WHEN THE WHALE SWALLOWS JONAH

Over the past few decades the number of mergers and acquisitions between big and small companies has been substantial. They seem to follow one of two scenarios - two giant companies combining to create a mega-force in the marketplace and make the resulting company one of the leaders in the industry, or the second case, a larger company acquiring a smaller one to broaden its product line and, therefore, offer its customers a greater opportunity for one-stop shopping. It is that second scenario that I would like to address this evening as I have lived the experience of being Jonah and I would like to share some of my thoughts about how it can be accomplished both rightly and wrongly.

The impact of an acquisition is felt across all segments of the merged business from the people to the facility to the financial to the marketing and so on. However, the impact is not all negative or positive in each category. There are plenty of good things to say about a merger but much of its success or failure is based upon the way the acquiring company handles the whole process. Perhaps the best way to approach the subject is to look at the various parts of a business and see what can go right and wrong in each during the merger.

<u>Financial</u>

When one thinks of an acquisition or merger, generally the mind focuses first on the financial implications. As the whale is the surviving entity, the questions arise as to whether the whale's financial position will be impacted negatively although it is usually assumed that the acquiror can afford it. If the acquiror is a privately-held company, this concern is usually only noted by their banker who may or may not be concerned by the added debt. If the whale is a listed company, the impact of the added debt may affect the price of the stock, particularly if there is some question about an enhancement of earnings or a possible dilution.

Once the decision to swallow Jonah has been made by the whale, Jonah has to do some soul searching as to the financial advantages or disadvantages of staying independent or becoming another meal for the whale. Growing a small company can be a real cash flow battle, particularly if the company is successful and grows very rapidly. There can be many sleepless nights for the owners and management and lots of time spent reassuring the banker. If the whale has deep pockets, a lot of stress can be relieved by the marriage. Also, the additional cash can allow the company to continue to grow at the rate that product demand requires, which brings added encouragement to all of the employees.

Some of the added funds which the whale can provide can be directed into better equipment, plant modernization and, ultimately, higher productivity. The results will be higher profits for the acquired business due to lower operating costs. As we mentioned earlier, if the whale is a private company and debt free, the cost of borrowed money may be lifted from Jonah's shoulders and their operating statement may be cleaned up considerably. However, in some cases the whale will impose an "administrative fee" or a "carrying cost" on the acquired entity which can be a bigger penalty than their original debt service.

Lastly, Jonah may smile as he goes to the bank or his brokerage to deposit his newly acquired funds. He moves from a position of holding pieces of paper in a small, privately-held company to suddenly being liquid. To many Jonahs this can be a very reassuring time in their lives, particularly if Jonah is no longer young and full of the same energy which he possessed when he acquired the small company.

In general, from a strictly financial viewpoint, the acquisition of a small company is a positive alternative for the acquired company, its management, and its owners. Whether it becomes a positive financial experience for the whale depends a lot on what the whale does with the acquisition. In the office furniture industry, with which I was recently associated, the track record for major companies acquiring smaller ones has been less than successful. You can probably count on two or three fingers the number of acquisitions today which are as or more successful than they were as independents. However, the reasons for this poor record are seldom related to the financial aspects of the transactions. The causes can be found in the other elements which come into play when acquiring companies and their acquirors are examined in detail.

Marketing and Sales

Many smaller companies do not have their own company salesmen. Instead they rely on the talents of individual sales representatives who handle a variety of related but non-competitive product lines. The direct selling costs of the company are encompassed in a pre-established commission rate which means that the company can control its selling costs very closely. Also, as these higher earning reps are usually more experienced and established in their territory than are company salespersons, given all other factors being equal, the company with reps may expect to get more sales for its pre-established commission percentage. One of the disadvantages of a rep force versus a company-owned sales force is the percentage of "mind share" which the company may expect to get from its rep with multiple lines as opposed to the 100% share expected from the company employee. Therefore, it requires that the small company equip itself with other benefits which it can offer the rep to increase its "mind share." These benefits may include stronger marketing support materials, external advertising, sales contests, and more attractive products in appearance, quality, price, etc. As a rule of thumb, a company has to be doing in excess of $40 million sales per year before considering its own sales force. One alternative would be to employ company people in major markets while having reps cover the smaller areas.

