GROWTH PROCESS TOOLKIT

Mergers & Acquisitions

Accelerating M&A Growth through Early-Stage Planning and Evaluation
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INTRODUCTION

The Pressure to Grow
In spite of the risks associated with M&A, today’s competitive marketplace makes it nearly impossible for an organization to achieve its growth objectives through organic growth alone. Indeed, recent studies suggest companies that don’t complement internal growth with external activity, such as M&A, find it increasingly difficult to provide the top-line and bottom-line results that shareholders expect. Companies looking to expand into new markets, pursue new innovation opportunities, and hit aggressive targets must therefore build M&A into their growth strategies.

The Irony of Good Intentions
M&A represents a tantalizing shortcut to accelerated growth – and while not entirely without merit, in reality, most companies that pursue this promise ultimately face losses and complexity rather than gains and simplicity. Countless business periodicals reference troubling statistics attesting to the seemingly insurmountable difficulties that accompany M&A, as outlined in part below.1

- 75% of larger mergers destroy, rather than create, shareholder value
- 50% of companies decline in productivity following a merger announcement
- 47% leadership attrition can be expected within the three years following a merger
- 14% drop in employee satisfaction can be expected immediately after a merger

Indeed, a close look at hundreds of deals made in the early- to mid-1990s led Business Week to conclude that even those deals that were several years old hadn’t begun to work. Of 150 deals valued at $500 million or more, more than half had destroyed shareholder value, and 30 percent contributed only marginal improvements.2

Therefore, while companies pursue M&A as a means to achieving growth targets, the reality is that most M&A activity ultimately fails to deliver shareholder value.3

What Are You Doing Wrong?
Much has been written on the challenge of integrating two companies once the merger or acquisition has been completed. Indeed, a recent Frost & Sullivan survey indicated that 50 percent of executives cite internal challenges as the primary reason for M&A failure. Other studies blame poor integration for up to 70 percent of all failed transactions.4

An often-overlooked problem, however, is the failure to conduct appropriate upfront market and target research that, if executed properly, lays the foundation for a successful transaction. In spite of the fact that early-stage research and analysis can go a long way toward mitigating the challenges faced during the final stages of M&A, companies continually under-invest in this activity and therefore succumb to the following pitfalls:

Pitfall #1: Your M&A Strategy is Reactive, not Proactive5
It is easy for companies to fall into the trap of pursuing a promising opportunity for superficial reasons – perhaps because competitors are also interested, perhaps because the company has a certain cachet that automatically suggests success. Regardless, the mistake here is that companies should never pursue a target simply because it is available, rather than whittling many opportunities down to a single, best-fit prospect.

Pitfall #2: You Believe What You Want to Believe6
As a company begins pursuing a target, the cost of abandoning the deal becomes ever greater. It is very easy for executives to convince themselves that all due diligence points to success – rather than acknowledging any surfaced warning signs (in spite of the fact that it is far less costly to walk away from a deal during the due diligence phase than to stubbornly see a bad deal through to completion). Put another way, many executives mistakenly suffer from over-confidence, escalating commitment, and an absence of skepticism.

Pitfall #3: You Don’t Know Why You’re Merging/Acquiring (Not Really)7
Harvard Business Review recently surveyed 250 senior executives who had done major deals and found that more than 40 percent had no “investment thesis” – that is, no projection for how the deal would grow the company. Furthermore, half of those who did have an investment thesis discovered within three years following the deal that the thesis was wrong. Ultimately, less than one in three executives pursued an M&A growth strategy for the right reasons and with the right process in place.
INTRODUCTION (CONTINUED)

What Are You Doing Wrong? (Continued)
The following case example illustrates how one company failed to avoid these pitfalls and suffered the consequences:

Case-in-Point: Rubbermaid’s Merger with Newell

Situation: Newell and Rubbermaid sell household products through the same sales channels and see an opportunity to reap significant cost savings by merging operations.

Action: Rubbermaid presents Newell with an exclusive opportunity to acquire the company. Convinced of the merit of the opportunity, Newell pursues the $5.8 billion merger rapidly and without examining other options.

Result: Once the deal is complete, the companies realized their operating structures are completely incompatible – leading to unending confusion that prevents rather than accelerates growth. In 2002, Newell writes off $500 million in goodwill – but not before Newell shareholders lose 50% of the value of their investment and Rubbermaid shareholders lose 35%.

