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THE INSURANCE MANAGEMENT PLAYBOOK

A Leader's Guide

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Chapter 14
MERGERS AND ACQUISITIONS: RISE ABOVE THE FAILING MAJORITY

MANY MANAGERS AND executives I've met, who aspire to be involved in an M&A deal at some point in their career, have one thing in common: They are all fans of Gordon Gekko, the investment banker character played by Michael Douglas. They romanticize about the 1987 movie, *Wall Street,* with visions of glory flashing before their eyes as they remember Gekko pacing around his large Manhattan office, barking orders, and ripping the competition's face off. "Greed is good" is a line most people remember from the movie. Of course, there's also the more recent *Wall Street: Money Never Sleeps* 2010 movie. After spending years in jail, Gekko ends up at the top of the world again. He's still the face-ripping and Machiavellian Wall Street guru we met in 1987, but he is portrayed as a humane character as well. The line I remember most from this movie is: "I have three words for you: Buy my book." I am glad you bought mine!

The real world of M&A is a tad bit less sexy than the great Michael Douglas leads us to believe, especially in an insurance context where it can be as fun as watching paint dry! If you thought start-ups are hard, then double the effort for insurance M&A transactions and multiply it by a factor of ten. To successfully execute a transaction you'll need to understand the drivers behind your M&A ambitions and if they align with your overall strategy, scope the market for targets and find willing sellers, perform due diligence, determine if they fit within your firm's culture, run valuation models, make an offer, negotiate like hell, manage the post-sale purchase price adjustment issues (there are almost always a few), and prepare to begin the even harder integration phase.

Proceed with caution: Experts estimate that a significant number of acquisitions fail to meet shareholders' expectations. Deloitte puts the number at 83 percent and McKinsey at 61 percent. Accenture's survey of more than 400 U.S. and European corporate executives revealed that 55 percent of deals did not achieve expected cost-savings synergies[13]. So, now that you have been warned, if you are not discouraged and want to forge ahead, remember to proceed with caution.

I will conclude this chapter with detailed M&A process maps. In the interim, let's try to answer the following fundamental questions with an insurance industry hat on:

- Why do you want to go down the M&A road?
- Do your immediate and extended teams have the expertise and bandwidth?

- Do you have the stomach for long and protracted due diligence and bidding rounds?
- Do you have the head-office's full support?
- Are your business cases (base-, best-, and worst-case scenarios) as well as valuations and financial models robust?
- Did you conduct proper due-diligence and line-up the right internal as well as external resources?
- Did you protect the downside?

1. Understand your Acquisition Motives

You and your senior team should unearth the motives behind embarking on the long, hard, and potentially distracting road of acquisitions:

1) Is it a geographical play to:
    a. Expand your franchise and regulatory footprint?
    b. Spread your risks as you want to grow but are concerned about accumulation?
    c. Keep up with your competition through a defensive move as they have recently made acquisitions in other territories?
2) Is it a vertical or horizontal product or segment play rooted in your desire to expand from a pure personal lines into a commercial lines insurer, add new lines or classes of business within a customer segment, or expand into mortgage insurance?
3) Is it a distribution play? Do you want to add bank-assurance or agency to your broker and direct sales channels?
4) Is it a talent play? Is there a team out there that you'd like to acquire in order to, say, build a weather- or an agricultural crop-insurance practice?

5) Is it an opportunistic play? Have you identified a distressed asset that fits within, or complements, your organization's capabilities and product offering?
6) Is it a cash play? Perhaps you want to buy a company in a stock deal to get hold of its massive cash reserves? You are convinced there is embedded value to be unlocked by investing the cash using your own "special sauce," growing ROE by an additional 1.5 percent, and creating more shareholder value.
7) Could your main reason be the analysts who keep pounding your stock because they believe you are sitting on too much cash and should embark on a stock buy-back plan or make an acquisition?
8) Is it a size play? Do you like the auto/motor business but realize, rightly so, that unless you have significant scale your expense ratio will never be competitive-enough to help you deliver sustainable quality earnings?
9) Is it an ego thing? Are you a Gekko wanna-be and want to show the world that you are able to seal big deals?

A recent example of points 2) through 5) above is Arch Capital Group's acquisition of CMG Mortgage Insurance Company from PMI Mortgage Insurance Co. The driver behind the deal, according to the *Wall Street Journal*, was to "allow ACGL to enter the rapidly improving US mortgage insurance marketplace and broaden its existing mortgage insurance and reinsurance capabilities."[14] Knowing how ACGL and its management operate, especially in the context of PMI which has been in "rehabilitation under the receivership of the Arizona Department of Insurance since 2011," I assume that Dinos Iordanou and Marc Grandisson, who I introduced earlier in the book, spent a lot of time with their teams thinking about PMI's cultural fit within Arch, the quality of the underwriting team and portfolio they are buying, and the embedded value they could unlock.