Another factor in the success of rep selling is the pre- established relationships as many sales are not made based on the product but on the reps and the confidence which the customer places in their relationship. When the whale decides to dump Jonah's reps and replace them with the whale's sales people, many customers will go with the rep to whatever line he or she now acquires. What looked like a continuing customer relationship to the whale, when he examined Jonah's customer list, suddenly no longer holds water. This can result in a significant drop in the sales volume of the acquired company which can take years to replace. Also, the method by which the reps are terminated can result in a negative attitude towards the whale if the reps are motivated to "bad mouth" the transaction. Loyal customers of Jonah's do not automatically become advocates for the whale and it's usually just the opposite. The whale's sales people who are taught heavily to sell "features and benefits" find it to be a tough task to overcome the long-term relationship which the rep has nurtured over many years. New believers must be found and cultivated quickly in order to maintain volume. In the office furniture industry the whales have all tried to make the change successfully but, to my knowledge, none has done it correctly or maintained volume. The result has been that many smaller competitors with continuing reps have grabbed market-share at the expense of acquired companies.

Of course, there are offsetting attributes and advantages which the whale brings to the party. First, the method of distribution plays a big part in whether the whale can generate the sales volume for the acquired company which they hoped to achieve when they swallowed it. If the whale has a strong distributor or dealer following and they exhibit a loyal support for the whale , they may be able to overcome some of the lost sales due to the change in sales force. Second, if the product line of the acquired company was primarily dealer-driven as opposed to being a specified line, then the transition is much easier for the whale if it has a cadre of committed dealers. The whale can then exert pressure on the dealer to promote the acquired company's line in preference to a competitive line which the dealer sales people may have been pushing. Third, the heavier advertising by the whale and the consequent stronger name recognition can make users aware of a small company whose advertising was limited and name was not well known. In the office furniture industry research studies continuously show that sales volume and name recognition are in direct correlation. Fourth, in the process of bidding on a major project where price is a primary consideration in the selection of the supplier, the big company can frequently sell the products of the acquired company by bundling those products into its bid, sometimes even implying that those products will be "free" if the major portion of the whale's regular line is selected. Finally, intra-company networking within the sales organization of the big company helps to identify potential sales opportunities throughout the world. Frequently, these situations don't come to light within the small company's rep group because there is the possibility of a battle over who should get credit and the commission for the sale.

Customer Service

An adjunct to the marketing and sales process, and in recent years a more critically recognized part of it through the awareness of quality as a vital element in a successful business, is customer service. This is an area where the small, independent business can outmaneuver the behemoth. However, when the small guy is acquired, the whale may see this as an opportunity where savings can occur by merging the small company's customer service function into an already existing department of people servicing the whale's current line of products. In the small company the customer service people are closer to the factory people as well as to top management. Information flows up and down quicker and easier and there is greater freedom for the customer service persons to make decisions to solve customer problems faster and be more responsive. Frequently, the problem revolves around a change in the schedule for shipment of an order. Here again the small company service person can plead the customer's case to the factory much more effectively than someone who can only communicate via phone or computer. In the small company, being less structured, the plant can make the change and retain a satisfied customer. In many cases the small company customer service person has been able to establish a personal rapport with customers which helps to cement the relationship between supplier and customer. If the consolidated service department loses the product and technical knowledge of the people who served in that capacity when the small company was independent, service on the acquired products may deteriorate and the customers can come to resent having to do business with the whale and the new product lines. The expanded service department people must now learn many more products and, frequently quite different ones.

In addition to the customer service people in the small, independent company the customer is usually able to obtain access to the top management team to work on both projects and problems. There is much to be said for the strong ties developed by being able to talk to the "boss." In one small company, when there was a problem with delivery and quality, the President moved his desk into the middle of the Customer Service Department to be readily available to answer questions and help solve problems. Big companies are today recognizing this attribute of the intimate relationship and are taking steps through their Quality programs to make the "lead guy" available whenever possible and necessary.

