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Selling the story

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Selling the story

A new study into the announcement of M&A deals finds that quality matters – clear, proactive announcements are strongly related to deal success.

Key findings:

- **Proactive announcements count:** 84% of deals announced as actual offers are completed, compared with just half of those which were announced in response to a leak
- **Leadership matters:** announcements with statements from both companies' chairman/CEO are associated with significantly higher levels of success than those without
- **Markets reward uncertainty – in the short-run:** leaked M&A deals, or announcements lacking information about the underlying strategic rationale, are actually rewarded by the markets in the very short term
- **PR firms earn their fees:** deals involving PR firms have a higher chance of completion than those without
- **Nail down the narrative:** a clear message can be obscured in the process of crafting a deal announcement – it's important to ensure key players are on board with the deal narrative from the start.

Carefully crafting a press release and drawing up a social media campaign might not be the top priority at the end of a gruelling merger or acquisition process. But perhaps it should be: new research from Cass Business School has found a clear impact on deal consummation and short-term shareholder returns from what it defines as "good quality" M&A announcements.

"There simply hasn't been any research in terms of the quality of communications, especially around announcements," says Jeetesh Singh, one of the authors. Rather, previous research has focused on communication processes during the post-integration implementation phases of M&A deals.

"This research clearly shows the importance of properly resourcing deal teams' communication efforts," says Professor Scott Moeller, co-author and director of the M&A Research Centre at Cass Business School, where the research was carried out. "This is especially the case given the proliferation of social media, and the need to be responsive to a much wider range of stakeholders.

"But it also throws up some surprising findings around the immediate market response to deal announcements," he adds. "For instance, it appears that equity markets can – in the very short term at least – reward a lack of public information about an M&A transaction."

The new research examined 198 public-to-public M&A deals in the UK from 1997 to the end of 2010, worth at least $100 million.

It looked at two metrics for deal success: whether the transaction was completed or not; and whether it led to short-term increases in the combined value of the target and acquirer, compared with the benchmark. This Cumulative Average Abnormal Return (CAAR) value was calculated from two days before the deal was announced to two days post announcement.

In terms of the nature of the deal communication, the research identified two types: proactive 'actual offer' announcements made by the acquirer (or acquirer and target); and 'responses to press speculation' announcements, typically following a leak. Most announcements (88%) were actual offers.

The research then looked at a number of elements relating to each announcement. These were:

- Timing – whether it was made before, during or after the trading day
- How the deal was characterised – either as a merger of equals or as an acquisition
- Whether the deal announcement included explanation of the strategic rationale or rationales behind the deal
- Whether it contained statements from CEOs and/or chairmen
- Whether it set out the proposed board structure for the merged firm; and
- The involvement or otherwise of public relations firms.

Proactive communication counts

To a large extent, the research confirmed assumptions about the importance of proactive M&A communication. For example, transactions with 'actual offer' communications are successfully completed 84% of the time, compared with just 50% for those deals where initial communication is in response to press or regulatory inquiry **(Chart 1)**.

Deals that were announced before the start of the trading day were more likely to be completed than those unveiled after the market open **(Chart 2)**, while deals with clear, well-defined strategic rationales were found to have a better completion rate (80% or more) than those without (60%).

But the research also threw up some less-expected results. The assumption was that deals that were proactively announced would also deliver positive short-term returns compared with those where the initial announcement was outside management's control. The opposite proved to be the case, with 'actual offer' deals providing a combined abnormal return of 2% over the five-day period, compared with 6% for 'response to speculation' announcements.

"We expected a negative return, because the market is responding to half-baked information. Certainly the probability of deal success is lower," says Singh. "But it may be that this sort of speculation causes a stir in the market, leading to the target company being bid up."

He notes that the analysis looked at share price movements over just five days, and that a longer time horizon, where the market has had more of a chance to absorb the information, may tell a different story. However, choosing a longer time period would have meant that fewer inferences could be have been drawn from the deal announcement, given the myriad factors that influence a company's share price.

Another counter-intuitive finding relates to the reaction of shareholders to the lack of any strategic rationale cited by parties to the M&A deal. "We expected that if no strategic rationale was given, we'd see negative returns in the five-day period," says Singh. "The opposite happened." **(Chart 3)**

The positive returns – an average of 7% CAAR, compared with 3% where three or more strategic reasons are volunteered – "could be attributed to higher anticipation in the market, and an 'anxiety factor' as investors wait for follow-up communication as to why the acquisition or merger is taking place," he says.

