

# How to Negotiate a Merger

By Geoffrey James

published on BNET.com 12/13/2007

So you've **shopped for the ideal company to acquire**, and on paper both companies look like perfect mates. Now brace yourself for the harsh reality of corporate marriage: Just as in real life, roughly half the time it ends in divorce. More than 50 percent of mergers fail. Many more would succeed, of course, if both sides knew how to bargain before either signing or aborting a deal. In this BNET Crash Course, we've boiled down what many M&A experts preach about the hard process of M&A negotiating into four basic steps that more companies ought to practice.

## Things you will need:

- Fortunately, you already set aside sufficient assets in **the planning stage**.
- Varies widely, from two days to *much* longer.
- **War room:** A conference room with file cabinets – both under lock and key. You'll need a place where your team can work on negotiations and due diligence without worrying about rumor control or leaks.
- **Investment Banker:** Your banker will be your primary intermediary during the negotiations, especially when somebody needs to play bad cop. Your banker also serves as a constant "reality check" on whether the deal makes financial sense.
- **Acquisitions Lawyer:** Acquisitions often involve public stock, which is heavily regulated. There are complicated rules for what you can say or do during an acquisition, lest you do damage to investors. Counsel can ensure you don't blurt out something that could botch the deal or unwittingly break the law.
- **HR Pro:** You're acquiring a group of people, not just a company, so you'll need someone to plan for relocations, orientation, changes in compensation and probably some layoffs.

step 1

## Make Your Initial Offer

### **GOAL: Define the ballpark parameters under which a deal is possible**

Just as a first impression often frames the future of a negotiation, the initial meeting frames the discussion to follow. As the acquiring firm, it's in your interest to make the first offer – after all, the acquisition is an expression of your overall strategy, and you'll be the company responsible for the merged entity's success.

"Before we negotiate, we always establish why we want to do this acquisition and the value it will provide, then we let those analytics drive the negotiating," explains Smith McKeithen, general counsel at Cadence Design Systems, a \$1.5 billion software firm that has acquired dozens of companies in the last decade. "You want to be certain the conversation takes place within the parameters you've defined for the deal."

Leaving yourself some bargaining room is obvious but crucial. Assuming you have done all the financial due diligence in valuation, a first offer generally should represent between 75 and 90 percent of the firm's true value. If an initial bid is rejected outright, it is likely the bargaining won't end in a contract anyway, so an acquiring company can save itself a great deal of time and effort with a smart bid.

## Hot Tip

### Practice Extreme Diplomacy

Creating goodwill at the bargaining table is a crucial first step. Randall Murphy, founder of the Dallas-based consulting firm Acclivus R3 Solutions, has trained executives in negotiating for more than 20 years. When it comes to backroom etiquette, he suggests that potential buyers:

- **Set a positive tone.** The relationship will evolve long after the negotiation; don't take positions or behave in ways that might later make it difficult for everyone to work together. Small comments that smack of bluster or derision could undermine big issues and a burgeoning relationship.
- **Don't sweat the small stuff.** The negotiation isn't just about inking a deal, it's also creating conditions under which both firms can thrive. Visualize what the alliance is intended to accomplish and use that as the basis for figuring out the details.
- **Build bridges between opposing positions.** Find creative ways to make everyone's objectives emerge from the final agreement. The last thing you want is for one side to feel that it "lost" a battle.
- **Don't forget the employees.** Don't underestimate the long-term importance of earning the goodwill of employees – on both sides.

step 2

## Negotiate the Terms

### **GOAL: Generate a detailed agreement that will lead to successful integration**

Once the initial offer is made, more complicated bargaining begins. What's important isn't just the final dollar figure the two parties zero in on but the rationale presented — particularly by the selling company — with each offer and counteroffer. For the acquiring firm, those rationales act as a critical valuation tool, according to Waltham, Massachusetts-based investment banker Doug Brockway, who as managing director at Innovation Advisors has helped a dozen mid-market technology companies negotiate and execute mergers.

