

Screening and scoring process in M&A deals of serial acquirers: evidence from the Russian and international markets

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Abstract

M&A deal market is growing every year. Most of the deals look absolutely lucrative in further on companies' integration but from the other hand majority deals declare unsuccessful integration due to many reasons and factors. This paper presents a study on the screening and scoring process as part of M&A strategies in Russian and international companies bringing the possibility for successful integration. It is hypothesized and valued on that an arrangement of the screening and scoring process in M&A is one of the key factors for the success of a transaction. In the frame of the study there have been selected 10 companies, classified as serial acquirers and 15 interviews with representatives of Russian and foreign companies from different industries have been conducted.

Keywords: *merger and acquisition (M&A); serial acquirer; target company; acquisition screening; scoring; acquisition strategy; Due Diligence*

1 Introduction

Serial acquirers amount to 9% of all the companies involved in M&A activities. They dominate the marker in terms of volume of mergers and acquisitions. They build M&A programs around frequent, continuous deal making and achieve notable success through establishing a full cycle of M&A process, focusing on searching target companies and integration process. They accumulate increasing expertise in conducting transactions, thus their best practices in targets' search have become the ground for a detailed study.

Theoretical part of the article includes case studies of 10 international serial acquirers. The practical part consists of 15 expert interviews conducted with representatives of strategy and M&A departments of Russian and foreign companies. Comparison of information on M&A

activity of 10 serial acquirers with practical information obtained from 15 expert interviews proves the similarity of approaches of different companies during M&A.

Analysis of case studies and expert interviews contains key indicators and approaches for screening and scoring target companies for acquisitions, but these methods are not a universal solution. Companies belong to different industries and countries, manage deals that differ in terms of volume and scale. Described approaches can be used as a theoretical base and practical examples of M&A process, but not as a template. A key to success in M&A is a company's understanding of its development trajectory and generating necessary competences, which, in turn, are associated with the corporate strategy.

Both a high rate of M&A and a high variability of the rate are negatively related to performance. An acquirer's size, the scope of its M&A program and experience weaken the negative effects (*T. Laamanen and K. Thomas*¹). Multiple deal makers exhibit lower short-term abnormal return (*Dr Kengelbach et al.*²). Developing a screening process for M&A targets is a significant step in creating an efficient M&A strategy (*S. Rosner*³). The calculation of a target's strategic fit, synergies, and costs savings is conducted and with effective management, the potential targets are organized and the best fitting target is selected for further investigation. (*Gleich et al.*⁴). It is reasonable to take time for evaluation of a target and review the potential seller company on its fit into an acquirer's strategy and consider potential alternatives (*F. Boos, B. Heitger*⁵).

2 Experimental

There have been selected 10 companies, classified as serial acquirers whose M&A processes are of potential interest for a detailed study and information on the screening process and scoring which has been available in open sources. There companies are: Dow (chemical industry), Tyco (security systems), Polycom and Cisco (telecommunications), Cemex (construction supplies), Mahindra& Mahindra (Automobile industry), Hindalco, Tata Steel (steel industry), Schneider Electric, Kone (engineering industry).

2.1 Analysis of Experts Interviews

A search for experts for interviews has been carried out on the basis of the following parameters. An expert needs to be a representative of a Russian or foreign company that regularly makes M&A transactions, have relevant experience in the field of M&A, hold a managerial position, be personally involved in several M&A deals. Some experts asked not to

disclose the name of their companies. In order to preserve confidentiality, we pointed out their position and the company's industry as table 1 shows.

Table 1 – A list of experts for the research

Company/ expert	Country	Industry
Director, Asia Pacific M&A Ca	The U.S.A.	Engineering industry
M&A Director SE	France	Power industry, Engineering industry
Business development manager Metso	Finland	Engineering industry
Chandan Lohia, ex. M&A at Aditya Birla Group	India	Group of companies in metallurgy, construction materials, telecommunications, chemical and textile production sectors
M&A, TNK-BP	Russia	Oil and Gas, Oil Refining Industry
Vasiliy Migunov, ex-director of M&A, Evraz Group S.A.	The U.K.	Ferrous metallurgy
Group of companies "Riemer"	Russia	Oilfield Services, Engineering
LLC "Novaport"	Russia	Investments in airports
Alliance Oil Company	Bahamas	Oil industry
Evgeny Volk, head of the strategic development of OJSC "MTS"	Russia	Telecommunications
Alexander Rantsev, Director of Strategic Development and Controlling, JSC "Power Machines"	Russia	Power machinery

2.2 General Characteristics of the Screening Process

Among a variety of suitable targets a well-established rigorous search mechanism of target companies defines the ones that match the customer requirements best. The key to success in the targets search is a clear definition of the basic principles and criteria for screening within the frame of a company's M&A strategy. However, the criteria for screening are specific for each company and each transaction.

