

# Doing the Deal

## Part 1: The High Stakes in Business Transactions

by Richard MacLean, Competitive Environment Inc.

*Providing support for major business transactions is arguably the most important strategic responsibility of an EH&S manager. The potential cost savings (if done correctly) or liabilities (if done poorly) can be enormous. A company may bet its future success on a single business acquisition or merger. Even purchases or divestments of plant and equipment can have a profound effect on a company. With so much at stake, one would expect that EH&S support for business transactions is a finely tuned and closely managed operation. Wrong. It is often ad hoc, with the EH&S manager brought in at the eleventh hour to rubber stamp a deal steamrolling along.*

*In this, the first of a three-part series on business transactions, we explore the internal politics of "doing the deal" based on a survey of best management practices of leading companies conducted by Competitive Environment. Next month, we will examine specific approaches to property risk assessments, and in the third and final part, we will analyze the value of environmental management system assessments in merger and acquisition activities.*

**T**here is something inherently "sexy" about major business deals. Business executives are drawn toward them like a bear to honey, and recently, mergers and acquisitions (M&A) have been occurring at fever pitch (see "Recent Major Mergers and Acquisitions"). The "urge to merge" is truly amazing, similar to the need for politicians to vie for a new sports stadium or major league team. Civic leaders may express unflinching enthusiasm for new sports arenas, but the public has begun to balk at the building of taxpayer-subsidized stadiums that appear to enrich a few, but fail to benefit the overall community. Much in the same way stadiums are receiving closer scrutiny by voters, M&A are now receiving careful examination by stockholders and analysts. The results are surprising. Only 17% of the major deals made during 1996–1998 increased shareholder value. In fact, a study by KPMG International showed that 53% of 700 deals actually reduced shareholder value.<sup>1</sup>

### EGOS, POLITICS, AND POWER PLAYS

If major business transactions are more often than not "bad" deals, why do executives pursue them? The simple answer is that so much is at stake politics and power plays drive the deal and determine the outcomes, not facts and reason. Executive management dynamics before, during, and after deals can be turbulent. As a result, specialized management consulting services have emerged to deal with such issues. David Greenspan,



executive vice president of management advisors Clemente, Greenspan & Co., explains, "There continues to be an increase in the number of M&A failures. Recent studies reveal that between 35 and 50% of all deals fail to even return cost of capital. But the most chilling statistic is that three out of every four deals fail to achieve either their strategic, financial, or operational objectives. So in essence, before you even begin, the odds are stacked against you."

In some cases, the initial strategy is flawed, yet ego and corporate hubris force the deal to proceed. In other cases, traditional due diligence—which focuses on legal, finance, tax, and accounting issues—is employed and not "marketing due diligence."<sup>2</sup> Marketing due diligence assesses a target company's growth-related strengths and weaknesses to ensure the success of a merger or acquisition. It transcends traditional due diligence by its dual nature, focusing on both "defensive" (risk avoidance) and "offensive" (growth) aspects.

While there may be an integration strategy, its execution is often flawed. Integration is a management process unto itself. Many senior managers are under the false impression that because they can manage, they can also integrate. Clemente, Greenspan reports that the firm is sometimes brought in several weeks after closing, once management realizes that the advice and execution of someone with specialized integration experience is critical to ensuring success. The clock is ticking. The eyes of Wall Street analysts are looking for results. And

the company is now faced with two diverse groups of people, products, and processes, with management trying to figure out what to do. Lack of foresight, in this case, is a recipe for disaster.

### STANDING IN THE WAY

The net result of these intense forces is that EH&S managers are sometimes brought in late in the process where there is already enormous momentum to get on with the deal. New, negative information is unwelcome. It's no wonder EH&S managers sometimes feel like the lone individual standing in front of the line of tanks in Tiananmen Square. Without unwavering support from the CEO and the Board of Directors, an EH&S manager can be very much alone.

The situation is analogous to the emotions and dynamics during a home closing. Realtors are all too happy to have their recommended inspector do the closing inspection; all parties want things to go smoothly. But it is experienced buyers who select their own independent inspector and factor any issues uncovered, rationally and objectively, into the closing. Sophisticated dealmakers in companies such as General Electric, Du Pont, and The Dow Chemical Company use a similar approach. They seek out the problems early and roll these into the negotiations.

To determine how the leading companies handle such issues, Competitive Environment conducted interviews with several dozen major corporations. This research determined that the first step for improving a company's business transactions process is to look for the danger signs—situations that produce inefficient reviews. Even the best companies are not perfect. Here are some of the problems Competitive Environment found:

- Management uses a case-by-case approach with the work coordinated by one or more senior-level people. Rarely are there hard and fast rules, detailed internal protocols, or formalized communication networks among the company stakeholders.
- Banking institutions have highly structured procedures for commercial transactions. For large corporations that do not have to tie an asset to an external source of capital, environmental due diligence reviews are not always executed consistently. Leases, minority ownership joint ventures, rights-of-way, toll production, and overseas acquisitions and divestitures may receive limited reviews or no review at all.
- The policies and communication networks are very informal. Potentially high-liability issues do not receive adequate corporate review because they are perceived

as "small business deals."

- The assigned due diligence person is not sufficiently high in the organization to intervene at the onset and/or does not have the power, authority, or will to influence the pending transaction. The person may be sufficiently high in the operation, but does not have an environmental background to fully appreciate the potential liabilities.
- Consultants or in-house resources do not have sufficient expertise to fully uncover the issues or use the information strategically in the business contract negotiations.