Product Design, Development and Engineering

A major key to success of the small company is the ability to bring a new product idea to the marketplace sooner. This results primarily from the faster decision-making process from concept to "let's go with it." Internal battles in the whale's chain of command over who has the authority to do what can be an anchor around its neck. It allows the little guy to get the jump. If the top management of the small company maintains and encourages an open-door policy, employees are more likely to feed good ideas in and upward, but if the company sanctions a policy of not going around the next level to get some action, good ideas can stagnate. The smaller, independent companies in the office furniture industry have been the trend setters in product design rather than the followers, and that is what has kept many of them alive. Because their engineering staff is smaller, they rely heavily on outside help from independent designers, model builders, and others who can inject a fresh outlook. However, prototype and testing costs are also harder on the small company budget.

As we heard in last month's speech, customers are becoming more demanding and today they want products customized to their particular needs. The percentage of business in standard products as opposed to specials has declined markedly in the furniture business and as the industry has matured, the battle for market share has intensified. The small companies used to have the specials business to themselves, but with the acquisitions, the big guys have had to learn to be more adaptive in order to retain the newly expanded customer base. If the whales are going to be more effective in product development and engineering, they must learn the lessons of the little guys - make decisions faster, get products to the market sooner, be product leaders not followers and be adaptive to customer needs.

Facilities and Production

This is certainly the area in which the whales have most of the advantages. Better facilities and equipment mean major cost commitments. Frequently the small, independent manufacturer cannot keep pace with the larger, better financed manufacturer in this regard. Investments in high tech equipment, automation, modernized factories in multiple locations, and impressive offices, and showrooms can make a difference to the company's operating costs as well as to its customers. Application of advanced industrial engineering technicians can contribute to better performance. Distribution points can enable the big manufacturer to get product to the customer quicker rather than have to get it from a single, small factory. If the whale applies these resources to the acquired company properly, it can become a big plus for the acquisition.

One element which the small, independent company has going for it in the area of production is the loyalty of the factory employees to Jonah, particularly if he has made himself well known to the people on the factory floor. After the swallow takes place, the factory people no longer relate to the "head guy" and a feeling of disorientation can take place. This is the time when the Human Resource folks need to make the right moves.

Human Resources

Probably the most significant difference for the employee in moving from the small company to being part of a big organization is the "family culture" versus the corporate structure. After our company was acquired, the employees who transferred many times came to me to say "I miss our old family. Things just aren't the same." This is not to say that the acquirer did not make every effort to assimilate these new employees but there is an internal rapport within the small company which is very difficult to duplicate. Good people seemed to stay with the small company for years and brought in their relatives as well while there was a fairly high turnover rate at the whale. There wasn't that sense of family unity which we mentioned earlier. Unfortunately, many of the most experienced employees from our company have now departed to greener pastures. This was helped by the fact that the whale relocated the company's manufacturing operations out of state and consolidated all the administrative functions into its headquarters organization.

There are, on the other hand, many advantages which the larger company offers in the way of human resources. Formalized training programs help to get the new employee up to speed faster while the small company usually must depend upon on-the-job training. The larger company can afford considerably better benefits to its employees, although it is questionable whether better benefits are that strong an inducement for the younger employees to stay. There is usually a higher pay scale at the larger company and that is attractive to all transferring employees. However, I contend that people don't leave a job solely for pay. They are usually dissatisfied with another element in their job equation, then they start looking for alternative jobs, and that's when they discover that they can earn more elsewhere. Because a small company is small, the job growth potential is limited and so are monetary expectations and additional perks. This is an area where the big company can play the trump card and win the hand of the small company employee. As we indicated in the beginning, much of the success of the whale in retaining transferring people depends upon the methods they employ in making the employee feel comfortable in the new and decidedly different environment.

