



# The Legis Report

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## Opportunities in a Turbulent Economy

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### INTRODUCTION

As Alan Greenspan puts it, we are now in the “age of turbulence.”<sup>i</sup> Our aspirations to obtain the American dream are curtailed by a meltdown of the finance industry, leaving us wondering where to go from here. Home ownership was a government priority. In this environment it was easy to let mortgage companies slide, allowing buyers to take out mortgage loans they could not afford. When home owners finally came to the realization that they could no longer make their mortgage payments, it was too late. Late payments were already accumulating and penalty fees became a new source of income for lenders. After years of passing down devaluating collateralized debt obligations and mortgage-backed securities, stock markets declined world-wide. The subprime mortgage crisis put a momentous strain on economic growth. However, some businesses have begun to focus on using this economic downturn to their advantage. Taking an organized approach to identifying strategies for growth, especially during and economic downturn, and then acting upon the opportunities presented, can set companies up for a bright and rewarding future ahead.

### STRATEGIES FOR GROWTH

Two significant factors that contribute to growth performance are revenue growth and value creation (or total returns to shareholders). For larger firms, it is difficult to maintain high growth over long periods of time. Often times, these firms will fail to achieve both revenue growth and increased total shareholder returns. Eventually, when firms can no longer attract shareholders or sustain growth, they become targets for acquisition. Firms that wish to maintain a growth sustaining framework look for alternative opportunities to raise capital and increase their top-line growth. One strategy for accomplishing this is through mergers and acquisitions (M&A). M&A is a phrase that covers the

process of buying, selling and merging businesses. Ambitious firms have turned to M&A strategies because of their tendency to contribute to top-line growth and financial performance. According to research by McKinsey and Company, M&A accounts for 30 percent of the revenue growth at an average large company.<sup>ii</sup> In 2007, M&A reached an all-time record of \$4.5 trillion in announced deals, up 24% from 2006. More than one fourth of the M&A volume came from U.S. deals.

However, these numbers alone can be a bit deceptive. During the third and fourth quarter of 2007, M&A total global merger activity declined 27% and U.S. activity fell 46%.<sup>iii</sup> This deal-making decline was a direct result of the housing bubble burst and concerns about the subprime credit markets. M&A activity may be decelerating because of the current state of our economy, but firms may still be able to take advantage of this unique economic situation.

### OPPORTUNITIES IN AN ECONOMIC DOWNTURN

The current economic downturn is a major contributor to the decrease in U.S. consumer spending. Government reports indicate that consumer spending is expected to shrink by 3% or more in the third quarter of 2008. This would be the first quarterly decline since 1990, just before the recession of 1991, and the steepest since 1981.<sup>iv</sup> This trend in decreased spending is prevalent in both individual consumers as well as for financial executives. Many financial managers know intellectually that a slow economy is the best time to find “bargain-basement” opportunities. However, fears of merger failure, especially in a down economy, will often override decisions to pursue M&A activity. Firms tend to undertake divestments during downturns and take on investments during economic prosperity. This is a natural tendency, but can be mitigated with proper discipline and strategy.

## ANALYZING AN OPPORTUNITY

A methodology that is used in preparation for M&A transactions is enterprise analysis. Enterprise analysis involves producing requirements for presale M&A activities. Two examples of this include gathering information about the potential buyer and acquisition target and determining the strategic fit between the two companies. A few items to consider are the companies' legal structures (to address unexpected legal, tax, or litigation issues that may arise), auditable financial reports with minimal red flags (mainly used during due diligence), and the operational plans for each company (to prepare for a smoother transition during implementation). If the company is selling, it must prepare the company to look as appealing as possible to a potential buyer. If the company is buying, it must determine the proper selection criteria for determining the best acquisition target company. Some of the criteria may include revenue range, geographic location, distribution channels, technology provided, and market share. These criteria are intentionally very general and expand to a much higher level of detail.

Subsequent to this initial review, both the companies should each form an M&A team of professionals that will help them throughout the rest of the process. This team should include a mix of accountants, M&A and tax attorneys, key members of management, and MBAs. Also, depending on which side of the transaction the company is on, a business broker can be of assistance with finding potential buyers or sellers that meet the selection criteria.

The entire M&A process can be a bit overwhelming to newcomers, but taking the first step is half the battle. It may take a couple of months or even years in some cases. There are time-consuming stages such as mandatory meetings, a long due diligence process, and negotiations that are necessary in every transaction.

## SEIZING AN OPPORTUNITY

Healthy companies that are willing to see the current economic chaos as an opportunity and utilize management strategies that will sustain growth will eventually ride out the storm. This is the time to approach the M&A market and discover those "bargain-basement" opportunities that will boost growth performance and create long-term value. For many industries, there is a desperate need to consolidate as the global financial crisis threatens to drive companies into bankruptcy. As a result, a rising number of inevitable takeovers are underway. Companies that do not have the capital to withstand the impact of both the global recession and

the global credit crisis are already starting to disappear. Hopefully, this turbulent economy will motivate many companies to take a step back, reevaluate their health, and find ways to take proactive steps to seize the right opportunities.

<sup>i</sup> Greenspan, Alan. *The Age of Turbulence: Adventures in a New World*. Penguin Press HC, 2007.

<sup>ii</sup> Viguier, Patrick. Smit. Sven. Baghai, Mehrdad. *The Granularity of Growth*. John Wiley & Sons, Inc., 2008.

<sup>iii</sup> Hall, Jessica. *International Herald Tribune*. "US Mergers Hit New Record..." <<http://www.ihf.com/articles/reuters/2007/12/20/business/OUKBS-UK-MERGERS-US.php>>

<sup>iv</sup> Uchitelle, Louis. *The New York Times*. *Full of Doubts, U.S. Shoppers Cut Spending*. Oct. 5, 2008 <<http://www.nytimes.com/2008/10/06/business/06econ.html?bl&ex=1223438400&en=f895f0fd514c47fb&ei=5087%0A>>

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## Board Election

Patrick Ray, JD, CCC, PMP was recently elected president of the AACE International Atlanta Section. AACE International is a multi-national organization with over 5,000 members dedicated to promoting cost engineering and related disciplines. Mr. Ray continues Legis' long involvement with AACE International in leadership positions.

## New Orleans Office

Legis Consultancy has opened an office in Louisiana to better serve our private sector and government clients located in the New Orleans area. Legis has experienced a dramatic increase in the need for its services for programs and projects in this area.



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