Key Takeaway: Do not under-invest in upfront research, analysis, and due diligence, and do not pursue any deal that does not fit squarely into a well-articulated growth strategy. You must know what you’re buying before you buy it.

The Solution
Former head of Lehman Brothers Warren Hellman famously wrote in his book The Synergy Trap that, “So many mergers fail to deliver what they promise that there should be a presumption of failure. The burden of proof should be on showing that anything really good is likely to come out of one.”

How do you meet that burden of proof? How do you show that anything good is likely to come out of a merger or acquisition? The answer lies in a strong understanding of the desired outcome of M&A – i.e., smart companies begin with the end in mind. As illustrated by the Rubbermaid-Newell fiasco, this does not mean considering integration issues once you’ve already begun or completed negotiations with a target company (and the cost for walking away is so high). It does mean carefully vetting all sectors and targets for alignment with strategic objectives – and never letting what you think, or want to think, get in the way of what you know.

In sum, smart companies follow a rigorous process for researching markets and identifying targets. They understand the very first steps in the process set the tone for everything to follow and plan accordingly. Importantly, they also understand specifically how the target fits into a larger growth strategy, and they know exactly what they can expect to achieve through the acquisition. The following case example shows how one company successfully pursued M&A with a total commitment to strategic fit:

Case-in-Point: Kellogg’s acquisition of Keebler

Situation: After decades as the market leader in the cereals/breakfast categories, Kellogg’s finds itself competing against lower-priced competitors and battling changing consumer behavior and the increasing irrelevance of breakfast. Between 1996 and 2000, Kellogg’s stock price declines by 20 percent.

Recognizing that Kellogg’s greatest asset is its brand strength, Kellogg’s refuses to engage in a price war and instead builds a strategy based on further cultivation of its brand value. Part of this strategy includes broadening its distribution apparatus – which it believes will be cheaper to buy than build internally.

Action: Armed with this strong strategic understanding, Kellogg’s conducts extensive market analysis to identify companies with well-aligned distribution networks and ultimately targets Keebler, a company with a highly sophisticated direct-store delivery system. Kellogg’s estimates that acquiring Keebler’s distribution system will add one to two points to its top-line growth.

Result: Following the Keebler merger, Kellogg’s revenues rise 43 percent between 1999 and 2003 and operating income nearly doubles.

Key Takeaway: Don’t pursue M&A without clearly defined objectives. M&A should fit within a larger growth context and should always be a means to an end, rather than an end in itself.
INTRODUCTION (CONTINUED)

How Do You Do It?
The answer lies in a rigorous process for managing each phase of M&A. Smart companies structure their M&A processes around specific activities that ensure that no corners are cut and all pertinent information is surfaced. This discipline forces them to collect the right information, and the tools they use force them to think about this information objectively.

Frost & Sullivan specifically organizes the M&A process into the following phases:

<table>
<thead>
<tr>
<th>PHASE</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>SECTOR AND TREND ANALYSIS</td>
<td>High-level analysis of all potential sectors and markets a company might evaluate when pursuing growth through M&amp;A</td>
</tr>
<tr>
<td>TARGET-SPECIFIC EVALUATION</td>
<td>Principled consideration of potential targets within an identified sector</td>
</tr>
<tr>
<td>TRANSACTION DUE DILIGENCE</td>
<td>In-depth research of the target company that takes place before a deal is signed</td>
</tr>
<tr>
<td>POST-DEAL INTEGRATION AND STRATEGY</td>
<td>Combination of both companies’ people, processes, and systems</td>
</tr>
</tbody>
</table>

As suggested by the shading above, this book will focus on the first two phases of M&A: Sector and Trend Analysis and Target-Specific Evaluation. As noted previously, many executives underestimate the importance of these activities and tend to spend less time on upfront research than they should. This book therefore takes a close look at those phases and lists the key activities and tools that will help save time and money down the road. The next page provides greater detail on what this book specifically features.
HOW TO USE THIS TOOLKIT

The Growth Process Toolkit for Mergers & Acquisitions

What it is: On a high level, this toolkit will help you ask the right questions and focus on the right activities throughout the early stages of M&A. If you use this toolkit, you will not be at a loss for how to get started, how to organize your information, or what to do next.