Information Processing

Another area of business where the whale has an advantage over the small company and can be of great assistance to it is in information processing. In the past the cost of purchasing and subsequently updating computer hardware was a major commitment for a small company so most continued to rely on manual systems which limited the availability of essential decision-making data and made the information processing more time consuming and labor intensive. As the price of hardware declined and the quality of software improved and packages became available, the smaller companies became more competitive in this arena. However, the major users continue to be the leaders in data processing application because they command the attention of the hardware and software suppliers. They can afford to make changes more readily, and they have the information processing expertise to try new applications.

When the small company is acquired, one of the first places to look for a consolidation is in the information processing area. There isn't much sense in maintaining two computers, two staffs or two locations. Besides, the whale will want to get possession of the new data and convert that data to its own format as soon as possible. It is important to remember that having the data is only a part of the total process. It's what is done with the data after it's generated that is critical. Although the small company was less sophisticated in information processing, once the answer was generated, the small company could generally react faster. Once their data were consolidated into the big company, there could be a wait-time to get certain reports in which the acquired company data were only a small part of the big picture.

Purchasing

There is little question that the prices for most everything which the small company has been buying will decline quickly when the leverage which the whale exerts upon its suppliers is extended to its acquisition. Former vendors are soon discarded and replaced by the ones which the whale has been using. Sometimes this can pose a real problem because much essential technical and product knowledge has previously been provided to the small company employees where staffs were limited. The vendors who were there to help are no longer responsive to your beck and call. The new suppliers of the whale lack the know-how to solve the problems and confusion results. Customer response time can be delayed.

Another of the positive advantages along with cost saving in the purchasing area is the ability of the larger Purchasing Department to specialize by material resource. This permits greater in-depth research into the options available in materials and applications to meet product manufacturing needs. This can lead to better product quality and improvements for the future.

Management Style

You've all read about the "entrepreneurial spirit " of the small company seeking to succeed in a competitive environment. This spirit is exhibited in a number of different ways but one area most apparent to the customer or outsider is being adaptable to customer needs. You've heard the expression about some companies - "they'll do just about anything to satisfy the customer and make the sale." There's a "willingness" attitude which pervades the whole organization. Management tells its people we don't use the word "NO" and "we'll do whatever it takes to make it happen".

Sometimes the big company people forget what made them successful in the beginning and how they got where they are today. The entrepreneurial-style is supplanted by the organization-style with everyone having to check decisions up the line and much CYA behavior exhibited. Often this results from an effort to be economical, but determining the right time to save a buck requires judgment and the authority to make split-second decisions and not have them second guessed. This is much of the logic behind the recent surge in "enpowernment theory" that the management philosophers are expounding. Hopefully, the good attributes of the small company management style can and will be extended downward to keep the large organization fluid and less rigid.

Conclusion

Well, you've now heard what can happen when Jonah is swallowed by the whale. There are many positive advantages to both Jonah and the whale. In my case it allowed me to continue working for the whale as a consultant for five years prior to retirement. For the whale it expanded their product line to make them a more viable player in an industry which was consolidating, was no longer witnessing double-digit growth and had "matured." In hindsight there were many things which the whale could have done differently and more successfully which might have made the transition smoother. Much of this could be attributed to the lack of knowledge which the whale's people had about how the acquired company marketed its products and conducted its business. The learning process took a while and in some cases there was a lack of "listening."

Within the office furniture industry there have been very few examples of real successful mergers in the last decade. In most cases the acquired units are either out of business or doing more poorly than they were before acquisition. In the most successful example the whale decided to leave the acquired company alone to run itself.

In the original story Jonah eventually succeeded in escaping from the whale after spending time in his stomach. I guess we'll never know how much the event resulted in indigestion for the whale, but in the office furniture manufacturing business the era of acquisitions caused a lot of whales to reach for the Rolaids, and it wasn't long before the surge in acquisition activity came to an abrupt end. Perhaps the whales discovered there was a better way to get fed - build your own business and concentrate on what you know best.

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Thatcher W. Rea Jr.
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