The Arch folks are some of the most disciplined technicians and deal-makers I have ever met. They are fun to hang around as well.

Whatever you conclude are the right reasons to justify going down the M&A path, you should only go after those opportunities that have the highest probability of success (read increase shareholder value and successful integration). We will tackle the topic of successfully integrating a merger or acquisition in the following chapter, which is innovatively entitled "Integration."

2. Team Bandwidth and Expertise

Consider bandwidth and the availability of internal as well as external expert resources before you start actively looking for targets to acquire. You can hire investment bankers, lawyers, auditors, and so on but you should also get your own staff intricately involved in the process. What will you do when integration time comes around? There really is no substitute for having internal bandwidth and expertise to execute effectively in an M&A environment.

Assess whether your team has the capacity to go through an acquisition as well as continue to deliver on its current obligations. You could always fall back on external advisors as well as regional- and head-office resources for business-casing, due-diligence, and more. Remember, however, that the deal falls within your territory and you should run it and be held accountable for its success. So, while you may call on the global head of bank-assurance to help you pitch for and win a big bank distribution deal in your territory, the last thing you want is to look like the middleman, and you certainly don't want the deal run out of headquarters once you seal it. Be the organ-grinder, not the monkey! Bandwidth is important.

I would say that the only three scenarios in which you should allow your organization to be overstaffed are when you are in acquisition, accelerated-growth, or crisis modes. If yours is a tightly-run organization, as it should be, and you come across a great but sizable opportunity, your team will be stretched to do a good job on the acquisition as well as continue to win in the marketplace. You should at least have a senior member of your staff in charge of potential acquisitions with enough time on his or her hands to be on the lookout for opportunities as well as work on them when they arise. This staff member can't do all the work, clearly, but you need a go-to-person to lead the project. This cannot be a junior member of staff or someone who has spent his or her entire career in one function and is therefore one-dimensional. This should be a seasoned insurance professional who has worked for a couple of different firms and understands the fundamentals of the business.

Guidance 1: Go-To-Person Profile

To give you a flavor of the profile you should look for, I will tell you about my choice, Samer Abou Jaoude, aka SAJ, my former chief of staff at Zurich Insurance Middle East. SAJ was my client back in 2001 when I hired him from AXA in the UAE to join Gen Re in Paris.

We clicked at an industry event cocktail party a year earlier in 2000. I advised you earlier in the HR chapter to look out for top talent when attending such events. I always try to lead by example. SAJ worked for Gen Re in Paris for six years, starting as a casualty facultative underwriter and ending up as the branch manager, running the French, Belgian, Middle Eastern, and North African markets. He then worked for PWC as senior manager of assurance, advising insurance company customers.

I hired him again when I partnered with Chedid Capital Holding to create a reinsurance MGA. SAJ and I then worked together on Chedid Re's rebranding as well as its processes and procedures reorganization. We also worked on Chedid Re's expansion into Saudi Arabia as well as Chedid Capital Holding's expansion in the insurance company arena and helped setup SEIB Insurance Company in Qatar. We were also involved in establishing Chedid & Associates, a retail insurance broker in Qatar. I hired SAJ again, this time as chief of staff, when I joined Zurich as CEO for general insurance in the Middle East. He was the perfect candidate to help me identify markets for Zurich's further expansion in the region as well as lead the integration of a local company that Zurich had acquired a month before I joined. SAJ had previously worked in retail and commercial insurance as well as facultative reinsurance, businesses that Zurich runs in the Middle East. He also brought a strong cultural knowledge of region, solid regulatory dealings, and an operational background. Find your company's SAJ to be your go-to person.

Tip 1: Merger-and-acquisitions assignments should be part of individuals' career development planning as well. I truly believe that frustrated second- and third-line managers or employees, especially if new career-development projects are not available over the next six to twelve months, will start to look around for other opportunities unless they are challenged. By challenged I don't just mean given more work. They should be carefully chosen from the top 20 percent of your keepers list, assigned to interesting projects, measured, mentored, congratulated, and recognized for having gone beyond the call of duty—and I highly encourage you to compensate them for their extra work. Involving your keepers in special projects will allow you to carve out career paths, demonstrate to the potential future leaders that you are giving them more exposure and challenges, and enable you to test them under new and different—and sometimes difficult—scenarios. You get to see if they sink or swim. This will also help you build bench-strength, which is critical in the integration phase and beyond.

