M&A, Meet CIA: Three lessons deal-makers can learn from Central Intelligence failures

SELECTED RESEARCH DATA

SUMMARY OF RECOMMENDATIONS

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Introduction

It is accepted wisdom that rates of corporate acquisition failures are disappointingly high. Such failure has prompted numerous academic articles and business publications reviewing specific failed deals in search of insights with the certainty of 20-20 hindsight. However, few articles offer practical guidance for improving the organizational and decision-making dynamics inherent in acquisition processes.

Beginning in the summer and fall of 2017, Joe Feldman, Dr. Milo Jones and Aaron Polack initiated research among acquisition professionals with the goal of developing actionable insights for executives considering growth through acquisitions[1]. Specifically, the research targeted input regarding how organizations identified future opportunities, future risks, and complex organizational decision-making and analyses can hinder effective planning.

Dr. Jones has studied the organizational dynamics associated with national intelligence organizations (notably the Central intelligence Agency), specifically reviewing their work prior to strategic surprises. His analysis, combined with our 2017 research, identified several factors common to both the CIA's stumbles and unpleasant M&A surprises.

Summary of recommendations:

Certain organizational dynamics present in intelligence organizations contribute to (a) risk of poor preliminary analysis, (b) ill-advised recommendations and (c) highly-consequential failures. These dynamics are also present in for-profit corporations.

Specifically, we propose three lessons from intelligence failures that have the potential to improve executives' preparations for successful acquisitions:

1. Nurture dissent – there is value in the observations of naysayers; assume positive intent and use dissent to consider new scenarios and unforeseen possibilities.
2. Due diligence's most valuable role is to identify key questions, not answers; exhaustive lists and "check the box" efforts avoid the difficult, though often crucial, analyses regarding an uncertain future. Use due diligence campaigns to interrogate anomalies rather than as an exercise in formulaic corporate foreplay.
3. Look at the numbers, and then consciously look beyond them. Non-spreadsheet risk is real, and its second-order effects can hit the bottom line, hard; in the same vein, avoid the "powerful inclination to count rather than interpret" and the false confidence that comes from quantification of inherently unquantifiable risks.

1 A recap of the research methodology, as well as brief bios of the three authors is provided on page 11.

Survey Respondents

Organizational roles:

Roles	# of respondents	% of respondents
CEO, COO, President, board members	15	7.0%
CFO	15	7.0%
Corporate development executives	126	59.2%
In-house legal counsel	7	3.3%
Other operating executives	11	5.2%
Private equity investor	8	3.8%
Investment bankers	15	7.0%
Outside legal counsel	9	4.2%
External deal advisor	7	3.3%
Total	213	100.0%

Deal experience:

Buy side vs. sell side	Transaction volume
Buy-side only – 113 (53%) Both buy-side and sell-side – 93 (43%) Sell-side only – 8 (4%)	Multiple deals per year – 113 (53%) One deal per year – 55 (26%) Less than one deal per year – 40 (19%) No completed deals – 5 (2%)

Industry experience:

Identification of and expectations for value drivers

SURVEY QUESTION: In your experience with buy-side acquisitions, how significant are the following value drivers to a deal's success?

	Nearly always significant		Often significant		Occasionally significant		Not significant		Total
	%	#	%	#	%	#	%	#	#
Revenue growth with existing customers	**49.5%**	93	**36.2%**	68	**11.2%**	21	**3.2%**	6	188
New customer acquisition	**38.3%**	72	**46.3%**	87	**14.4%**	27	**1.1%**	2	188
Expense synergies	**35.5%**	67	**35.5%**	67	**23.3%**	44	**5.8%**	11	189
Geographic expansion (whether domestic or cross-border)	**22.5%**	42	**36.4%**	68	**35.3%**	66	**5.9%**	11	187
New product pipeline	**20.6%**	39	**38.6%**	73	**35.5%**	67	**5.3%**	10	189
Enhanced research/technical capabilities	**10.5%**	20	**34.7%**	66	**41.1%**	78	**13.7%**	26	190
Added executive talent	**7.5%**	14	**26.1%**	49	**52.7%**	99	**13.8%**	26	188
Other (please specify)									11

"Other" included: strategic market fit, recurring revenue, intellectual property, brand strength metrics, operating level talent vs. executive, client loyalty/recurring revenue levels

SURVEY QUESTION: Looking back at your most recent acquisition(s), what analyses or diligence efforts proved most helpful to identifying and realizing potential value?