The formal screening methodology includes 4 steps (as figure 1 shows) and starts with defining clear inclusive/ exclusive criteria for selecting and prioritizing target companies. Secondly comes drawing up a long list of potential targets. The next step is applying the search criteria to shrinking the long list. And finally an acquirer selects the most attractive companies to acquire.

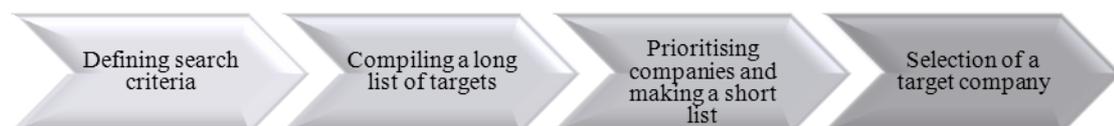


Fig 1. – Screening stages

2.3 M&A Strategy as a Continuation of the Company's Strategy

The M&A process consists of 5 stages as figure 2 shows.



Fig 2. – Stages of the M&A process

The process starts with a decision on the strategic fit of the transaction and planning its milestones. Then a company runs screening and scoring of the wide range of potential targets for acquisition in order to narrow the list of the target companies. An acquirer negotiates and familiarizes himself with target companies and harmonize conditions of the deal. The next step is Due diligence (DD) that forms a clear picture of the investment's object, provides an assessment of the company's financial status and comprehensive study of its activities. Finally comes a stage of closing the deal.

Serial acquires have achieved considerable success through alignment of the full cycle of M&A process, focusing on technology of searching suitable target companies and post-merger integration practice.

2.4 The Objectives of M&A Deals

A table 2 summarizes purposes of M&A deals, which have been identified in a study of 10 companies. On the basis of the study of 10 serial acquirers, 3 key reasons for M&A can be pointed out.

2.5 Criteria for the Screening Process

The table 3 provides a summary of the screening criteria for M&A transactions, which have been identified in a study of 10 companies.

3 Results and Discussion

In the majority of companies in this study a process of M&A fits an overall business strategy of inorganic growth. Business units may get involved into the global strategy development and determine what competencies the company needs to improve on.

Herein the discovered in interviews top important criterial for the screening process in M&A deals.

Table 2 – The objectives of M&A deals

A company's name/ Purposes of M&A	CEMEX	Cisco	Tyco	Polycom	Dow	Kone	Schneider Electric	Tata Steel	Hindalco	Mahindra & Mahindra
1. Expanding geographical presence and access to new markets	✓	✓	✓	✓	✓	✓	✓	✓	✓	
2. Extension of products and services range	✓	✓	✓	✓	✓		✓	✓	✓	✓
3. Access to new customers	✓	✓	✓	✓	✓	✓	✓	✓	✓	
4. Acquiring technological competences, access to R&D	✓	✓	✓	✓	✓		✓	✓	✓	✓
5. Getting qualified personnel		✓	✓	✓				✓	✓	
6. Improvement of productivity and efficiency of an acquirer	✓							✓	✓	
7. Strategic long-term investments	✓		✓				✓	✓	✓	✓
8. Acquisition of large companies for restructuring	✓				✓			✓	✓	
9. Contributing to infrastructure and resources of an acquiring company		✓			✓			✓	✓	
10. Cost reduction				✓	✓			✓	✓	
11. Acquiring attractive assets at a low price during a crisis					✓					✓