On a more technical level, this growth process toolkit presents Frost & Sullivan’s best thinking and work on the early stages of M&A (i.e., Sector and Trend Analysis and Target-Specific Evaluation) in a step-by-step implementation format. This research gives Growth Team Membership (GTM) members proven processes, tools, and templates to help you successfully manage the M&A risks and pitfalls listed on the previous pages.

How it will help you: This toolkit will help you and your team execute early-stage M&A activity. While we recognize that Transaction Due Diligence and Post-Deal Integration are critically important phases, we believe that they become infinitely simpler if due attention is paid to the first two phases – phases that, as previously noted, most companies tend to ignore, and as a result we have chosen to focus our efforts on this area.

How to use it: This book is divided into two sections: Sector and Trend Analysis, and Target-Specific Evaluation. Within each section, we have outlined a variety of activities that you should complete. For each of those activities, we will provide you the tools, templates, scorecards, or checklists that you need to complete that activity to a Frost & Sullivan standard. You can read this book cover-to-cover, or you can reference the clickable table of contents to access specific sections.

Be on the look-out for various reminders throughout this book. We will alert you at key stages when you should involve certain stakeholders, or when it might be a good idea to leverage additional GTM resources to help you with certain activities.

We encourage you to bookmark this toolkit, save particularly helpful tools to your desktop, and share it with your colleagues. We also encourage you to contact your Account Executive if, at any point in your analysis, you require assistance.

The Growth Process Toolkit’s Key Terms and Definitions

For full clarity, the table below lists Frost & Sullivan’s definitions for several terms used frequently throughout this toolkit.

Key Terms and Definitions

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market</td>
<td>A geographic region considered as a place for sales</td>
<td>U.S. Market</td>
</tr>
<tr>
<td>Sector</td>
<td>A distinct subset of a market; can also be a subset of an industry</td>
<td>U.S. Airline Sector (subset of the U.S. Market and of the global airline industry)</td>
</tr>
<tr>
<td>Segment</td>
<td>A distinct subset of a sector</td>
<td>Commercial Airlines</td>
</tr>
<tr>
<td>Target</td>
<td>A company under evaluation M&amp;A by an acquiring organization</td>
<td>Southwest Airlines</td>
</tr>
</tbody>
</table>
As noted previously, a recent study of senior executives who had done major deals revealed an alarming lack of focus: more than 40 percent had not articulated a specific reason for accelerating growth through M&A.

As a result, the first step in this toolkit – a precursor to all the activities that follow – is to use the template below to state outright your goals for pursuing M&A. This tool should help you ensure the following:

- **Agreement between you and your colleagues** – While you and your peers may believe you are on the same page about strategy and execution, this perception may in reality be off-base. Consensus on goals and expectations at the outset of any activity is a good idea – but even more so when navigating waters as complex and risky as M&A.

- **Exclusive focus on options that align with the stated purpose** – A singular focus on strategic fit will greatly reduce the likelihood of going down a wrong path or making a costly mistake. Shared commitment to the Goal Statement will prevent team-members from reactively pursuing opportunities that, while appealing, do not align with your organization’s growth strategy.

Think of this as a living document – something that you can revisit over the duration of a project to refocus team members on shared objectives, or even make adjustments as necessary. Click here to download.

<table>
<thead>
<tr>
<th><strong>COMPANY NAME</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GOAL STATEMENT: TEMPLATE</strong></td>
</tr>
</tbody>
</table>

**Description:** What is the purpose of this merger or acquisition?

*Hint: Do you want to gain new capabilities or access to new markets, pursue new innovation opportunities, increase top-line growth, or something else?*

- **(a) What purpose will M&A serve within our larger growth strategy?**
- **(b) Which specific sectors do we want to investigate? Why?**

**Measurement:** How will we determine success?

- **(a) Short-Term:** How much time do we have to demonstrate the value of the merger or acquisition to shareholders? What metrics can we realistically influence during this time?
- **(b) Long-Term:** What signs of success would we expect 3 to 5 years following the deal? How can we quantify these expectations?

