

Strategic Drivers of Successful Acquisitions

The following was taken from a conference presentation by John W. Loeb, a Principal with the J.H. Chapman Group, L.L.C.

You may be familiar with what we call a reactive acquisition program in that you receive Offering Memorandums from firms such as ours on a regular basis. You are contacted because an investment banker believes that you may have an interest in acquiring the company. However, the belief is formed without meaningful knowledge of your interests or criteria and therefore most of these contacts do not result in an acquisition.

In those cases where there does appear to be a fit, the buyer is involved in an auction process competing with others that may have greater financial strength or more leveragable synergies.

A pro-active acquisition program provides the buyer with the ability to identify specific targets that, based on marketplace information, fit one or more of your pre-determined criteria. These companies are normally not currently "for sale". By the use of experienced acquisition specialists, hopefully the J.H. Chapman Group, companies, when presented with the opportunity to sell to a company that brings more than just money, are often attracted and can be successfully acquired.

It is relatively simple for buyers to determine their financial criteria. Those are concepts which are easily understood by the advisor as well. However, when implementing an acquisition program, companies should be prepared to go beyond their financial criteria. This is made possible when the buyer and its advisor clearly understand the strategic drivers of an acquisition and can quantify the synergies, so that a diligent examination determines that future profitability falls within the financial criteria, even though on the surface, the criteria may appear to be exceeded at the time of closing.

Most acquisitions are driven by the concept of strategic fit. This means that the buyer believes that the target is compatible. In many cases, however, two companies that may differ in attributes may make them even more attractive. Such a case exists when the products, services or qualities exclusive to one company fill a capability gap inherent in the other company and vice versa. While this is a justifiable rationale for a merger or acquisition, it is normally not enough.

Too often the assumption of a strategic fit serves as the main driver for an aggressive cost-cutting approach. The numbers often look good but, in practice, the strategy frequently fails because the benefits of initial cost reductions may not continue. The hard savings are easy to identify and are probably achieved as planned. However, the soft savings are more difficult to quantify and often seem elusive when two cultures are put together.

The best M&A driven strategic advantage is comprised of multiple synergies that:

- focus on growth rather than only cost savings
- integrate easily to form the merged entity
- deliver benefits that materialize over the long term.

While the remainder of this presentation will identify strategic drivers, it needs to be noted that there are exceptions, particularly when the reason for an acquisition is growth without concern for strategic advantage. It was out of this thought process that certain food companies in the 70s and early 80s became conglomerates – for example, Beatrice with over 400 profit centers and Consolidated Foods, now Sara Lee, with a number of totally independent industries and companies. Much of the merger and acquisition activities since the mid-1980s has been the result of de-conglomerization and greater focus on a company's core strengths and products. For example, Agrilink, which was formerly called Curtice-Burns, made eight acquisitions and then, most recently, four divestitures. Dean Foods divested the frozen vegetable group to focus on dairy and specialty foods. Beatrice was totally separated and sold in many, many parts. Sara Lee significantly reduced their products and independently operating companies.

There are many reasons why companies forge unions through corporate combinations. Growth synergies are far more difficult to identify, quantify and implement than the savings synergies which are usually quite apparent and easily measurable.

What are some of the strategic drivers of a successful acquisition?

1. **Effecting Organizational Growth** – By increasing its scope and leverage simply by becoming bigger, companies usually increase liquidity and access to the capital markets while broadening the name or brand awareness into an additional geographic market. While there are basic economies of scale, growth is best when combined with other strategic synergies. Then the advantage of size can act as a foundation and catalyst for increased market share, production enhancements, and new market penetration that can lead to a distinct competitive advantage.
2. **Increasing Market Share** – Unless a company introduces a totally new product, market share increases are a zero sum game. Pampers in the early 60s, SlimFast in the early 80s, are new item examples. New services such as computer software and new efficiencies through packaging such as chill pack poultry or pre-cut and washed salad makings are other examples. However, food companies which conduct expensive sales and marketing battles to grab already established brand loyalty from a competitor often achieve little growth with reduced profits. More often than not, acquiring a competitor is less expensive and offers greater opportunity for increasing market share profitably. Sometimes, a buyer's non-core brand can explode through a seller's distribution network. Conversely, a seller may offer products not central to their marketing but which fit splendidly with the buyer product line.
3. **Gaining Shelf Space in New Markets or Access to New Distribution Channels** – A similar or related product that is #1 in a local or regional market is often more valuable than a #3 or #4 national brand. Also, a similar product packaged for a new distribution channel, such as convenience stores, warehouse and club store markets, or foodservice, is most valuable to companies who have great strength at conventional retail but little expertise and distribution in other channels.
4. **New Products** – Companies that focus on growth are always considering the “make or buy” decision. Clearly, new products that have at least gained acceptance in a local or regional market or channel of distribution are desirable. These companies

offer extraordinary potential for a company who has strong national or international marketing capability.