	Corporate development execs	CEOs	CFOs	Legal	Private equity investors	Bankers	Others	Total	
Customer analyses	38	3	4	2	3	3	6	59	**26.8%**
Strategic fit	5	1	0	0	0	1	0	7	**3.2%**
Quality of earnings, financial	21	2	1	1	0	1	4	30	**13.6%**
Expense synergies	17	1	2	0	0	1	0	21	**9.5%**
Integration planning	4	0	0	0	0	0	1	5	**2.3%**
Organizational	15	0	1	3	2	2	4	27	**12.3%**
Operational, technology, supply chain	18	1	2	1	1	0	1	24	**10.9%**
Compliance, regulatory, legal	5	1	0	1	0	0	1	8	**3.6%**
NPV, IRR	1	1	1	0	0	0	2	5	**2.3%**
Market, industry, competition	9	1	0	0	2	2	2	16	**7.3%**
Other	11	0	0	1	0	1	5	18	**8.2%**
Total	144	11	11	9	8	11	26	220	**100.0%**

Selected verbatims:

- "Kick the tires - walk the plants and meet with management. Presentations, financial reports and product roadmaps are often dressed up to make the target look at good as possible. We've used a scorecard during our walk throughs and management meetings."
- "Understanding customer relationships of the target; a tricky one, given limitations on candor with customers about what may be coming down the pike."
- "Analyses: Revenue opportunities from new and existing customers.; Diligence: Follow up with non-senior executives without senior execs present."
- "Market study completed by independent third party, direct calls with customers and potential customers"
- "The more you can (or have a 3rd party) validate the stickiness of existing customers, their incentives to stay, and the likelihood of attracting new customer business."

Risk sources

SURVEY QUESTION: In your experience with buy-side acquisitions, how significant are the following risks to a deal's success?

	Nearly always significant		Often significant		Occasionally significant		Not significant		Total
	%	#	%	#	%	#	%	#	#
Loss of key executives, other personnel	**30.2%**	57	**45.5%**	86	**22.8%**	43	**1.6%**	3	189
Loss of customers	**56.9%**	107	**25.5%**	48	**13.3%**	25	**4.3%**	8	188
Revenue growth not achieved	**48.7%**	92	**39.7%**	75	**10.6%**	20	**1.1%**	2	189
Expense synergies not realized	**26.3%**	50	**43.2%**	82	**24.2%**	46	**6.3%**	12	190
Financing issues	**10.1%**	19	**16.4%**	31	**28.0%**	53	**45.5%**	86	189
New product/services disappointment	**8.5%**	16	**32.8%**	62	**46.0%**	87	**12.7%**	24	189
Cultural clash between entities	**30.5%**	58	**39.0%**	74	**25.3%**	48	**5.3%**	10	190
Insufficient integration	**32.6%**	61	**38.5%**	72	**24.6%**	46	**4.3%**	8	187
Regulatory issues	**10.0%**	19	**18.4%**	35	**40.5%**	77	**31.1%**	59	190
Geopolitical issues	**2.1%**	4	**9.1%**	17	**46.5%**	87	**42.3%**	79	187
Other (please specify)									7

Risk quantification

SURVEY QUESTION: Do you agree or disagree with the following statement: "The vast majority of risks in an acquisition can and should be quantified." Why or why not?

	Agree	Agree with conditions	Disagree	Disagree (cit-ing "people" issues)	
Corp Development execs	54	14	25	7	100
CEOs	8	0	1	0	9
CFOs	6	1	2	2	11
Legal	7	0	5	0	12
Private equity investors	5	1	1	0	7
Bankers	3	3	2	0	8
Others	14	3	6	0	23
Total	97	22	42	9	170
	57.1%	**12.9%**	**24.7%**	**5.3%**	**100.0%**

Selected verbatims:

Agree	• "Acquisitions are all about creating value. If you don't understand the risks, you shouldn't be in the M&A game." • "Agree. The decision to execute the transaction should not be based off estimation." • "If you cannot quantify them - and develop risk mitigation strategies up front - you are not doing your job" • "Everything is quantified"
Agree with condi-tions	• "It depends; I think an attempt should be made to quantify the vast majority of risk , but time does not always permit such a comprehensive exercise" • "Agree that efforts need to be made to quantify risks but flexibility needs to be included to address unexpected surprises (positive and negative)."
Disagree	• "Many risks are of a qualitative nature and the impact could be vast - so at best one can assign ranges which then become quite meaningless. Applying averages/ midpoints from such ranges is often misleading." • "Quantification could be a pointless exercise. Risks should certainly be identified, and perhaps an order of magnitude assigned in order to prioritize and balance. But arriving at an exact quantification requires too many assumptions, which will inevitably prove inaccurate"
Disagree (citing "people" issues")	• "the impact of key executives staying or leaving or of cultural friction is significant but difficult to quantify" • "One critical risk is organizational assimilation and blending of cultures. I am not smart enough to attempt to quantify that in a sensible way"

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Effective pre-closing preparations

SURVEY QUESTION: In your experience, what pre-closing activities are most effective in preparing for operational success with an acquisition, that is, achieving value, managing risks, preparing for surprises?

