



Merger Miseries Four - Do Do Diligence

by Robert Whipple: MBA, CPLP

This is the fourth in a series of articles on the trials and tribulations of mergers and acquisitions. The topic for this episode is "due diligence." In every merger there is a phase where a kind of Kabuki Dance occurs. The outcome is fairly certain, but the parties investigate each other in order to negotiate the deal with higher confidence.

Actually "confidence" is a good word for it because the con-men involved in going through the motions are often more interested in subterfuge than transparency. The exercise has an aura of discovery where the acquiring party obtains lots of data and several tours, so they ostensibly have good data going into the actual negotiation.

The interesting point in this dance is that the level of deception can never be truly known until several months down the line after the deal is consummated. In some cases the disclosure is mostly forthright with only a few areas where the sellers are bending the truth, AKA "putting our best foot forward." In many cases it degenerates into conscious deception or downright fraud. Let's examine why this is the case.

Our society is structured with the doctrine of caveat emptor, or "let the buyer beware." Under the doctrine, the buyer could not recover from the seller for defects on the property that rendered the property unfit for ordinary purposes. The only exception was if the seller actively concealed latent defects or otherwise made material misrepresentations amounting to fraud. The problem with this definition is that what may seem like polishing the brass to one lawyer might constitute deception to another. Let me illuminate a few examples of behavior that is considered OK versus behavior that is marginal or even totally illegal.

You have put your house on the market. You know there is a large problem of termites eating the wooden beams near the foundation. Sweeping up the loose sawdust on the floor to make the problem appear less evident or severe would be simply "staging" the house for sale, and it is perfectly legal to clean a house thoroughly before listing it. Covering up the damaged area with a new board in order to hide the nest is not appropriate, although many home sellers do things like that. They might list the subterfuge as a "cosmetic upgrade." Certifying that the home is free of termites in a signed statement would be outright fraud. Of course, in buying a house, you would hire

an inspector who is trained in how to look for termite evidence and other problems, so the ability to hide a large infestation is limited.

The same phenomenon takes place in due diligence for organizational mergers. Teams of consultants go in to look at the facilities, inventory, and financial records of the seller to protect the buyer from exaggerated or incorrect claims. In a merger situation, it is easier to hide minor or remote problems than it is for a homeowner to hide termites from an inspector.

Smart buyers find the right kinds of experts to gather the right data, do the careful research and forensics, and ask the numerous carefully worded questions that force disclosure of any flaws or potential time bombs. An excellent attorney/legal firm specializing in a particular type of transaction can ensure that both parties in a deal are protected. Scrutiny must go far beyond the straight accounting issues into other areas that could spell trouble for the organization over time.

It is also important to focus on due diligence regarding personnel issues. The intellectual abilities and motivation level of the current workforce are substantial parts of an organization's assets. These less-tangible assets are no less important than the buildings, physical inventory, and accounts receivable statements of an organization. If the population included in a merger has habitually been abused by the current owner, the buyer is going to inherit these problems on steroids once the merger becomes public knowledge. How can a potential buyer accurately assess the level of human related assets?

Survey assessments of the current populations would be tempting, but there is a high probability of a Hawthorne Effect in doing surveys. A Hawthorn Effect occurs when people change their behavior or input based on the knowledge that they are being surveyed for a certain reason. This renders the data less valid. The information may show a rosy picture only to have the truth of a sweat shop environment come out after the merger.

The use of extant data is a more objective process. This is where existing historical records of HR data are collected and benchmarked with other companies of similar size and structure. These might include the following types of information:

- Wage rates for all levels of employees
- Absentee data going back several years to spot trends
- Safety incidents and accident rates (OSHA reportable and otherwise)
- Turnover rates and length of service trends
- Reports of disciplinary actions
- Union grievances and other labor relations data
- Manager turnover and tenure information
- Training records including the number of training hours per employee per year
- The communications plan of the organization (both internal and external)

- Performance appraisal information and trends separated by individual leaders

The use of extant data is much more difficult for a seller to disguise because the data are available and verifiable. If some of the metrics show alarming trends, these can be used as levers to investigate further with focus groups or individual interviews. The important thing is that the buyer needs to spend as much time and energy developing a profile of the human assets of a proposed acquisition or merger partner as is done with the physical and product portfolios of the other party.

Bob Whipple is CEO of Leadergrow, Inc. an organization dedicated to growing leaders. He can be reached at bwhipple@leadergrow.com 585-392-7763. Website www.leadergrow.com BLOG www.thetrustambassador.com He is author of the following books: *The Trust Factor: Advanced Leadership for Professionals*, *Understanding E-Body Language: Building Trust Online*, and *Leading with Trust is Like Sailing Downwind*