3. The Gut Test

Do you have the stomach for M&A deals? When I interviewed for one of my first larger P&L jobs, I was asked at around 3:15 p.m. that day, forty-five minutes later than the meeting was scheduled, by a potential future boss if I had the "stomak furr it" in a heavy Scottish accent. I had written him off as a head-office executive on a London Friday afternoon, until I realized what he meant a few years down the line. So, I ask you now: Do you have the stomach to do an acquisition? They are tough. They are lengthy. They are nerve-racking, especially when they involve, as they usually do, multiple bidders for the same target. The waiting periods can be long, and out of ten deals you bid for, you'll be lucky to secure one. This can drain your organization's resources and staff morale.

If you are planning to be in M&A mode for some time as part of your expansion strategy—a push into emerging markets for example—for the next three years, you might want to consider assembling a dedicated, internal SWAT team to lead these projects. Otherwise, you might risk slippage as your team may not be able to keep up with the pace and continue to deliver on its ongoing obligations.

4. Head-Office Support

Do you have the group's financial backing and political support? Do they understand what's at stake? More importantly, have you painted a rosy picture in the business case or realistically shown that it's going to get ugly before it gets pretty? Some companies have a reputation of coming on strong to a new market and then retreating when things don't work out exactly as planned. You don't want to do this, especially in emerging markets, as people have very long memories and are often skeptical of quick and big entrants. You're going to be in the market and business for the next one hundred years, so let that long-term time-frame guide you when you are planning for an acquisition. The company should be committed for the long-term.

5. The Business Case

To obtain the group's support and attract investment dollars, you need to present a convincing business case. You should always, but especially in difficult economic times, shoulder the investment responsibility very seriously, as jobs may be cut and savings attained in parts of the organization to invest in higher-growth emerging markets or business segments in your home country. Your firm is supporting the investment with the clear expectation of future growth and higher ROEs, but the road to profitability can be long, especially in the insurance business. Impress upon your team members to take such investments very seriously.

Make your business case concise. If your firm likes big decks, then by all means thicken them up and kill more trees! Beware of decks prepared by hired consultants. Rip them apart, and again hire a local future manager early on in the process to vet them and give you a reality check. Trust me, it's worth the extra investment. You have to be brutally-honest with yourself and your firm about the potential success of the acquisition and future integration. Many ambitious corporate executives who want an acquisition or two under their belts put up unrealistic numbers and get everybody excited about the upside until they get a big wake-up call when things don't pan out as envisioned.

Challenge: Are the growth plans and ROEs realistic? Is the investment commensurate with the potential *realistic* cost-savings and growth opportunities? Can you hire the right caliber of professionals locally instead of flying in a bunch of expensive expats? Does your excess-of-loss underwriting approach, if you are a reinsurer, work in an overwhelmingly proportional marketplace? And so on.

Guidance 2: The main Components of your Business Case

1. Start with an executive summary on the target company and explain why you believe it qualifies as a good fit for your firm.
2. When it comes to numbers, present base-, best-, and worst-case scenarios. Here are some elements you ought to consider:
   a. Growth: What is your projected growth plan, where will this position you from a market-share point of view, are the numbers realistic, and did you take into account profitable growth and not just piling more auto/motor and medical insurance premiums on the books to just grow for the sake of growing?
   b. Loss ratios, severity as well as frequency, given your projected portfolio mix.
   c. Expense ratios—integration as well as business as usual.
   d. CAPEX.
   e. ROEs.
   f. IRRs.
   g. Breakeven points.
   h. Payback timescales.
   i. Cash-flow projections.
   j. Discount ratios and your cost of capital.
3. Compatibility between your underwriting approaches and philosophies and the target's.
4. Actuarial pricing models.
5. Overall projected portfolio retention rates. You may realize that a lot of the business you acquired does not fit your underwriting appetite.
6. Reinsurance structure.

7. Claims: Opening, closing, and reserving philosophies, releases, strengthening, and so on.
8. Choose a deal financing structure that is ideal from a balance sheet and P&L point of view. Options include cash, stock, cash and stock, bond or share issuance, loans, private equity investments, and other mechanisms.
9. Investment strategy and projected returns.
10. The cost of capital if future cash injections may be required to shore up solvency and its effect on your ROE projections.
11. Receivable and recovery assumptions.
12. What can your firm bring to the table to create value? Operational synergies, IT systems, better controls, and more?
13. Real estate valuations if you are keeping the bricks.
14. Branding value.
15. Enhanced franchise value.
16. Staffing models, redundancies, staffing levels, pension liabilities, HR integration and recruiter costs.
17. Customer profiles, density, and potential for up- and cross-selling.
18. Product and customer retention rates.
19. Existing and potential distribution channels.
20. Open compliance and litigation issues.
21. Team bandwidth.

Your finance and M&A teams will then plug the numbers into a model and provide base-, best-, and worst-case scenarios for you and senior management to review and made an informed decision.

