



THE MISSING ASSET

On several occasions during the past year, I received phone calls from managers of agriculturally related businesses. During our conversation, the manager would express his concern over the possible acquisition of, or merger with, another business. In most cases, this phone call would be followed by a personal visit with the manager. As a first order of business, the manager would display the latest financial statements for his own operations and those of the firm being considered for acquisition or merger. This would be followed by a brief analysis of financial security, profit potential, and asset evaluation. If the discussion concerned a possible acquisition, our attention would soon be focused on the asset column of the Balance Sheet. The manager would show deep concern for the indicated value of listed assets, the proportion of debt levied against them, and their probable purchase price if the acquisition were to reach fruition.

Having discussed each of the listed assets, the manager would likely be surprised by my statement, "The firm's most important asset, of course, is not shown on the Balance Sheet." His first reaction to this statement would be to assure me that all of the firm's physical facilities, equipment, inventory, etc. are properly listed. "No," I would then reply, "there is a MISSING ASSET. No where on that Balance Sheet is there listed a value for management." For some reason, the manager had failed to recognize that along with acquiring a firm's plant, equipment, and inventory, the purchase would also include its management.

The Management Audit

Auditing a firm's financial records, counting its inventory, evaluating its capital assets, and forecasting its sales volume are inadequate for the purpose of acquisition (or merger) consideration. Remember, the entry on the bottom line of a P. & L. Statement is historical, not predictive. An analysis of a firm's past operations will not foretell how profitable it is likely to be in the future until that missing asset is also incorporated into your considerations.

For example, let's assume the XYZ Farm Supply Co. is considering the acquisition of a similar operation located in another community some distance away. What is the firm worth? How much should XYZ pay for the firm? These questions can only partially be answered by an analysis of relevant financial documents. Management becomes the critical component in setting the price and/or proceeding with the acquisition. Who is going to manage the newly acquired firm, for example? If the former owner is to remain as manager, will he continue to be as highly motivated as when the business was his? Will the top salesman remain with the firm after it has been acquired by XYZ? Such questions cannot go unanswered.

In fact, such questions need not remain unanswered. The XYZ Farm Supply Co. could conduct a MANAGEMENT AUDIT. A management audit is a new method of evaluating "managerial assets" within your own firm or in a business which is under consideration as an acquisition (or merger)

prospect. Each management audit should be tailored to a specific situation. However, it normally consists of eight “subject considerations.”

Each of the eight subject considerations in a management audit is like an important piece of a jigsaw puzzle -- the overall picture emerges only after all the pieces have been properly assembled. In the following discussion, I shall discuss each of the subject considerations in light of their contribution towards making intelligent acquisition (or merger) decisions.

The Management Team

Who are the key management people in the business and what are their strong and weak points? This is the first and, perhaps, most deceptive question which must be investigated. Management personnel who, on first glance, appear to be vital to the business may, later prove to be easily replaceable. This often occurs in the case of smaller agribusiness firms where the present manager is the founder or owner of the business. Many people are inclined to attribute the entire success of the business to the efforts of this one individual. In fact, however, the personal growth of the manager may have been exceeded by the growth of his firm, thanks to the diligent efforts of his subordinates. This manager frequently acts and talks like he has full control over (and has performed) every aspect of his business. Do not accept your first impressions. Look closely at the number two and three people in the management team for further evidence of management talent. At these lower levels of management you will often discover the real kingpin to the management team; the younger, more ambitious, better educated, and totally dedicated employee who during the past five years has really contributed most to business profits and overall performance. The

top executive may turn out to be the most easily replaced administrator.

Once the key persons in the management team have been identified, their relative strengths and weaknesses must be assessed. Such an assessment must be conducted, however, in light of their potential performance AFTER acquisition. After all, the final acquisition decision will be based on 1) who the key management people are, 2) what their talents and abilities are, and 3) whether and how these abilities will be applied under a new ownership arrangement. If a previously successful business suffers a loss of its key management personnel due to an acquisition, the firm's value to the purchaser has been greatly reduced. Your objective must be to discover how great such losses are likely to be and how costly it will be to re-staff the acquired firm with comparable personnel.