5. **Responding to Changes** – Companies are often forced to modify or change their products, marketing, operations or services in order to stay competitive and profitable. Social, economic and demographic shifts result from factors beyond a company's control. Such changes can be viewed as either opportunities or threats but, in any event, must be acted upon.

Frequently an acquisition can provide the vehicle for change. An example was clearly evident in the chain bagel bakery and restaurant industry. In that business, Starbucks repositioned coffee from a "wake me up" to a dessert as well as an accompaniment to pastry and desserts. Without exception, hundreds of bagel bakeries and restaurants either developed or acquired a coffee brand to go with their bagel and restaurant brand. Big Apple Bagels purchase of Brewster's coffee is just one example.

6. **Capitalizing on Political and Regulatory Change** – Government deregulation in once heavily regulated industries such as energy, telecommunications and banking have led to increased competition and extraordinary merger and acquisition opportunities and execution. The ever changing health care environment has provided those financially strong companies with an opportunity for tremendous growth through acquisition. In the 60s and 70s and continuing to this very moment, the government's interest in and laws governing the role of minority businesses has provided joint venture and acquisition opportunities in a variety of product and service businesses.
7. **Acquiring Innovations in Products or Technology** – Frequently, innovations in products and technology are achieved by smaller, newer and entrepreneurial companies. These companies often reach a point at which they are better off being owned by a larger and stronger entity that can maximize their opportunities. It is here where the equation of 2 plus 2 equaling 5, 6 or 7 is most possible and where the buyer and seller can most readily agree on the future value of the entity. For example, the innovation of kettle potato chips resulted in a number of acquisitions of small companies by such companies as Curtice-Burns, now Agrilink, Nally's purchase of Tim's Cascade, and Anheuser-Busch's purchase of Cape Cod Potato Chip Company. The acquisition of Golden Valley Microwave Popcorn by ConAgra is yet another example.
8. **Reducing the Number of Competitors** – This is clearly a most natural driver of acquisitions in that it increases sales and market share and reduces pricing pressure. These acquisitions almost always face major regulatory reviews. They do occur. Coca-Cola acquiring bottling companies, IBM's purchase of Lotus, Anheuser-Busch's purchase of brands like Michelob, Miller Brewing's acquisition of numerous brands, and AOL buying CompuServe are just some of the well-known companies that have significantly increased market share both domestically and abroad, through acquisitions. Supermarket acquirers like Safeway, Kroger and Ahold are further examples. Finally, Dean Foods' consolidation of the dairy industry illustrates the building of market share through acquisition.
9. **Strengthening Reputation** – One strategic driver that is the most difficult to quantify is the value of adding a company and its product or services to strengthen the buyer's image and reputation in the marketplace. Years ago, Flowers was

recognized as a leading low cost producer of branded and private label bread and rolls. About a decade, Flowers acquired all the Winn-Dixie bakeries and private label became dominant. Flowers has acquired Pies, Inc., a nationally recognized quality brand of foodservice pies, Mrs. Smith's pies, the leading national brand frozen pie in supermarkets, and Keebler, a leading national brand cookie and cracker manufacturer. These acquisitions changed and strengthened Flowers by providing expertise in brand merchandising.

10. **Financially-Based Acquisitions** – Lower interest rates are often a primary driver for acquisitions in that strong companies can acquire other companies using inexpensive debt rather than high cost equity. For the larger public companies, their own high market values are frequently a good motivation driver to acquire in that these companies can use stock as cash. This situation is less prevalent in transactions involving an entrepreneur or family business in that they usually are quite reluctant to exchange a known risk, namely their company, for an unknown risk of somebody else's stock.

These are just some of the strategic reasons that we see as we assist food companies in their acquisition program. Our clients are knowledgeable about these drivers and provide us with an understanding of which are the most important to their situation. With this information, we can develop the strategic acquisition target list and make those contacts. To acquire good, profitable and growing companies, a buyer needs to identify and quantify synergies. A strategic acquisition can only be justified if the acquiror has a clear understanding of his objectives and how the target fits the strategy long term.

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