6. Due Diligence: A Tough, Tedious, and Supremely Important Task

A. Target Vetting

Your acquisition motives should serve as a guiding light when deciding which targets to short-list prior to commencing due diligence. You may need to find potential suitors with a bolt-on Japanese operation, a massive and underutilized cash pile, or the $1.5 billion auto/motor book that you covet. Keep an eye out on other potential deals, as you should always remain opportunistic, but have a defined universe of targets that most likely fit within your culture and strategy to remain laser-sharp and -focused.

B. Does it Fit?

Below are a few scenarios that give you a flavor of what type of questions you should be asking to determine if a potential suitor fits within your organization's culture and overall strategy:

- Are you buying a profitable organization whose underwriters do not heavily rely on underwriting manuals or rating tools whereas your underwriters can't go to the bathroom without consulting the manual and its six related tools?
- Are you mainly a Midwestern US firm that is buying a NYC-based outfit with operations in Moscow, Dubai, London, and Kazakhstan?
- Are you buying into a similarly large, agency-driven insurance company that delegates significant underwriting and, more pertinently, claims authority to its agents whereas your organization delegates zero claims authority, keeping it all at the head-office level?

- Are you a paperless organization with underwriters juggling two screens at a time and nothing moves at the target firm unless it's made of trees and has a ton of ink on it?

Why did I just go through the above scenarios? By the way, they are not extreme; they represent basic differences of appetites, modus operandi, and philosophies of companies. Not one is better than the other, except for the tree-killing insurers out there. They are just different. So, does this mean that a paperless outfit can't acquire or be acquired by a paper-crazy shop? *No*. It will just realistically take a couple of years to get the paper files scanned and stored online, to implement a document-management system, and, most importantly, to effectuate cultural change—*yes, change management is the toughest*—so that folks who are used to hauling files across hallways start dragging them across screens.

It goes without saying that if a paperless environment will ultimately reduce your ER by, say, 0.6 percent, you should water down the cost-savings impact in your first two years' projected P&L, as you will be transitioning into that end-state over time. The fact that you won't realize full cost efficiencies or attain synergies in the first two years should not stop you from doing the deal. Insurance requires patience, and it is a long-term business. After all, unless you are a CEO who's about to retire or a job-hopper who can't see beyond the end of the next two quarters, you should not be deterred. This is particularly true if head-office management is long-term-minded and does not expect you to produce miracles in insanely short timeframes.

Financial market analysts tend to focus on the next quarter's results whereas you are building a business for the next 100 years. I believe it would be better if your company is not publicly-listed. You won't have to worry about short-term stock-price hits due to analyst concerns about the risks of M&A transactions and possible initial expense pressure. Having a management team with a successful M&A track-record will surely alleviate some of the analysts' concerns. You could also explain your story to the analysts and show them that while today's investments and resulting increase in ER will drag EPS down by 2 to 3 percent, this will create hundreds of millions of dollars in terms of longer-term savings and, consequently, a ton of future profits.

C. Due Diligence Nuts and Bolts

Due-diligence (DD) is not an exact science. Its effectiveness also greatly depends on the type of seller you are dealing with. If they are inherently ethical and honest folks, they will be very transparent. If they are very shrewd businesspeople, they may not tell you everything but won't hide material facts. If they turn out to be crooks, well then you really won't know what you don't know. Irrespective of the type of seller you end up across the table from, you better have a good lawyer. We'll talk more about lawyers in a bit and how to vet 'em and pick 'em.

Your third-party advisors, if you hire some, will usually include service contract disclaimer language that is longer than the project scope description. These provisions basically explain that the advisors are really not responsible for anything they miss during due diligence. Put differently, your ass is on the line at the end of the day though you may have spent a fortune on DD. Use external advisors strategically and keep a close eye on costs. Also make sure that the junior consultants they assign to work on your project have not been working on a McDonald's multi-unit franchisee deal the previous week and need to learn the difference between IBNR, case reserves, and a knock-for-knock agreement.[15] Your operation should never serve as the training ground for consultants, especially during an M&A deal.

The depth of due diligence also depends on what you are permitted to examine by the sellers and for how long. There is always the issue of disturbing the target's operation and keeping the discussions confidential. The longer DD takes and the more intrusive it becomes, the higher the probability that the public will know about it. So, unless the sellers are desperate, you will probably not be able to perform as deep and thorough due diligence as you'd like. In this case, and if you are highly-suspicious about the accuracy of figures, management's honesty, or some other matter but you really need to do this deal for whatever reason, make sure your lawyers include tight and favorable representations and warranties clauses in your purchase agreement. My advice is that you not proceed if you suspect foul play, as you'll end up spending years in litigation later.

Tip 2: Strive to maximize the use of your own people to conduct due diligence. This lowers the probability of information and news leakage; secrecy and discretion are very important when negotiating acquisitions. Furthermore, your own company's employees understand your objectives and culture better than outsiders. You likely have a lot of great internal resources who would kill for the opportunity to help out. It gives them good experience, enhances their CV, and provides career progression, plus it can be fun. However, they may have a limited understanding of the local culture of the target firm or the language. This is where, as I recommended in the start-up chapter, hiring from the local market early on in the process could pay off.

