



Billion DOLLAR Blowout

Can you escape the status quo thinking that blinds you to both risk and opportunity?



By Nigel Lake

“The biggest risk is not taking any risk. In a world that is changing really quickly, the only strategy that is guaranteed to fail is not taking risks.”

So said Mark Zuckerberg in October 2011, seven months before Facebook's US\$104-billion IPO.

Since then, the company's market value has had some ups and downs, but rather more of the former than the latter, reaching a peak market value of close to US\$250 billion, incredible for a company that is just 11 years old.

Along the way, it has made quite a few acquisitions. Many of these have been small investments in technology, capabilities, and people. Others have been much larger, and arguably highly defensive in nature. The latter includes the purchase of WhatsApp for US\$22 billion in February 2014 and Instagram for US\$1 billion in April 2012, just before the IPO. Both target companies were rapidly gaining traction with consumers for applications that were dangerously close to Facebook's core business. So buying these businesses made eminently good sense, even as a purely defensive play.

Millions of technology students and would-be entrepreneurs dream of turning their ideas into something worth a billion dollars, or even more. But what about the opposite? In every industry, the largest companies have typically been built by a combination of organic growth and major acquisitions. Indeed, in many sectors, there has been no alternative to M&A if you have wanted to stay near the top of the curve for economies of scale. But no matter what the attractions of large-scale acquisitions (and I've seen plenty in my career), it's important to remember how many companies have managed to turn \$10-billion investments (or even more) into nothing, in just a few short years.

Microsoft acquired the mobile phone business of Nokia in April 2014. Barely a year later, it announced that it was writing off virtually the whole of its investment. As the *Financial Times* commented at the time: “The near-\$8.5bn hit to profits also underlined a fact that has become hard to ignore: Microsoft's rearguard action to keep the Windows operating system at the centre of the tech world is officially over.” The company had turned to M&A at the eleventh hour to attempt to plug its blind spot in mobile devices, and had singularly failed.

In October 2011, HP acquired Autonomy for US\$11.7 billion. Within a year, HP had announced a writedown of \$8.8 billion, citing “serious accounting improprieties” and “outright misrepresentations”. The founder, meanwhile, pointed the finger back at the acquirer, blaming HP's running of the business. Either way, HP had made a massive bet and had lost nearly all its investment.

The truth is it is shockingly easy to think of M&A transactions that have destroyed over \$10 billion of value. In late 2002, HSBC acquired Household International, one of the biggest US lenders to people with poor credit ratings. At the time, *The Wall Street Journal* commented: “The move is a striking departure for HSBC, long known for its parsimony and aversion to flashy deals.” Within a few years, HSBC was incurring huge credit losses—writing off US\$11 billion in the 2006 financial year alone. In 2009, the bank wrote off the balance of remaining goodwill, put the business into run-off, and booked a £17-billion provision against further bad debts.

In October 2007, a consortium of Royal Bank of Scotland, Fortis, and Banco Santander acquired ABN AMRO for just under

US\$100 billion, the largest-ever bank acquisition. The transaction was spectacularly ill-timed, and within months Fortis had been bailed out by the Dutch government. Santander has escaped more or less unscathed, but RBS required a massive bailout from the UK taxpayer and was nationalised. Given the extent of government support needed to rescue these businesses, arguably the outcome was even worse than the spectacularly ill-conceived AOL-Time Warner transaction, which led to a US\$99-billion goodwill write-off.

The lessons from these disasters have been well documented, so I will add only one brief observation. To this day, strategic advice is frequently delivered without any robust supporting financial analysis of the expected outcomes in terms of margins, profits, return on capital, or valuation. Meanwhile, the financial advisers who opine on transactions are very careful to make clear that they are not giving an opinion on the commercial assumptions which drive their financial models. So is it really surprising that such massive corporate disasters happen so regularly, when strategic thinking, commercial prospects, and valuation are so disconnected? On this subject, it is interesting to note that Facebook's acquisition of Instagram was reportedly completed without the involvement of any investment bankers at all.

Frighteningly, massive corporate value destruction is not solely the result of M&A gone wrong. Not so long ago, both BlackBerry (then known as Research in Motion) and Nokia were US\$100-billion companies. BlackBerry now languishes near a long-term low of around US\$4 billion. Nokia has managed a reasonable recovery (to some US\$25 billion at the time of writing), but has still been outperformed by Apple by a factor of over 100x. These are truly shocking outcomes for businesses that were once synonymous with quality, innovation, and reliability in mobile phones.

These successes and failures pose important questions for business

leaders today. The pace of change and increasing volatility in many parts of the economy have made it easier than ever to outperform your competitors, or to be outperformed by them. New businesses can emerge organically from left field and redefine whole industries in just a few short years. M&A remains as important as ever to stay ahead of your competitors on a number of levels, but the risks associated with poorly chosen or poorly executed deals are higher than ever.

So how can you escape status quo thinking that will blind you both to the opportunities and to the risks?

First, accept Mark Zuckerberg's advice that doing things the same has become more dangerous than doing things differently. Be prepared to take risks in order to explore opportunities, and be prepared for some of these to be failures. Even more importantly, challenge your shareholders to support you in taking these risks, and explain to them why. At the time of its IPO, the large majority of Google's value (even in net present-value terms) lay beyond year 10. Larry Page and Sergey Brin recognised this. Their prospectus ‘owner's manual’ should be on every leader's desk:

“As a private company, we have concentrated on the long term, and this has served us well. As a public company, we will do the same. In our opinion, outside pressures too often tempt companies to sacrifice long-term opportunities to meet quarterly market expectations ...

“If opportunities arise that might cause us to sacrifice short-term results but are in the best long-term interest of our shareholders, we will take those opportunities. We will have the fortitude to do this. We would request that our shareholders take the long-term view.”

Second, look at your business from a vantage point outside your industry—try to imagine how others see you, rather than how

you see yourself. Ask yourself, and your colleagues, why the business operates the way it does. All too often this will stem from historical constraints imposed by market conditions or technology that existed years or even decades previously which are no longer relevant to the business today. Where you find legacy solutions to legacy problems, take the opportunity to redesign your business for the future.

Third, look for inflection points driven by long-term trends—points where the effects of incremental change finally cross the tipping point—and make a new approach clearly more attractive than whatever it replaces. This is precisely where Nokia failed in relation to mobile phones: not recognising the inevitability of the birth of the smartphone. It is also precisely what is happening in the energy sector, where renewables are becoming cheaper than fossil-fuel power sources.

Finally, make sure that major decisions are based on a combination of strategic thinking, proper assessment of risk and uncertainty, robust financial analysis, and a clear perspective on the long term. This is where so many major investments have failed over the years. And in your moments of doubt, where instincts kick in and you are tempted to hold onto the status quo, remember this: The status quo has proved to be the corporate undertaker's best friend. Although people may still say that ‘no-one ever got fired for hiring IBM’, the truth is that IBM had a near-death experience and had to reinvent itself almost completely. The IBM referred to is now largely owned by Lenovo—no-one buys that IBM any more. •

About Nigel Lake

Nigel is CEO of global advisory firm Pottinger and an entrepreneur with a passion for diversity, innovation, environment, and action. He is author of *The Long Term Starts Tomorrow* and is a senior associate of the University of Cambridge Institute for Sustainability Leadership. Follow him on Twitter at @Nigel_Lake.

About Flashpoint

Very few businesses can rely on incremental growth to ensure long-term success. The safety of the status quo has been consigned to history by technological innovation and the accelerating pace of change. In Flashpoint, we explore potential disruptions and inflection points in major industries, and provide tools to help leaders guide and support their teams through this environment.

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