But short-term market reaction is of course only a small part of the story, notes David Badham, Deputy Director of the M&A Centre. "Clarity in terms of how you express synergies, and how they relate to completion, is very important," he says. "It helps sell the deal on the day, but it also conveys a message that you have started planning the integration. If you've put a number in an announcement, you have to live or die by it – if you've worked things through that thoroughly, it's logical that you've a better integration plan."

Chart 1 – Communication type vs. Deal status

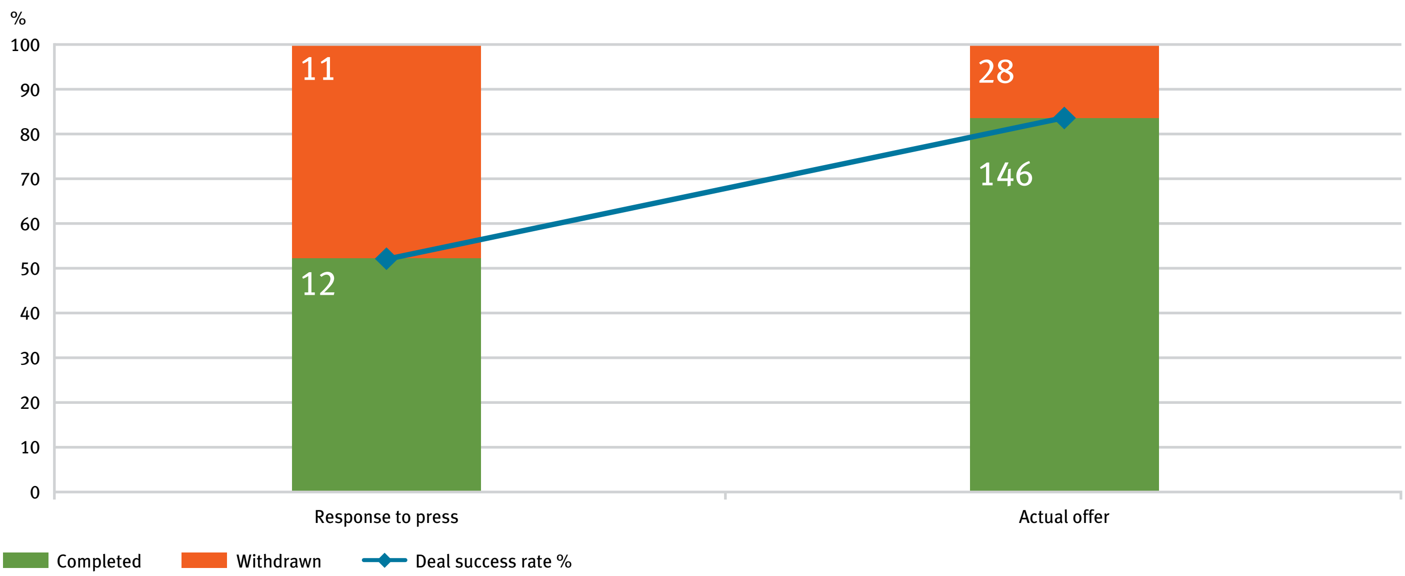


Chart 2 – Announcement windows vs. Deal status