	Corporate development execs	CEOs	CFOs	Legal	Private equity investors	Bankers	Others	Total	
Combined, early due diligence, integration, planning team	14	0	0	0	0	0	2	16	**8.9%**
Integration Planning (general comment)	30	2	2	2	2	3	2	43	**24.0%**
Organizational	24	2	1	3	3	3	9	45	**25.1%**
Synergy analysis	5	0	0	0	0	0	1	6	**3.4%**
Operational	7	0	1	1	1	1	3	14	**7.8%**
Project Management	1	0	0	0	0	0	0	1	**0.6%**
Overall vision/plan for business	11	1	0	0	1	0	2	15	**8.4%**
Dedicated "naysayer"	1	0	0	1	0	0	1	3	**1.7%**
Scenario analysis	4	0	0	0	0	0	0	4	**2.2%**
Diligence	5	2	0	2	0	0	4	13	**7.3%**
Incentives	1	1	0	0	0	0	0	2	**1.1%**
Financial analysis	4	0	1	0	0	0	2	7	**3.9%**
Customer planning	2	0	1	0	0	2	4	9	**5.0%**
Capital expenditures	1	0	0	0	0	0	0	1	**0.6%**
	110	8	6	9	7	9	30	179	**100.0%**

Selected verbatims:

- "Stationing leaders from acquiring co. in the new organization; however, do not forget the original business."
- "A well thought out integration plan lead by someone who is dedicated to delivering that plan; i.e. not an extra part of someone's day job."
- "Leadership continuity planning through the transition, creating clarity for responsibilities of the transaction's KPIs [Key performance indicators]"
- "Combining diligence findings / learnings with an integration strategy"
- "Should have a designated 'naysayer' to challenge the deal merits and play Devil's advocate; Sensitivity analyses should consider a broad range of outcomes, both positive and negative; Thoughtfully structure earn-outs to incentivize achievement of positive outcomes and also consider the impact if expected outcomes are not achieved"
- "Operation due diligence and a detailed, well thought post transaction 100 days plan"
- "Need to trust people to do the right thing"
- "Not setting unrealistic performance goals to justify transaction price"
- "Focusing on integration process and being able to hit the ground running on day one. Having some of the difficult HR conversations up front"

Reality vs. Plan

SURVEY QUESTION: In retrospect, which pre-closing analyses or diligence efforts provided results/information that most diverged from reality after the deal closed?

	Corporate development execs	CEOs	CFOs	Legal	Private equity investors	Bankers	Others	Total	
Revenue shortfall, customer issues	39	5	6	0	1	2	6	59	**41.3%**
Organization, culture	12	2	1	4	1	1	3	24	**16.8%**
Operational	8	0	0	0	0	0	1	9	**6.3%**
Legal, litigation	2	0	0	0	1	0	0	3	**2.1%**
Expense synergy	6	0	0	0	0	0	1	7	**4.9%**
Wage pressure	1	0	0	0	0	0	0	1	**0.7%**
Financial projections	6	0	2	1	0	3	2	14	**9.8%**
Incremental investment required	2	0	0	0	1	0	1	4	**2.8%**
Market conditions	2	1	0	0	0	0	1	4	**2.8%**
Integration	5	0	0	0	0	0	1	6	**4.2%**
Other	9	0	0	0	0	0	3	12	**8.4%**
	92	8	9	5	4	6	19	143	**100.0%**

Selected verbatims:

- “Sales growth and synergy expectations have sometimes deviated from reality, especially when sales growth required significant capital expenditure, for which we underestimated the “ramp-up” period.”
- “The cultural divide between us and acquired talent. It turned out to be stronger than predicted”
- “The speed at which cost synergies could be realized. It is always difficult to reorganize/restructure a business soon after an acquisition while not trying to do too much too soon.”
- “Revenue synergies almost never materialized to the extent forecasted.”
- “People issues well masked”
- “lack of understanding of business dynamics because of lost people is deadly”
- “Synergies predicted are rarely accurate”
- “Seller provided assessment of contract pipeline. It was a wonderful work of fiction.”
- “The employees’ dedication or lack thereof to the new company. If they don’t feel part of the new company, loyalty and knowledge flies out the window”
- “Usually speed of integration / time to realize new / increased revenues. Overly optimistic.”

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Organizational, cultural fit

SURVEY QUESTION: Was any formal effort made to evaluate the cultural fit between the buyer and the to-be-acquired firm?