**Importance:** How essential is this deal to the organization’s future growth potential?

*Hint: Do you need to keep pace with competition, jump-start stalled growth, or something else?*

- **(a) What are we specifically buying that is so integral to the success of our growth strategy?**
- **(b) Can our company achieve the desired growth objectives without pursuing M&A? If ‘yes’, then why is M&A still our best bet? What are alternative options?**

**Buy-In:** Who has contributed to and/or approved this statement? Who still needs to sign off?

- **(a) What are plans for ensuring that signoff occurs?**
- **(b) How will we modify our goal statement if we receive push-back from key stakeholders? On which points are we willing to budge, and on which must we hold firm?**

Reminder! This is a consensus-building tool, so be sure to involve as many stakeholders as you can in this exercise.
I. MARKET SECTOR OVERVIEW – ACTIVITY 2: GEOGRAPHIC ANALYSIS (CONTINUED)

Tool #2: Country Evaluation Exercise (Continued)

Directions

1. List out all geographic criteria that your organization deems as crucial to the success of geographic expansion through M&A. This should be an interactive exercise and help ensure consensus on goals for geographic expansion.

2. Weight these criteria on a scale of 1 to 10, assigning points values that total 100. The higher the score, the greater the weighting.

3. Check “yes”, “no”, or “unknown” for each attribute.

4. In the scoring column, assign the number of weighted points for a “yes” response and 0 points for a “no” or “unknown” response (e.g., if a criterion is worth 5 points and the country meets the criterion, you would check the “yes” box and then place a 5 in the “score” column).

5. Final score equals the total value of “yes” responses.

6. Anything you score as “unknown” should be revisited – by the time you are finished filling out this scorecard for each country under consideration, you should have no “unknowns” left.

7. You will need to determine a minimum percentage of accountability for a country to still meet your criteria (e.g., anything scoring less than 75% - 75 out of 100 total possible points – does not qualify for further exploration). For any score that comes in under this amount, you will need to either remove that country from consideration or conduct additional due diligence to fill in unknown area (since an “unknown” can become a “yes”, thereby improving a country’s total score).

Remember: In addition to assessing countries’ potential, this exercise can also help you evaluate regions, cities, or provinces. You and the growth team should consider this a framework for any market entry decisions you need to make – even for those that don’t specifically involve M&A.
### III. COMPETITIVE ANALYSIS – ACTIVITY 3: POTENTIAL PARTNERSHIP DIAGNOSTIC

**Tool #1: Competitor Compatibility Scorecard**

<table>
<thead>
<tr>
<th>Ideal Attributes</th>
<th>Weight</th>
<th>Yes</th>
<th>No</th>
<th>Unknown</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>CRM system compatible</td>
<td>6</td>
<td>X</td>
<td></td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Located within 100 miles of our headquarters</td>
<td>10</td>
<td></td>
<td>X</td>
<td></td>
<td>10</td>
</tr>
<tr>
<td>Distribution network in currently underserved markets</td>
<td>10</td>
<td></td>
<td>X</td>
<td></td>
<td>10</td>
</tr>
<tr>
<td>Target is less than half our size</td>
<td>8</td>
<td></td>
<td>X</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Growth targets are similar in scope to our own</td>
<td>8</td>
<td></td>
<td>X</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Company is privately held</td>
<td>10</td>
<td></td>
<td>X</td>
<td></td>
<td>10</td>
</tr>
<tr>
<td>Management team is united around a common vision</td>
<td>4</td>
<td></td>
<td>X</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Management team is highly centralized</td>
<td>8</td>
<td></td>
<td>X</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td>Track record of strong customer service</td>
<td>6</td>
<td></td>
<td>X</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Potential synergies with our own product line</td>
<td>10</td>
<td></td>
<td>X</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Employees are accustomed to a meritocratic environment</td>
<td>4</td>
<td></td>
<td>X</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Brand values align with our own</td>
<td>6</td>
<td></td>
<td>X</td>
<td></td>
<td>6</td>
</tr>
<tr>
<td>Low staff turnover</td>
<td>12</td>
<td></td>
<td>X</td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>

**Total** 100

# YES RESPONSES: 5  
# NO RESPONSES: 3  
# UNKNOWN RESPONSES: 5  
COMPETITOR COMPATIBILITY SCORE: 44%  
(44 out of 100 possible points)

(Directions listed on the next page)
III. COMPETITIVE ANALYSIS – ACTIVITY 3: POTENTIAL PARTNERSHIP DIAGNOSTIC (CONTINUED)

Tool #1: Competitor Compatibility Scorecard (Continued)

### Directions

1. List out all competitor criteria that your organization deems as crucial to the success of a merger or acquisition.

2. Weight these criteria on a scale of 1 to 10, assigning points values that total 100. The higher the score, the greater the weighting.