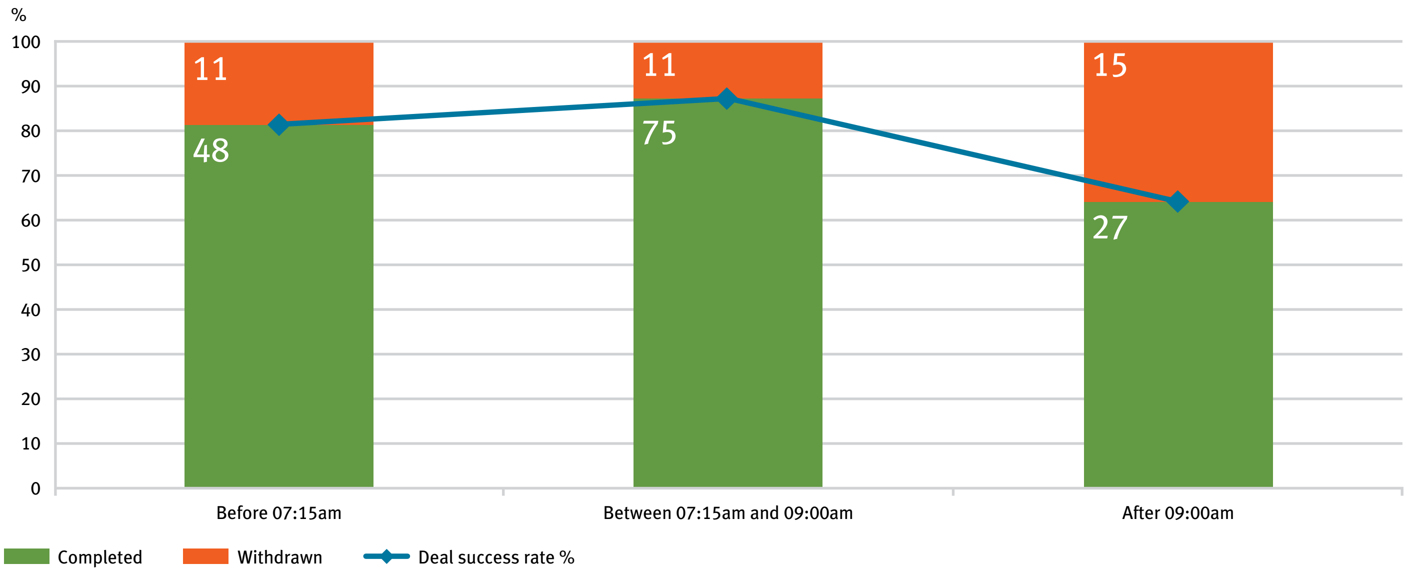
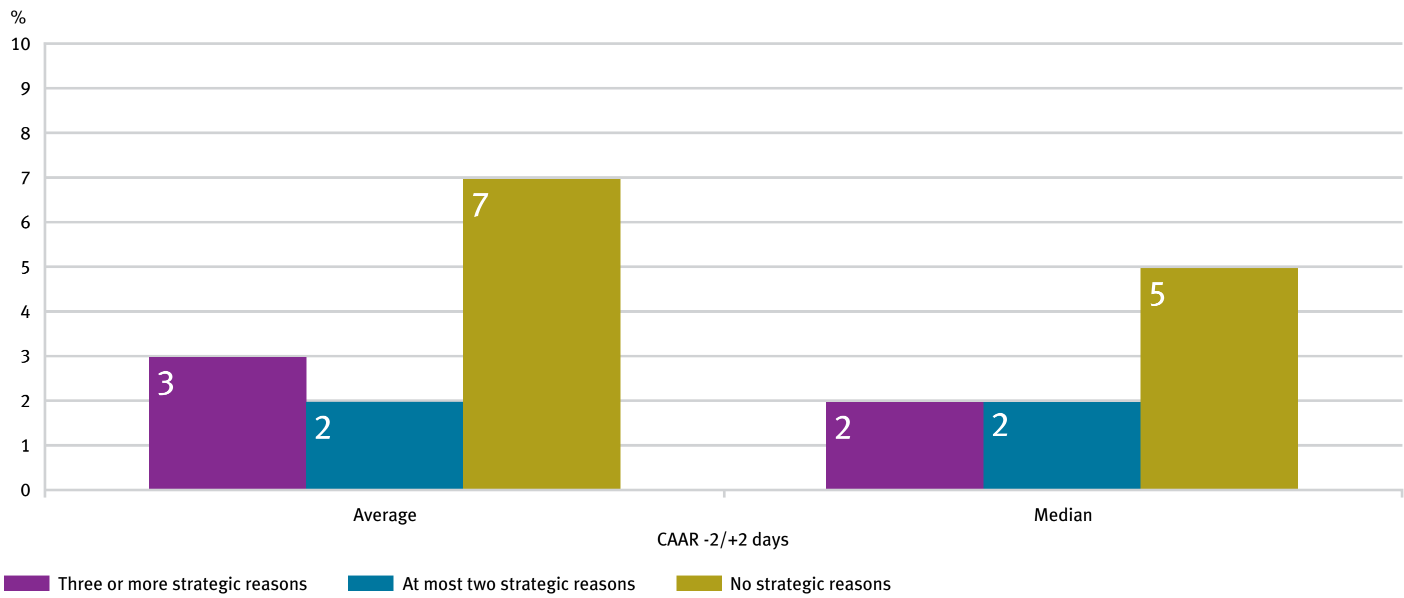


Chart 3 – Strategic reasons vs. Combined CAAR



Preparing for the worst

With half of deals involving reactive announcements failing to close, leaks remain serious threats to M&A deals.

"A lot of deals leak, and it can be quite hard to row back against the 24-hour news cycle if that leak doesn't quite portray the narrative in the way the parties to the deal might like," observes Chris Salt, a partner at Headland, a London-based corporate communications consultancy. "How good the communications strategy is for coping with a leak is particularly important."