	Yes (with enthusiasm, specifics)	Yes	Yes, but...	No	Total
Corp Deve	33	18	9	23	83
CEOs	5	1	1	1	8
CFOs	0	5	1	2	8
Legal	1	2	0	6	9
PE	0	4	0	1	5
Bankers	3	0	0	2	5
Others	6	6	2	5	19
Total	48	36	13	40	137
	35%	**26%**	**9%**	**29%**	**100%**

Selected verbatims:

Specific effort reported	• "Yes, but difficult until you really spend months living in the business." • "Yes - effective - integration model aligned with this analysis." • "Absolutely. Culture is a top 3 success factor with us along with Employee Retention and Valuation"
No/nominal effort reported	• "Not really. Therefore, we have to live with the aftermath" • "...feeling based" • "No diligence issues rose to the level for a full cultural type study requirement"

SURVEY QUESTION: In your experience with buy-side acquisitions, how significant are the following risks to a deal's success? [NOTE: as previously shown on page 3]

	Nearly always significant	Often significant	Occasionally significant	Not significant
Loss of key executives, other personnel	30%	45%	23%	2%
Cultural clash between entities	31%	39%	25%	5%

Naysayers

SURVEY QUESTION: In your most recent acquisition(s) experience, which among the following were "naysayers"... that is, people who doubted the wisdom of the deal and were against proceeding (check all that apply)?

	Responses	%
CEO	12	*5.6%*
CFO, finance	42	*19.4%*
Senior sales, marketing	22	*10.2%*
Senior HR	9	*4.2%*
Senior operations	31	*14.4%*
Senior R&D	15	*6.9%*
Legal	4	*1.9%*
Strategy execs	1	*0.5%*
CIO	1	*0.5%*
Corporate Development	1	*0.5%*
Other operating	29	*13.4%*
Inestment bankers	0	*0.0%*
Board of Directors	35	*16.2%*
Minority owners	1	*0.5%*
Family owners	1	*0.5%*
Capital sources (e.g., lenders)	12	*5.6%*
	216	*100.0%*

Selected verbatims:

- "In our experience the decision has been shared and agreed in advance and there were no 'naysayers'"
- "none, fully consensus across all of the above is pre-req of pursuing an acquisition"
- "Anyone who was not part of the planning for the acquisition on either side of the deal."
- "Internal legal counsel - they are very good and telling the CEO all the things that could possibly go wrong. NOTE: the job of the corporate development executive is to reframe the spurious objections that all the above executives will raise."
- "Strategic thinkers at the executive level with different agendas"
- "None, we would not proceed if there were significant doubts within the organization"
- "Very few were in opposition to deals -- most were supportive because of a 'make a deal happen' mentality"

SURVEY QUESTION: How was the opposition deal with as part of the company's deliberations regarding the acquisition? For example, was the opposition considered as: constructive, a distraction, substantiated, unhelpful...?

	Constructive	Distraction	Substantiated	Unhelpful, ignored	Ignored, with regrets	No nay sayers	
Corp Deve	46	12	3	6	2	3	72
CEOs	1	0	2	0	0	1	4
CFOs	2	1	3	0	0	0	6
Legal	1	4	2	0	0	0	7
PE	1	1	2	0	0	0	4
Bankers	0	1	2	0	0	0	3
Others	3	3	9	0	0	0	15
Total	54	22	23	6	2	4	111
	48.6%	**19.8%**	**20.7%**	**5.4%**	**1.8%**	**3.6%**	**100.0%**

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Research methodology

During summer of 2017, we conducted an online survey (Survey Monkey), generating over 200 responses from senior corporate executives and advisors active with acquisitions.

The survey prompted particularly for feedback and lessons learned with regard to the following:

1. where has actual post-closing acquisition experience diverged from pre-closing planning,

2. what role have "naysayers" played in pre-closing deliberations and planning for future scenarios,

3. what areas have provided the most surprises following an acquisition, and

4. how important is quantification of risks in preparing for post-closing integration.

Additionally, we conducted several one-on-one interviews with CEOs and investors to explore their experiences and learnings from acquisitions as may pertain to the intelligence community learnings that we propose relevant and valuable to corporate acquirers.

Author biographies

Joseph Feldman started Joseph Feldman Associates in 2003 to advise a wide range of companies on growth through acquisitions. Additionally, Feldman has been actively researching ways in which acquisition success rates can be improved and has published findings on this topic in *Directors & Boards, CIO Review*, among other publications.

Dr. Milo Jones has been a Visiting Professor at IE Business School in Madrid, Spain since 2008. At IE, he teaches "Intelligence Tools for the Business Professional" and "Geopolitics" in the MBA, Masters in Finance and Executive Education programs. He is the co-author of *Constructing Cassandra: Reframing Intelligence Failure at the CIA, 1947-2001*, published in 2010 by Stanford University Press.

Aaron Polack is Head of Business Development for Lion Equity Partners, a Denver-based private equity firm focused on acquiring non-core divisions from larger companies. Currently, Polack manages the business development activities of the firm including deal sourcing and evaluation, marketing, and add-on acquisition efforts for portfolio companies.