Table 3 – Criteria for screening

A company's name/ Screening criteria	CEMEX	Cisco	Tyco	Polycom	Dow	Kone	Schneider Electric	Tata Steel	Hindalco	Mahindra & Mahindra
1 Strategic compatibility		✓	✓	✓	✓			✓	✓	
2 Specific products and services range	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
3 Certain technological competence		✓	✓	✓	✓		✓	✓	✓	✓
4 Innovation (technology, products, business model, etc.)		✓	✓	✓	✓					
5 Market leadership	✓			✓	✓			✓	✓	✓
6 Location and geography of operations	✓	✓		✓	✓	✓	✓	✓	✓	✓
7 Potential to dominate a particular market	✓	✓		✓	✓	✓	✓			
8 Linguistic and cultural similarities	✓							✓		
9 Poor infrastructure	✓									
10 Good financial condition of the target company			✓	✓	✓		✓			✓
11 An economic downturn										✓
12 A pace of an acquisition				✓						
13 Synergy effects								✓	✓	✓

3.1 The amount of M&A Deals

Table 4 – The amount committed M&A transactions

A company	M&A deals
Caterpillar	10 transactions per year on average, 5 transactions in 2013
Schneider Electric	About 50 transactions from 2010 to 2013
Metso Oyj	3-4 M&A transaction per year on average
OJSC "MTS"	5-7 transactions per year: 9 deals in 2010, 18 deals in 2011, 7 deals in 2012

3.2 Channels for receipt of information about the Deals

Table 5 – Channels of the information about M&A targets

A company	M&A deals
Caterpillar	business units, investment banks
Schneider Electric	business units, investment banks, direct offers from the sellers and partners
Metso Oyj	business units, information about players of the market, suppliers and distributors, consulting firms and investment banks
Aditya Birla Group	recommendations of companies that are parts of the conglomerate, banks, associations, public reports
TNK-BP	potential targets are known in advance, the market is well-known
Evrast Group S.A.	offers from banks, the company channels, market opportunities analysis
Group of companies "Riemer"	initiative of the shareholders and the company's management
Alliance Oil Company	market research, an offer from investment banks, owners of companies
LLC "Novoport »	market research
OJSC "MTS"	market Information
OJSC "Power Machines"	market analysis, offers from the owners of companies

3.3 The M&A duration

Table6 – Duration of M&A

A company	Duration of M&A process
Caterpillar	From approval of a target till signing an agreement of intent - 6-9 months
Metso Oij	From 4-6 months (in case of no difficulties) up to 1.5 years
TNK-BP	Up to 2 years

3.4 Department of M&A

Table 7– M&A department in companies and its main functions

A company	M&A Department	Number of employees involved	Areas of responsibility
Caterpillar	Yes	20	- internal consulting division for the entire company; - support business units of the company in all matters connected with the M&A process; - consulting services for business units dealing with joint venture creation, strategic alliances
Schneider Electric	No	8 (M&A team)	- Corporate Strategy Division is responsible for screening targets, an assessment of the strategic relevance and feasibility of a deal; - M&A team reports to CFO and is responsible for M&A from choosing a target till finalizing the deal.
Metso Oyj	No	2 (constantly)	- Corporate Strategy Department is responsible for transactions support. The Department includes a sub-team specializing in M&A;

		focused on M&A)	- Functions are flexibly allocated within the Department, and powers, employees are involved in M&A processes 40-50% of their working time; - the department supports the entire process and get stuff from business units involved at different stages.
Aditya Birla Group			- A team from a Corporate Strategy Department performs functions of M&A support. - M & A process is led by the Head of Corporate Strategy Development Department.
TNK BP	Yes	3 employees are getting involved in a deal	M&A Department collaborates with relevant business units, holding coordinating functions at all stages
Evraz Group S.A.	Yes	N/a	An M&A department supports deals but it does not searching target companies
LLC "Novaport"	No	–	- A Corporate Finance Director and an analyst deal with M&A processes in the company; - Shareholders are involved in M&A process.
Alliance Oil Company	No	–	- A Business Development Department represented by 2 employees is in charge of the M&A targets search; - During a deal the Department works closely with other entities in the company.
OJSC "MTS"	No	–	M & A functions are performed by the Department of Strategic Development