"At a certain stage in the deal process, you should be ready with a story if the deal leaks, and teams should be ready for the worst," says Badham. "If someone else leaks, and you're not ready – if you don't have financing in place, for example – you may find you're not able to make a formal bid."

Looking to company leadership

As might be expected, deal announcements containing quotes from CEOs or chairmen of both the target and the acquirer company have the highest rate of closure, at 91% **(Chart 4)**. Those with no leadership statements were successfully completed 67% of the time. But announcements with a leadership statement from just one side of the deal have the lowest completion rate, at 57%. This might be because the absence of one side from the announcement indicates hesitancy or outright opposition to the deal, the researchers speculated.

"It's very important that leadership is visible – not only at the announcement, but throughout the whole deal," says Michel Driessen, head of Operational Transaction Services at professional services firm EY. "Leadership may not have all the answers at the announcement stage, especially if the deal is done very quickly. That's usually understood by the market, as long as the leadership continues to communicate."

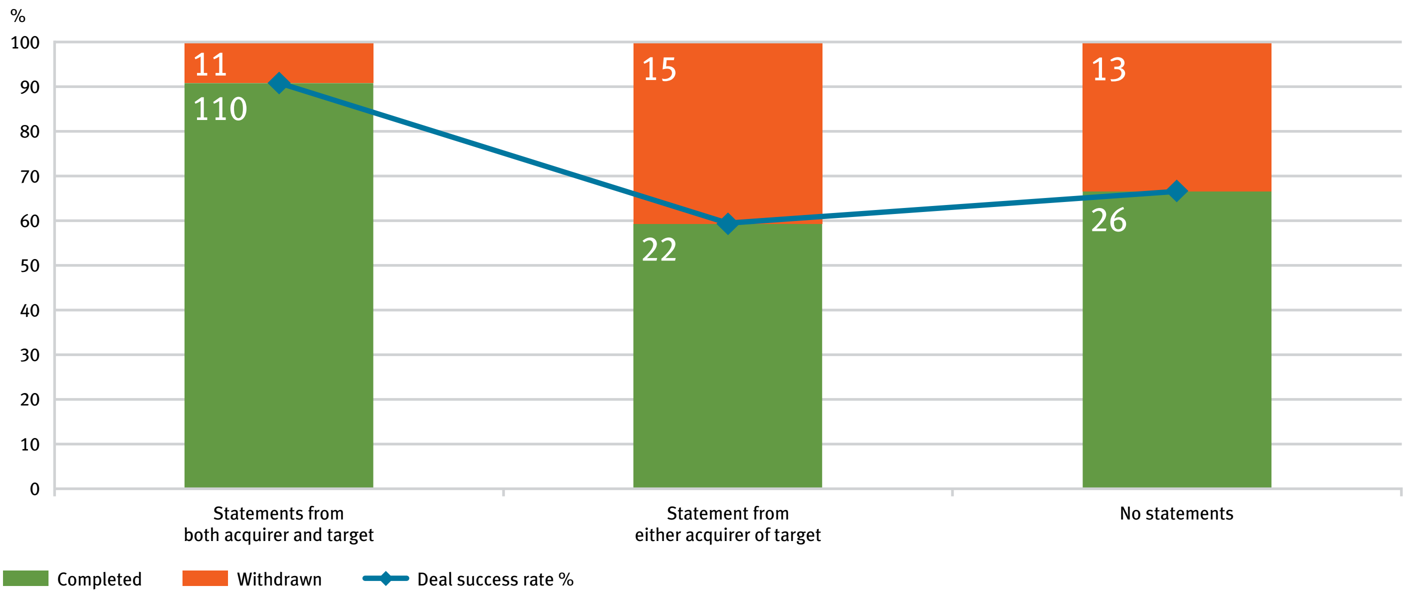
The research begs the question as to why some companies find it difficult to be specific at the time of deal announcement.

Driessen at EY has a number of explanations. "Sometimes there are conflicting interests and it will be difficult to convey this in the actual message – for example, when an acquirer is seeking to keep the leadership of the target company on board, perhaps," he says. For example, companies often talk about a merger of equals, when the deal is perhaps more of an acquisition. "That may be creating expectations which can't be often fulfilled."

He adds that deal teams can simply underestimate the time involved in crafting a message. This is especially the case with the growing importance of non-traditional communication avenues. "Communicating through social media is very important – a lot of people still don't understand that, or take the implications on board."

Moeller agrees. "The press matters, but these days it's not only about the FT. There are hundreds of blogs, Twitter, etc. It's important to get your side of the story to the right people."