Along these same lines, a firm may demand a premium price because of its superior management talent. If the firm which you are thinking of acquiring has such talent, you may wish to offer a premium price in anticipation of management's favorable influence on future performance. How can you guarantee that such talent will not resign following the acquisition? Employment contracts, stock participation agreements, and long-term payments of the purchase price which are related to the firm's earnings after it has been acquired are all vehicles commonly used to assure the continued service of high quality management.

Post-Acquisition Departures

Who is likely to leave the firm following its acquisition and what are the likely consequences? In answering this question, one must remember that those management personnel with the greatest talents also have the -- greatest number of alternative job

opportunities. Many employment agencies in this country exist solely on their ability to place business executives, unemployed due to merger or acquisition, in new jobs.

Employees displaying high levels of achievement in a firm being acquired will probably have little difficulty in obtaining an equally attractive position elsewhere.

Middle-Management Advancement

In the direct purchase of another firm, it is likely that the top management will be replaced or lost. Persons existing at the middle-management level, however, are more likely to remain with the acquired firm. This is not a rigid rule, but does appear as a part of a normally anticipated pattern. An inventory of middle-management talents, therefore, becomes mandatory. Such an inventory should indicate whether managerial talents will be available in future years to fill positions of greater importance. It should identify promising people and, thereby, enable the acquiring firm to discuss with these persons their prospects and expectations under the new ownership. Such discussions should be in the form of encouragement towards their continued advancement and career development.

Dead Wood

It is not unusual to find an acquisition that is made contingent on the retention of certain management personnel; not all of whom contribute much to future operations and performance. Such individuals carry with them the infamous title of "dead wood." According to Kurt Einstein, a highly regarded management consultant, dead wood is the resultant product of a combination of employee insecurity plus lonely desperation.

Employee insecurity arises due to changes in the organizational environment and primarily reflects a fear of the unknown. It is not difficult to visualize how employees of a

recently acquired firm might develop certain anxieties. New policy decisions, new operating procedures, and the appearance of unfamiliar personnel in areas of authority all tend to create and compound speculation and rumor. Management personnel who have been retained following acquisition begin to wonder how the new ownership will affect them personally. Erroneous assumptions soon develop into open anticipation and everyone's ulcers activate in unison. Further insecurity develops if the person perceives his responsibilities increasing at a rate beyond his ability to cope with them.

In an attempt to combat this feeling of insecurity, the employee soon begins to strike back at the organization. His combativeness may appear in the form of total emotional withdrawal or, on the other extreme, incoherent objection to all proposals or procedures. Regardless, the result is likely to be a reduction in general managerial efficiency, internal communications breakdown, or both.

If dead wood is likely to be a result of an acquisition, perhaps you had better think twice before proceeding. Direct and open communications with retained employees may eliminate the creation of dead wood in an acquired firm. However, once created, dead wood can become a painful and long-lasting burden on the firm. In this case, prevention is less costly than the cure.

Post-Acquisition Orientation

Will the personal ambitions and achievement goals of management personnel retained after acquisition remain the same? Every person has different ambitions and goals, many of which are directly related to the situation within which they perceive themselves as being. Once this situation changes due to a change in ownership of the firm, what becomes of their earlier held goals and

ambitions? While generalizations on this question are dangerous, the answer may directly affect the acquiring firm's ultimate success.

Suppose it appears that the management package being acquired has shown personal success-orientation over the pre-acquisition years. It seems likely that the success orientation would not change after acquisition. However, you discover, much to your dismay, that their success-orientation was linked directly to pride of ownership and disappeared entirely when this ownership was transferred to others. This is but one illustration of an unfavorable shift in management orientation.