In summary, the underlying issues are largely due to problems with (1) communication, (2) authority/accountability, and (3) expertise.

### DOING IT RIGHT

What separates the leaders from the rest is the formality of the process, the technical competency of the review, and the strategic use of information during negotiations. The leaders include reviews of even small leases or joint ventures handled by competent environmental professionals in networks that extend to overseas operations. They also use a multifunctional

team approach with strong corporate oversight and business executive backing. For example, General Electric, known for its decentralized, hands-off control, has chosen business transactions as one of the few management areas where corporate exercises tight control and guidance over its business groups.

How much control is the minimum? It depends. The major break points are from single to multi-

business corporations and from domestic-only manufacturing to multinational operations. A relatively small company based only in the United States with a single product line may need only a competent technical person at headquarters coordinating the issue as a part-time assignment. This works if there is a close working relationship between this person and upper management. Some multibusiness groups and multinational corporations attempt to use essentially the same structure. The result is a reactionary, ad hoc approach covering only the major business deals.

As with most EH&S programs, striking the right balance and factoring company culture represent much of the challenge. For example, middle management at the business group level may circumvent corporate oversight if

- corporate policies are overly prescriptive;
- insufficient control is allowed at the business group level;
- there is no accountability;

### Recent Major Mergers and Acquisitions

- \$ Chrysler's merger with Daimler Benz
- \$ Exxon and Mobil's merger
- \$ Honeywell's merger with Allied-Signal
- \$ Alcoa's acquisition of Reynolds Metals
- \$ Mattel's acquisition of The Learning Co.
- \$ Total Fina's acquisition of Elf Aquitaine

- short-term personal rewards overpower concerns for long-term company liability; and
- corporate sends mixed messages, for example, rewarding managers for taking unacceptable risks, if they "prove successful."

## CONCLUSIONS

Corporations are beginning to recognize the need for more structure to what has been to date largely ad hoc. The leaders use due diligence data strategically to negotiate better deals and minimize future liabilities. Some corporations may think that's what they are doing, but they may not be aware of all the options they have available to improve their competitive position.

In the next two *EH&S Advisor* columns, we will examine some of the specific steps that EH&S professionals should take when reviewing deals. The latest version of Standard Practice for Environmental Assessments: Phase I Environmental Site Assessment Process (ASTM E-1527) was approved in April 2000. We'll look at its extended role beyond just Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) liability protection. We will also consider the importance of reviewing management systems during M&A as a means of detecting underlying weaknesses that may cause problems after the deal is done. ☺

## REFERENCES

1. Deogun, N. Merger Wave Spurs More Stock Wipeouts, *The Wall Street Journal*, November 29, 1999.
2. "Marketing due diligence" is a registered trademark of Clemente, Greenspan & Co. Inc., Glen Rock, NJ; phone: (201) 444-1236; Web site: <http://www.cgadvisors.com>.

## PLEASE ASK, PLEASE TELL

Is there an EH&S topic you would like to address in *EH&S Advisor*? Do you have information to share with your colleagues? Are you interested in coauthoring a column on the subject? *EM* is very interested in your ideas. Please contact Richard MacLean by phone: (480) 922-1620 or e-mail: [maclean@competitive-e.com](mailto:maclean@competitive-e.com).

## About the Author

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## EH&S ADVISOR CHECKLIST



### Business Transactions

#### 1. Obtain Executive Backing

- Executive backing is essential because of the high organizational level at which business transactions occur. The only hope you have to cut through the politics is to be supported at the highest level.
- Obtain corporate "veto power." The key is to have the authority to probe wherever and whenever necessary.
- The level of control can vary considerably from an "approval" by a corporate officer, to a "nonobjection" sign-off, to activity monitoring and intervention only on transactions that represent a high risk.

#### 2. Provide Corporate Oversight, Leadership, and Policy Direction

- Oversight is not the same as the direct corporate management of all due diligence projects. The work may be done at a site or business level, but if significant risk is uncovered, the decisions need broader input and approval.
- Policies should be in writing and should be communicated with the intent of changing the corporate culture so practices are automatic and ingrained.
- The overriding considerations are as follows: executive support, accountability, clarity of process, communications, and technical expertise.

#### 3. Establish Cross-Functional Teams

- Teams foster greater communication across functional groups.
- Large projects are typically organized and carried out on a case-by-case basis. Smaller projects are typically done by an in-house technical expert.
- Larger companies should have an individual(s) assigned full time with most of the detailed engineering contracted out. Individual business groups can use their own technical resources on an as-needed basis supplemented by corporate specialists.
- Establish an active communications network to obtain broad coverage. For example, assign individuals to geographical regions or business groups to coordinate activities.

#### 4. Broad Coverage

- Recognize potential liabilities and focus on the risks from even mundane or routine transactions.
- Include acquisitions, joint ventures, divestitures, leases, toll production, and rights-of-way.
- Written guideline documents and training are important tools to improve coverage. A larger, centralized group of technical experts may be required if no written guidelines exist.
- Companies are moving in the direction of functionally equivalent performance standards or worldwide best practices. Avoid possible liability (criminal and civil penalties/punitive damages) in developing countries that copy established regulations, but do not currently enforce them.