Chart 4 – Deal success vs. Leadership statements categories



Why narrative matters

Meanwhile, the often drawn-out process of crafting an announcement, which necessarily involves input from lawyers, tax experts, and a plethora of advisors, can risk obscuring that story, warns Salt at Headland.

"The risk is of 'announcement creep' – you start out with something that clearly conveys your strategy, and what you're trying to achieve, but as different interests have their input, it becomes less clear. It's very hard to produce a clear announcement document," he says.

The answer, he says, is to reach agreement on the transaction's underlying 'narrative' early in the deal process. "The advice we give is to ensure that all the closest advisors are in the room, and agree a narrative, an idea of what you want the announcement to achieve, before you get into the word-by-word writing.

"It might sound fluffy, but it's very important. If the lawyers, etc., are all broadly in agreement, you've got a better chance of success."

Having a financial PR firm on side is also helpful, the research concluded. It found a higher completion success rate where both sides were represented by PR agencies **(Chart 5)**. This reduced where only one side had PR representation, and dropped further where neither side had employed a PR firm. The effects of PR representation on short-term value creation were inconclusive.

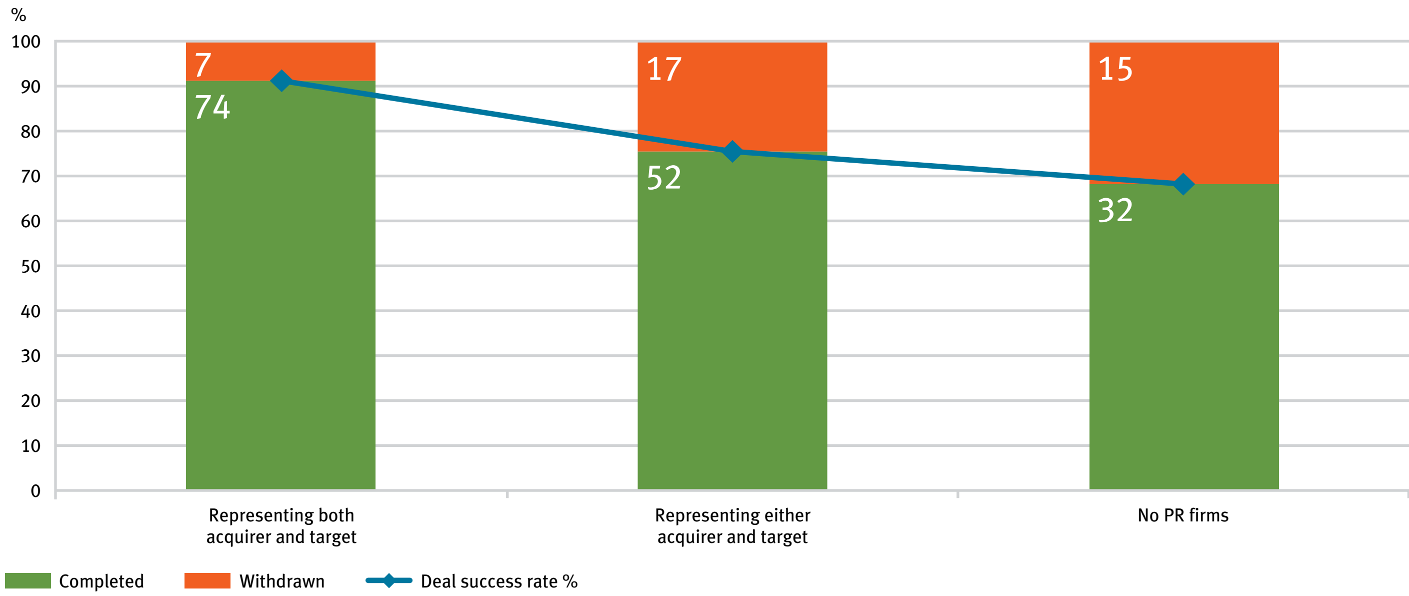
"Whether it's from a PR agency, a strong in-house communications team, one of the bankers or the CEO, what's important is someone who believes in the usefulness and power of good communications," argues Salt. "If you start to think about communications when you're crafting a press release or an RNS statement, you're in trouble."

Next steps

The research opened up a number of avenues for further investigation, says Singh. For example, the research did not take into account whether the deal was friendly or hostile – a factor that could impact a number of elements of the announcement, such as leadership statements or information about board composition.

"There's a lot of scope to go into more depth," says Singh, such as in terms of the value added by financial PR firms, and the relationship between the quality of the deal announcement and longer-term value creation. "There's a lot more research to be done," he concluded.

Chart 5 – Deal success vs. PR firms categories



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