"Because the business of the seller's firm must be described in detail in order for negotiations to be meaningful," Brockway says, "the negotiation becomes an extension of due diligence,

allowing you to better assess whether your original impression of the firm and its value were correct.”

Financial negotiations also allow the buying firm to probe issues that might affect the success of the merger, such as unexplained variations in the other company’s revenues.

“You should emerge from the financial discussion with a very clear picture of exactly what you’re buying,” says Lance Urbas, CEO of Westwood, Mass.-based security software firm IntelliReach, who has completed several acquisitions throughout his career.

As you learn more about the selling company during the negotiations, do constant fact-checking of everything presented. Edward Weiss, who served as general counsel for Lanham, Md.-based Group 1 Software when it acquired several firms and was later acquired by Pitney Bowes, explains: “The more critical the piece of information, the more skeptical you should be.”

## The Legalese

### Do They Really Own Their Products?

If you don’t already have lawyers doing this for you, here is a do-it-yourself list of tasks to ensure that the company you’re buying has legal rights to all their products:

- Check the [U.S. Copyright Office](#) for any registrations that conflict with what the seller is offering.
- Check the [U.S. Patent and Trademark Office](#) for any trademarks that conflict with their brand names and to ensure that any patents they’ve filed don’t have obvious problems.
- Do a LexisNexis search for liens, litigation, or legislation that could affect acquired assets.
- Create a list of every employee and contractor who designed any product or process in the selling firm. Confirm that there is contractual ownership of all contributions.

Source: Edward Weiss, counsel at Bregman, Burbert, Schwartz, and Gilda

step 3

## Negotiate the Personnel Issues

### **GOAL: Ensure that the talent you’re acquiring remains in place and productive**

Two general rules should govern negotiations about how many and which types of jobs will make up the final agreement, according to Dennis Weldon, director of corporate development

and investor relations for Mentor Graphics, an Oregon-based software firm with revenues of \$825 million, which has acquired more than 20 companies over the past ten years.

**1. Avoid pressure tactics.** A merger negotiation can often be an emotionally charged process from the start. Overly aggressive tactics can end up alienating the very people you'll need to make the acquisition work. When acquiring much smaller firms, for instance, Weldon says he'll often help the seller find better representation at the bargaining table.

**2. Use time to your advantage.** Often the seller isn't really ready when you first enter negotiations, so you should plan for breaks in the negotiations so that all the parties can consider the wisdom of going forward.

## **Danger! Danger! Danger!**

### **Beware of Cultural Landmines**

Brockway, the investment banker and managing director at Innovation Advisors, cautions that M&A negotiations sometimes founder on cultural issues:

1. What will be the title of the top manager of the selling firm after the merger? The titles CEO and president are big status symbols to employees of the selling firm – consider title changes carefully.
2. Will the company name and brand name survive the merger? Employees can be fiercely loyal – not just to a company or a product but to their names as well.
3. Where will the new headquarters be located? Unless the two companies are located very close together, the prospect of relocation can be a game-changer for many key employees.

step 4

## **Draw Up the Contract and Get It Signed**

### **GOAL: Complete the process and move forward to the implementation**

Negotiations don't end when you go to contract; it's often the negotiating of the specific terms that causes the biggest problems. The best way to ensure a smooth contract process is to document all those decisions and commitments made during the bargaining phase. Then, when verbal agreement is reached, review the main points and obtain an agreement from both parties not to surface additional issues.

To this end, it's important to keep the corporate lawyers on a short leash, Brockway says. "It's easy for a lawyer to turn a contract into a bone of contention, especially on minor issues," he says. Thus, while details may emerge that weren't anticipated, you should try to keep the discussion tracked to what was verbally agreed upon.

It's also a good idea, well before signing, to get key individuals from both firms together to begin planning merger integration. Mentor Graphics, for example, aggressively courts its

soon-to-be-acquired employees. “We find that they’re more likely to remain if we take the time and trouble to let them see that Mentor is basically a good company to work for,” explains Weldon.

Copyright © 2007 CNET Networks, Inc. All Rights Reserved.