Here are a few additional ways you can gain more insight into a potential target's operation during DD:

- Find out if your company or someone you know employs some of the target's former employees. Talk to them to gather intelligence but beware of any non-disclosure agreements they may have signed.
- Mystery shop the hell out of the target. Learn about their products, customer service, claims service (if you can), billing and receivables policies and collection diligence, renewal process efficiency, complaints handling, controls, and the speed of their system. How do you do this? Buy a policy at an agency and contact the target's call center within twenty-four hours maximum to check if your policy has been registered in their system. Investigate whether their call center staff will try to up- and or cross-sell you. Most call center agents who handle consumer in-bound calls still do not attempt to cross- or up-sell. Well, why should they, if they are not

properly-trained, incentivized, and management is too cheap and lazy to do anything about it? Does the company have a strong sales culture? Do they live by SLAs and care about customer centricity?

- Call brokers and reinsurers you do business with on a global or regional level and ask for their opinion about the target. They will generally give you at least an idea about the firm's culture, whether they are conservative or aggressive underwriters as well as their payment ability and willingness, management's bench-strength, and how their systems work. But do it carefully and confidentially, especially if your target is a publicly-listed company. You don't want to run afoul regulatory rules.

Tip 3: Use old-school due diligence. This may sound crazy, but do open up the cabinets if are allowed and have someone who understands the local language, if different from yours, dig in and read some files. For example, documents you should read and understand well are claims files as well as real-estate leases and land registries. You kind of want to know how many buildings, offices, and storage facilities you are taking over. Silly, huh? Why, you ask? Well, let's say you are shown around the offices in a given building, and there are two of them on the second and third floor. The local-language lease contract, had you read it, would have pointed you to a third location in the basement. You buy the firm, stumble on the keys, and eventually find out that you either own or have also rented a basement. You walk in and, surprise, you find boxes full of claims notifications that have not been processed, tax bills, or a second set of books (the real ones perhaps this time)—you name it. You should be obsessive about details and as intrusive as you realistically can be during due-diligence.

Tip 4: Unless you really like investing in real estate, I would recommend that you strip these assets out of the deal and ask the sellers to keep the bricks. They can dispose of them separately if they like. You're in the insurance business and may not want to tie up your capital in buildings, lands, and so on. However, some real-estate assets are historical landmarks and may give you elevated status in your new territory. If you can get your hands on a historic building in downtown Tokyo and have your company logo displayed at the top, there could be significant branding as well as employee pride value in that.

7. Protect the Downside

Whenever you make an acquisition, especially if the deal includes an entity that is outside your home market, you really need to protect the downside. You don't do so by only having a purchase agreement in place; you need to have the right contract in place, in the appropriate language, and drafted with the governing jurisdiction's laws in mind. It is also very prudent to withhold part of the agreed purchase price for 3 to 6 months after the transaction closes. This is particularly relevant when it comes to the adequacy of claims reserves and will give you and external auditors the opportunity to look under the hood and validate your assumptions about the target's business and its value. You'd be lucky if the seller allows you to withhold 30 or 40 percent of the agreed value but the amount should not be negligible. As for the withholding mechanism, one option is to just keep the cash. This would be the ideal scenario. Alternatively, you could agree to draw up letters of credit, preferably through a multinational bank with whom you have a strong relationship, which condition the release of the remaining funds to the sellers on the auditors' valuation findings. The mechanisms could be complicated and this is when we get to talk about lawyers.

I am a licensed, though inactive, attorney in the State of California. After interning for lobbying and law firms in Washington, DC, and working for a federal bankruptcy judge in San Francisco during my law school years, the closest I wanted to get to the law was hiring lawyers. It just wasn't for me. So I studied like hell, took and passed the California bar the first time around, and ran as far away from the law practice as possible. I had an inclination to write back when I was in law school, between 1995 and 1997. I served as editor and later editor-in-chief of the *Berkeley Journal of International Law* in my final year. It took me seventeen years to write my first book.

Case study: You are instructed by home-office to work with your company's global law firm to draw up highly-elaborate and -sophisticated purchase price adjustment (PPA) provisions to help you protect the downside. In case you uncover matters that diminish the agreed-upon value you could invoke the PPA to claim against the seller. You end up with a $150,000, 300-page document that is supposed to make you sleep better at night. Assume that your target is domiciled in a civil law jurisdiction and your global law firm's strength is in common law. They engage local counsel and you later realize that they were not up to the task to handle such a complicated matter.