Suppose, on the other hand, the firm being acquired displayed a chronic case of management doldrums, i.e., deflated ego and a pessimistic personal outlook. The acquisition of this firm by an ambitious organization with a progressive image might convert the personal goals of the management team into more acceptable ones. This change in management orientation would, therefore, appear as a plus factor for acquisition.

Internal vs. External Advancement

Prior to the consummation of an acquisition, one must determine whether the new leadership will be generated internally (from within the acquired firm) or externally (from within the acquiring firm). This decision should not be taken lightly as it may seriously affect employee morale, attitude, and job performance. This is especially true if a small firm is being acquired by a much larger firm, or if there are plans for substantially changing the operations of the acquired firm. Management personnel costs associated with transfers, terminations, and promotions play no small part in the ultimate success of an acquisition.

A management audit must consider all the underlying costs which would subsequently be incurred as a result of needed management personnel changes. Such costs could range from out-of-pocket recruiting expenses, new salaries, and moving costs for those executives being transferred to the newly acquired firm, to less direct costs associated with training time, unfulfilled positions, and lessened management control during the time that such personnel transfers are being made.

A management audit might also reveal windfall savings which could be achieved due to the release of ineffective management personnel.

Employee Perceptions

What is the perception of each individual and the management team, as a whole, towards their counterparts in the acquiring firm? Remember, perceptions are just as important as realities in so far as their ability to influence a man's performance and his personal commitment to his firm and his job. In other words, you must be able to anticipate employee reaction to an acquisition not only as they appear to you, but as others are likely to perceive them.

Frequently people proceed with an acquisition (or a merger) thinking they know how their managerial colleagues will react. Their expectations prove correct only if all others perceive the acquisition exactly as they do; which is a highly unlikely prospect. The result is a painful assimilation of the newly acquired firm, internal bitterness among the new members of the management team, and persistent misunderstandings about the long-run intent of the acquisition. Meaningful future predictions, therefore, should be based on a detailed and unbiased appraisal of each individual's perceptions, expectations, and attitudes towards the acquisition.

Management Compatibility

As was indicated above, each person's perceptions of a potential acquisition are likely to differ. While such differences may exist, the attainment of compatibility need not be ruled out. Different perceptions, so long as they are all favorable ones, may prove to be very compatible. The question of management compatibility can best be considered when evaluating the characteristics of the two firms concerned. Here one must ask how well the managerial talents of the acquiring firm will meet the managerial requirements of the firm being acquired. It is doubtful, for example, that the manager of a farm supply firm could assume, via acquisition, the total managerial duties of a food processing firm without some degree of difficulty. Of course, some of the managerial talents required by the two firms would be similar, if not identical. Yet others would require a different set of skills entirely. The existence of management compatibility, therefore, will depend on the degree to which managerial responsibilities of the two firms overlap.

Summary

If an agribusiness firm is considering an acquisition (or a merger), the analysis of relevant financial documents is mandatory. The value of all assets being acquired must be assessed in light of their ability to contribute towards overall firm performance and profit. The Balance Sheet is a financial document commonly used in making such an initial assessment. Unfortunately, one of the most important assets relevant to potential acquisitions is never listed in any financial document. The missing asset is management.

The management audit is a method of analysis designed specifically to assess the value of a firm's management team. In conducting a management audit, the analyst attempts to

answer, in a step-by-step manner, the following eight questions:

- a) Who are the key management people in the firm under consideration, and what are their strong and weak points?
- b) Who is likely to leave the firm following its acquisition, and what are the likely consequences of their departure?
- c) What types of middle-management talents are available in the firm being acquired, and how can they be best utilized?
- d) How can one avoid the emergence of dead wood management?
- e) How can one assess the potential effects of post-acquisition orientation changes in its management personnel?
- f) How can one anticipate the benefits and costs of internal vs. external management advancement?
- g) What are the perceptions of each individual on the management team towards the potential acquisition?
- h) What degree of management compatibility would be attainable as a result of the acquisition?

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