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Business Life

How board directors can help cool 'deal heat'

Anthony Goodman
Leading view

Chief executives sometimes see the transaction as an end in itself

How should board directors respond to what Jack Welch called one of the deadly sins of mergers and acquisitions – "deal heat", the fervour felt by management undertaking a large transaction that often blinds them to the downside of the deal.

In the wake of the recession, some cash-rich companies are on the lookout for acquisition targets. Yet how many of these deals will end up destroying shareholder value because they were driven by an overexcited chief executive?

David Shanberg, an M&A adviser at Baker Pacific, which advises on deals in the technology sector, tells his clients: "Be on the lookout for any member of the team (including yourself), in 'deal heat', in which the desire to complete and momentum behind a transaction trump debate over the difficult decisions."

If chief executives cannot control themselves, then their boards have to help. Responding to the way in which deal heat seems to have melted Cadbury, Lord Mandelson, the UK business secretary, said last month that board directors had to be more proactive in this area.

Pointing out the duties of directors under the UK Companies Act, he highlighted the responsibility of directors to consider the long-term impact on stakeholders beyond the shareholder. "Obviously we need directors equipped to be stewards rather than just auctioneers," he said.

In my work with board directors in the US and Europe, I have often heard how many of them have had to deal with this challenge.

As one US lead director put it: "We dealt with deal heat through regular phone calls with management and the board – with data – and contributed to defining questions before going ahead."

It falls to the board chairman to provide leadership and to counterbalance an overheated management team. In the US, where the chief executive may also be the chairman, this is part of the lead director's role.

One told me: "The lead director has to ensure that management doesn't run ahead of the directors in terms of making decisions on these issues . . . Once management gets momentum, they tend to view [completing the deal] as a victory."

If a lone board director is uncomfortable with a deal then they need to act with courage and speak up during board meetings. The board chairman can help by providing air time and cover for dissenting voices.

In some cases, the chairman of the board's audit committee may also play a key role. An audit chair at a European company revealed that it was often up to this person – the board's professional sceptic – to "play devil's advocate" and ensure the board "discussion covers what could go wrong".

Some board directors also reported that they find it easier to cool deal heat by insisting that management work within the framework of the company's board-approved strategy.

One US lead director said: "If an acquisition doesn't fit into the [strategic] framework, that's a red flag to say: 'Slow down on this deal and let's talk about this.'"

Working at the strategic level early in the deal can help with an aspect of deal heat identified by Mr Welch: "By the time a merger starts to appear attractive, deal heat has already started to creep in. And with it, the ability to back away starts to creep out."

Other board directors recommend a focus on how the transaction will be integrated. According to one UK director: "Independent directors should cool it down by demanding the right information on implementation plans and people – things that the management may not keep up with when trying to calculate the returns."

A "what if" discussion – strategic or tactical – is not enough. A US lead director, for example, asked at a recent meeting of board directors: "How do you ensure the process enables the board to say no? We regret so many [deals]."

This does not happen often. A survey conducted last year by Directors and Boards magazine found that 22.9 per cent of boards had voted down or materially changed a potential acquisition or sale in the previous year.

Voting down a transaction is the nuclear option for a board and may lead to the exit of the chief executive, since it would be taken as a vote of no confidence. Yet a poorly conceived and executed deal can destroy a company.

Given the evidence of massive miscalculation across industries and countries, management teams should think twice about the nature of the deals they undertake. If not, a robust board process can ensure cooler heads prevail.

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