A valuation issue arises and you file a claim under the PPA. The seller disagrees with your valuation and you hit a wall. You run down to the local courthouse and sue. The local judge thinks that your document isn't fit for purpose because, for example, the PPA notification provisions are in conflict with, or unclear within the context of, the local civil code procedures. You fight it out in court and eventually win, but you have spent hundreds of thousands of dollars on litigation expenses. This also leads to delays as well as a credibility issue with the head-office. They entrusted you with closing the deal fast, and you are now in your sixth quarter of legal battles with the seller. The bank which holds the letters of credit, by the way, can't help you though you engage the powers that be at their head-office. You are in litigation and they have to wait till final adjudication to act. Of course you could also sue the lawyers for malpractice but that's really beside the point and the insurance limits they purchased may not be adequate to make you whole. You don't need another headache. You've got a business to run. So, get the right lawyers on board from the start and try to withhold the cash.

Tip 5: Go with your company's global or regional law firm but also, using your local connections (again I can't stress enough the importance of hiring local people in-the-know), vet the local law firm that the global one suggests as local counsel. Don't take their word for it, because they are XYZ global firm. Trust me; most times the top firm in Dusseldorf, New York, Tokyo, or Paris is unheard of in Kenya, Almaty, Kiev, or Riyadh. The real point I am trying to get to here is that you need to pick your advisers wisely; don't always assume that the global ones are best suited for every situation. Your contracts should be drafted in such a way that you are assured swiftness of legal process and result when an issue arises. Also make sure you have enough political firepower in case someone with local political connections starts yanking your chain. Retained former ambassadors, especially of economically- or militarily-powerful countries like the United States, could come in handy in these situations. On the other hand, if your firm belongs to a hummus-, chocolate-, or banking secrecy laws- producing country, you may not carry as much political clout.

Tip 6: I am not sure how realistic this option is, but you could always try to buy M&A insurance that protects you against unknowns, such as unpaid taxes (income, insurance, and Social Security), claims-reserving deficiencies, and loss of license due to seller's fault or interference with your economic interests. The price of the M&A insurance may be prohibitive though. If reserving is in question, you'd be hard-pressed to find an insurer who would agree to cover the deficiency or at least do so without charging you a fortune. Furthermore, you may not want to open up your books to a competitor and have them take a good look at your deal and valuations methods. At the end of the day, you will most probably forgo this option, but I had to raise it because, after all, we must practice what we preach by leading by example and selling at every opportunity.

Guidance 3: Purchase Price Adjustments

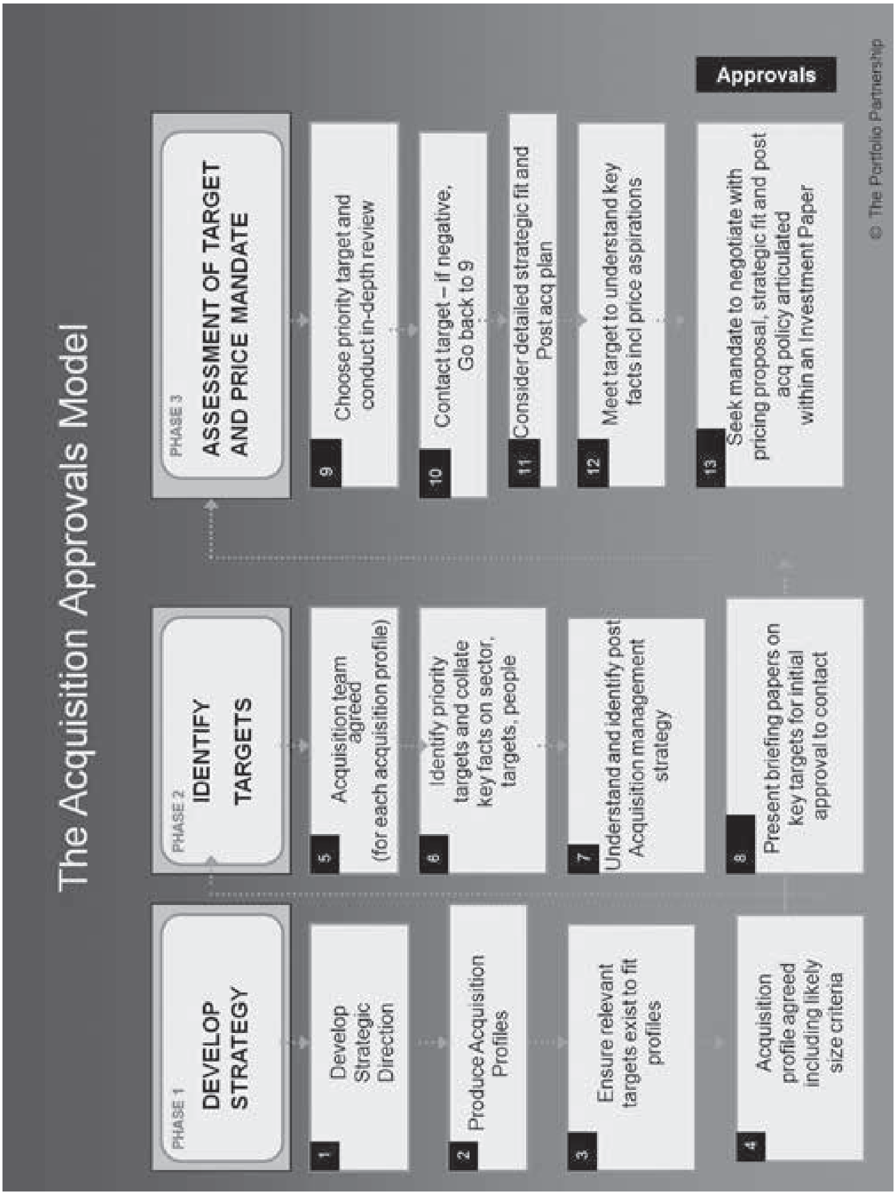
Let's talk about these some more. Purchase price adjustment (PPAs) provisions are lengthy but essential parts of your purchase agreement. They are particularly relevant in the insurance world as you are dealing with a lot of subjective and company-specific philosophies that have an impact on dollars and cents: Reserving and underwriting approaches, claims opening and closing methods, pension obligations, investment guidelines, and more. They are also hugely valuable when you uncover a discrepancy between the target's agreed value and the real one. So, in the context of insurance M&As, PPAs and their representations and warranties section should at least cover the following elements:

