CEO Carly Fiorina was finally forced out in 2005. Meanwhile, with quiet and relentless momentum, Dell continued to profitably grow its PC sales until finally it toppled HP from the number-one PC position in 2004. Dell maintained a growth in sales (17.1 percent), net income (6.4 percent), and return on assets (13.7 percent) that was significantly greater than comparable numbers for the much larger HP.

In 1997, Michael Dell told me that every week his office was inundated with intense investment bankers, corporate lawyers, and other assorted dealmakers trying to entice Dell to do deals, any deals, so that Dell could look like HP. Ignoring them was a full-time job. Michael Dell was smart. Conventional mergers and acquisitions can easily cripple your chances of breaking from the pack.

In this chapter, I want to prove to you that your company is far more likely to thrive if, like Michael Dell, you just say no to many merger and acquisitions “opportunities” and resist the usually flawed rationales for them. However, I also demonstrate that there are indeed valid acquisition opportunities that can help your company break from the pack. But in a Copycat Economy, you’ll need to employ new and rigorous standards for consolidating with other companies. After I present the reasons most mergers and acquisitions fail, I reveal six criteria guaranteed to help your company pull ahead of the pack, and guaranteed to drive deal-hungry investment bankers and egoistic CEOs crazy.

## **Failure to Succeed: The Record on Mergers and Acquisitions**

Merger and acquisition, or “M&A,” has become the growth strategy of choice for a huge number of executives. Is your company stuck in Commodity Hell? Are margins shrinking and customers bolting? Do you have few prospects for growth? Are your investors and board members getting restless? There’s nothing as fast and sexy as a high-profile merger to quickly inflate your numbers and show that you’re a “bold, can-do” leader.

During the 1998–2000 bubble era, annual deal volume averaged \$1.6 trillion, peaking at a whopping \$3 trillion in 2000. By 2004, it had dropped to “only” \$809 billion, still a 30 percent increase over 2003. In 2005, the number went up another 30 percent; in Europe, it went up 50 percent. The numbers are shockingly high and cut across most industries. Invariably, when I begin work with a new client, I hear the words “There’s a lot of consolidation going on in our industry,” as top executives cast a hungry look at a menu of other companies that they think might provide them with nutritional value.

A slew of rationales and justifications exist for all this frenetic deal-making activity. You’ve heard them all: Mergers are supposed to increase sales, market share, synergies, the breadth of product portfolios, and distribution channels for products, while providing cross-marketing opportunities, economies of scale and scope, leverage with suppliers, market exposure, and geographical penetration. Mergers are also supposed to spread risk, save taxes, and reduce redundancies. What could possibly be wrong with that? But the fact is, all those

lovely, conventional-wisdom reasons for merger deals are like the beautiful but deadly Sirens beckoning Ulysses. They look and sound great, and too often they'll run your ship right into the rocks.

More than a decade's worth of evidence shows that the HP/Compaq acquisition debacle was actually the rule, not the exception. As early as 1995, a *BusinessWeek* cover story, "The Case Against Mergers," reviewed the available data and declared, "Over the past 35 years, mergers and acquisitions have hurt more than helped companies and shareholders." In 1997, Mark Sirower of New York University published *The Synergy Trap*, summarizing data on 168 deals and concluding that literally two-thirds of them destroyed shareholder value. The analysis in *Barron's* 1998 cover story, bluntly entitled "Why Mergers Don't Work," leads it to state that "most of the research indicates that between 60 percent and 80 percent of mergers are financial failures."

Other studies went on to find the same results. Steven Rattner, deputy chairman of Lazard Freres, reported in 1999 that his firm discovered that in the mid- to late-1990s, "the average acquirer's stock was 3.7 percent lower than its industry peer group a year later." According to Rattner, "companies that remained on the acquisition sidelines performed better in the stock market than acquirers." That same year, Harvard's Robert Eccles and his colleagues published empirical research in the *Harvard Business Review* concluding that "well over half of mergers and acquisitions failed to create their expected value" and, in fact, "in 59 percent of the deals, the total market-adjusted return of the acquiring company went down *on announcement*. That means the market thought the deal would destroy rather than create value for the shareholders...." In 2000, a KPMG study found that 83 percent of 700 large mergers failed to boost stock price, while a McKinsey study found that only 23 percent of acquisitions ever recover the costs of the marriage, and the *Wall Street Journal* ran a lead story with the headline "Big Mergers of '90s Prove Disappointing to Shareholders." A series of studies by Booz Allen & Hamilton published in 2001 showed that "fewer than half of these mergers succeed.... By whatever measure you choose—stock price, revenues, earnings, return on equity—most deals fall short of expectations."

More recently, in 2005, *BusinessWeek* reported that its own "investigations in 2002 and 2004 showed that 61 percent of big deals hurt the buying company's shareholders. Half of them also leave customers dissatisfied." *Fortune's* take on the matter in 2005 was not dissimilar: "Today's merger craze is most likely to have the same results