3.5 Compiling long list and shortlist

Table 8– Criteria for a long list

A company	Formation of a long list
Caterpillar	Defining potentially interesting companies in 8 key sectors of the economy
Schneider Electric	No long list, target companies are identified by the company's business units. There is a list of interesting targets that are regularly being monitored
Metso	Company continuously monitors the industry and related sectors, tracking major players and competitors
Aditya Birla Group	A dynamic long list of targets, containing 60-70 companies with a description of market activities and main characteristics. There are 3 criteria: manufacturing capabilities and potential synergies, MCap, financial multiples. A separate long list is created for each industry.
TNK-BP	A long list of potential target companies is pre-determined based on the market and its key players.
Evraz Group S.A.	A long list is compiled on the basis of raw materials and production base of companies.
Group of companies "Riemer"	A search of companies is divided by 3 groups of competencies: drilling, production and servicing of downhole equipment and construction assets. The long list exceeds 100 items.
LLC "Novaport"	There is a long list of 15 companies chosen by such characters as passenger traffic, geography and availability for M&A
Alliance Oil Company	Continuous monitoring of potential 200 targets with an annual increase of 15-20 offers, mainly small oil companies and oil fields. The criteria to include a company in the list: the volume of oil and gas reserves, the price factor.
OJSC "MTS"	A list includes 20 potential companies. The criteria to include a company in the list: valuation multiples $EV / EBITDA = 5,5$, $EV / Sales = 2,3$, the city's population is 200 thousand or more, the company's market share is at least 20-30%, good financial performance.
OJSC "Power Machines"	A list consists of strategically relevant companies based on their financial and economic condition.

Table 9– The criteria for the short-list

A company	A criteria for a short list composition
Caterpillar	A product range and a rate of differentiation; the skills of the management team; a technological base, a cycle of a business; intellectual property; compatibility with the Caterpillar distribution network; R&D capacity; synergy opportunities.
Schneider Electric	Stage 1 - ranking and evaluation of targets by the company's business divisions with the involvement of the Department of Corporate Development and Corporate Strategy; Stage 2 - using the general criteria of the investment attractiveness, industry specific criteria. A list includes 5-10 companies on the basis of geography and product line.
Metso	Strategic compatibility in products and services; company's size does not exceed the financial capabilities of Metso; company is available for sale; environmentally friendly companies; profitability and operational efficiency improvement of an acquired assets after becoming a part of Metso.
Aditya Birla Group	Each company is selected strictly for specific needs Financial and non-financial aspects are evaluated on the basis of all available public information about it. Comparison of costs of building a similar business from the scratch and M&A; financial forecast of a target company before and after the acquisition; changes in the market position of a target company before and after the acquisition; synergy effects.
TNK-BP	Short list depends on offerings on the market; reaching new markets through M&A; financial attractiveness of the company (NPV); volume of inventory; political factors.
Evraz Group S.A.	Shareholders' selection of target companies; market research; comparison of costs of building a similar business from the scratch and M&A.
Group of companies "Riemer"	Stage 1 - studying companies from a long list considering 7 criteria: type of production/ services; scope of activities; geographical factor; production capacity; major clients (customers); shareholders; financial results. Stage 2 - 3 ranking criteria: an opportunity to acquire control in the shareholders capital; operational efficiency; detailed competency analysis.
LLC "Novaport»	Availability for M&A deal - readiness for sale; aprice factor.
Alliance Oil Company	Financial modeling, evaluation of the production profile, CAPEX, OPEX.
OJSC "MTS"	Availability for M&A deal - readiness for sale.
OJSC "Power Machines"	Strategic relevance of business, financial and economic condition of the company.

4 Conclusions

Firstly, all companies set targets for an acquisition on the basis of the corporate strategy. Some omit compiling long lists and short lists, but all companies consider strategic compatibility as a key criterion when choosing a choosing a target. A developed strategy sets the basis for elaborating criteria for the targets search, such as location, client portfolio, a range of products or services.

Secondly, the majority of companies adhere to the traditional approach to screening and scoring. Search for potential targets is conducted through analyzing market opportunities, comparing acquiring assets with strategic objectives. Some companies engage external parties such as banks, investment consultants and contractors or exploit the internal potential by involving company's business units, which understand the need for assets to expand the business. Companies tend regularly update their long lists of acquisition targets, which requires fewer resources than creation of new target lists each time for a new deal.

Thirdly, the general screening criteria include sectorial and geographic filters, the possibility of acquiring a target company, a more detailed valuation of operating assets, its financial condition, as well as a price cap of the acquirer. Some companies constantly monitor and analyze the market. When ranking the companies and compiling a short list many acquirers face a problem of a shortage of information, especially if the target is non-public, or belongs to an insufficiently explored industry such as logistics. If an availability of a target company for sale was not examined at the stage of drawing up a long list, this criterion is beginning crucial for a short list. Also, at this stage, companies value targets and assess multiples and conduct peer analysis.

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