- Claims: IBNR and case-reserves deficiencies, non-booking of claims, claims recoveries and premiums receivables that may be barred by a statute of limitations but remain on the balance sheet.
- Taxes: Corporate tax, Social Security contributions, stamps, and other governmental obligations.
- Reinsurance: Make sure that all outstanding claims have been declared to the target's treaty and facultative reinsurers and the premiums have been properly accounted for. You could end up collecting $1 million from reinsurers on claims recoveries and paying out $1.5 million in premiums due.
- Capital adequacy and solvency deficiencies.
- Loss of license due to the actions of previous management and shareholders.
- Specific timelines for post-closing financials reviews.
- A specific formula that is compliant with local law for notifying the sellers of any adverse findings. Be crystal-clear as to what needs to be done, when, and by whom and that the process is compliant with the jurisdiction you availed yourself to.
- Unauthorized use of post-closing intellectual property, such as the logo, customer lists, models, and more.
- Overall interference with economic interests, such as non-compete provisions and loss of key staff or business volume within a certain period. Push for at least 3 years.
- Open litigation or material complaints.
- Inaccurate or fraudulent asset valuations.

Conclusion

Whatever strategic drivers led you down the M&A path, you should remain objective and convinced that you are doing the right thing at the time you make the decision to merge or acquire. The ultimate metric should be the creation or destruction of shareholder value. Acquisitions take a lot of time and are costly. As previously warned, most research indicates that around 50 percent of M&A deals fail.[16]

Ian Smith, the CEO of The Portfolio Partnership, shared with me the below well-organized and straightforward model that illustrates the acquisition process.