3. Check “yes”, “no”, or “unknown” for each attribute.

4. In the scoring column, assign the number of weighted points for a “yes” response and 0 points for a “no” or “unknown” response (e.g., if a criterion is worth 5 points and the country meets the criterion, you would check the “yes” box and then place a 5 in the “score” column).

5. Final score equals the total value of “yes” responses.

6. Anything you score as “unknown” should be revisited – by the time you are finished filling out this scorecard for each country under consideration, you should have no “unknowns” left.

7. You will need to determine a minimum percentage of accountability for a competitor to still meet your criteria (e.g., anything scoring less than 75% - 75 out of 100 total possible points – does not qualify for further exploration). For any score that comes in under this amount, you will need to either remove that competitor from consideration or conduct additional due diligence to fill in unknown area (since an “unknown” can become a “yes”, thereby improving a total score).

### Reminder!
This scorecard serves dual purposes. First, listing out ideal candidate attributes (without considering any single candidate specifically) helps you determine at the outset what sort of competitive merger or acquisition will benefit your organization the most. Second, filling in the scorecard for each potential target will help you evaluate all targets fairly, collect the most relevant information about each candidate, and make informed decisions regarding each target.

On a final note, this scorecard is highly subjective – and for a good reason. Identifying your top attributes for an ideal acquisition candidate – and weighting them according to importance – will force alignment between all members of the growth team, and a shared commitment to the objectives outlined in the goal statement.
IV. INDUSTRY ECONOMIC ANALYSIS - ACTIVITY 1: INDUSTRY BENCHMARKING

Tool #1: Investment Themes Worksheet

Overview
What is it?
A framework to help you analyze the impact of any particular market driver. This chart will help you organize your assessment of who may benefit from a market driver, how, and why.

Why should you use it?
You need to consider the potential market alterations that any driver could bring about. If a sector stands to grow in a direction that’s well-aligned with your organization, M&A may be a particularly viable growth strategy for you. Conversely, if investment themes suggest the sector is moving in a direction that aligns poorly with your goal statement, anticipation of that shift will help you avoid a potentially costly misstep.

Investment Themes Worksheet (Sample: U.S. Airline Industry)
Complete this worksheet for each sector under consideration.

<table>
<thead>
<tr>
<th>Theme</th>
<th>Trend</th>
<th>Why Significant</th>
<th>Who Will Benefit (e.g., companies, investors)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory Issues</td>
<td>Push to reduce the compliance terms of Sarbanes-Oxley Act</td>
<td>May lead to lower market prices and increased M&amp;A activity</td>
<td>Airlines, Customers, Investors</td>
</tr>
<tr>
<td>Innovation Outlook</td>
<td>Incorporation of “high style” elements into low-cost carriers (e.g., Japanese StarFlyer)</td>
<td>May require other low-cost carriers to upgrade their in-flight experience</td>
<td>First Movers, Investors</td>
</tr>
<tr>
<td>Environmental Considerations</td>
<td>Investments in new technology to offset rising fuel costs</td>
<td>May indicate the beginning of “green” air travel - but improvements in fuel efficiency may be offset by more planes in the air</td>
<td>Investors (in new technologies adopted by the airlines)</td>
</tr>
<tr>
<td>Geopolitical Situation</td>
<td>Unstable political situations in key oil-producing countries, including Russia, Venezuela, Iraq, and Saudi Arabia</td>
<td>May increase the cost of fuel (or make cost highly variable), leading to cost reductions and higher ticket prices</td>
<td>Oil producers, investors in oil-rich countries</td>
</tr>
<tr>
<td>Customer Behavior</td>
<td>Customer willingness to pay a premium for goods/services that meet the perceived value of quality</td>
<td>May present an opportunity for carriers that invest in the customer experience</td>
<td>Any airline that invests in the customer experience in spite of cost restrictions</td>
</tr>
<tr>
<td>Economic Conditions</td>
<td>Recent request to suspend regulations affecting flight slots</td>
<td>May reduce fuel/operations costs through reduced delays/time on ground</td>
<td>Airlines</td>
</tr>
</tbody>
</table>
END NOTES

1 Laura Pedro, et.al., “Begin With the End in Mind: Tips For a Successful Merger, Acquisition, or Joint Venture”, PulvermacherFirth, 2004: 2.


8 Ibid.


10 Laura Pedro, et.al., “Begin With the End in Mind: Tips For a Successful Merger, Acquisition, or Joint Venture”, PulvermacherFirth, 2004: 2.