The Acquisition Approvals Model
PHASE 1
DEVELOP STRATEGY
1 Develop Strategic Direction
2 Produce Acquisition Profiles
3 Ensure relevant targets exist to fit profiles
4 Acquisition profile agreed including likely size criteria
PHASE 2
IDENTIFY TARGETS
5 Acquisition team agreed (for each acquisition profile)
6 Identify priority targets and collate key facts on sector, targets, people
7 Understand and identify post Acquisition management strategy
8 Present briefing papers on key targets for initial approval to contact
PHASE 3
ASSESSMENT OF TARGET AND PRICE MANDATE
9 Choose priority target and conduct in-depth review
10 Contact target – if negative, Go back to 9
11 Consider detailed strategic fit and Post acq plan
12 Meet target to understand key facts incl price aspirations
13 Seek mandate to negotiate with pricing proposal, strategic fit and post acq policy articulated within an Investment Paper
Approvals
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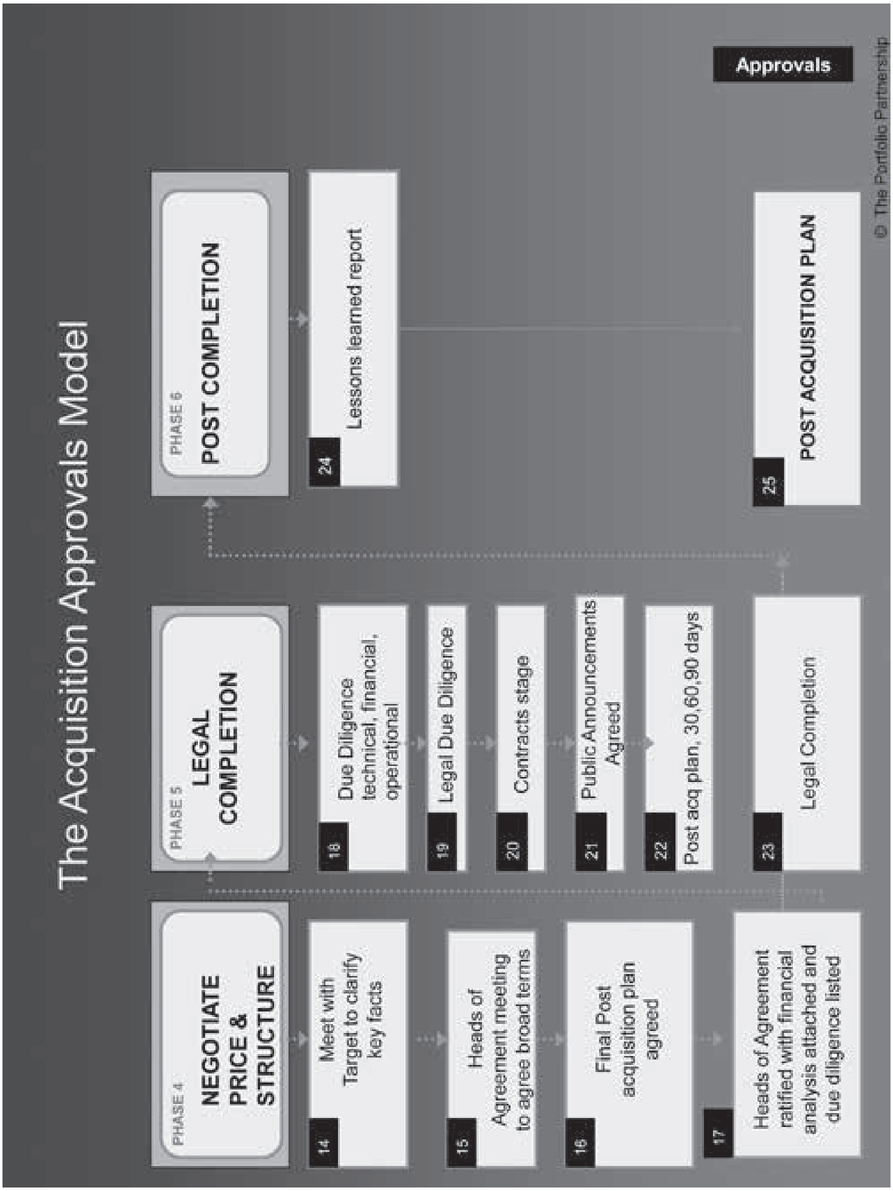
The Acquisition Approvals Model
Approvals
PHASE 4
NEGOTIATE PRICE & STRUCTURE
14
Meet with Target to clarify key facts
15
Heads of Agreement meeting to agree broad terms
16
Final Post acquisition plan agreed
17
Heads of Agreement ratified with financial analysis attached and due diligence listed
PHASE 5
LEGAL COMPLETION
18
Due Diligence technical, financial, operational
19
Legal Due Diligence
20
Contracts stage
21
Public Announcements Agreed
22
Post acq plan, 30,60,90 days
23
Legal Completion
PHASE 6
POST COMPLETION
24
Lessons learned report
25
POST ACQUISITION PLAN
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During a recent e-mail exchange with Ian, he suggested the following advice for people using the model:

1. "Successful acquisitions are about buying what you want to buy not necessarily what's up for sale.
2. Acquisitions are merely another tool to successfully execute your strategy.
3. Preparation is key. Most acquisitions fail because of a lack of post-acquisition planning.
4. When you are buying you are actually selling at the same time. You are selling the fact that you are a great fit for the target owners. You are selling the fact that the deal is a great thing for both the acquirer's staff and the target's staff.
5. The key to executing the process: Go for no as early as possible. That's why the process continually asks: Do you really want to move to the next stage? Aborting acquisitions 5 minutes before legal completion is very expensive.
6. Finally remember on price: Sellers aspire to price, buyers perceive value. Only the buyer can put a personal value on the target business. The seller is really aspiring to a price they hope to achieve."

A final word: Mergers and acquisitions also require careful coordination with your as well as the target firm's regulatory bodies. This is especially true if you already have a strong presence in the market where the target operates. Avoid running afoul of antitrust issues. Similarly, if the firm is publicly-listed, you should make sure that you are compliant with the disclosure requirements of the relevant capital market authority, such as the Securities and Exchange Commission (SEC) in the United States. The same level of coordination is also required with rating agencies, your own and the target's.