BY PHIL PHILLIPS, PHD
CONTRIBUTING EDITOR
PHILLIPS@CHEMARKCONSULTING.NET

Is there a best time to acquire or divest a business?

A look at the advantages and pitfalls of investing during an economic downturn.

Most economists would say that North America and Europe remain in a quasi-downturn with mixed positive/negative indicators. All, I believe, would agree there is a credit crunch in both regions. If 20 executives from the paint and coatings industry were asked the following fundamental question, there would be many varied answers. The question is, "When is the best time to acquire or sell a business? In a downturn phase or during an upturn phase in the economy?"

There are three scenarios to consider in either one of the two extreme phases

- Proactively seek acquisitions;
- Stay conservative and just get through this phase; and
- Sell off non-core or near-core businesses.

Considering a downturn economic environment some executives would look for opportunities to extract asset bargains that will assist them in growing and creating future value for their stakeholders.

It is the opinion of some experts that "staying conservative and just getting through this phase" (a downturn) is absolutely the wrong strategy. In other words, provided a company has the resources to acquire, they should do so in a downturn without question.

Despite the old adage often mouthed by executives in all industries, "Invest in a downturn," very few put their money where their mouths are. They generally become conservative in downturns, cutting costs, headcount and other so-called "quick-fixes."

After considerable research of 200 global companies and in their book, The Granularity of Growth, Baghai, Smit & Viguerie observed two sets of results were obvious.

First, of the potential strategic moves companies can take to grow in a downturn—divest, acquire, invest to gain share—an effective acquisition strategy (defined as growth through M&A at a rate higher than that of 75 percent of a company's peers) created significant value for shareholders during an upturn, on the other hand, divestments created slightly more value than acquisitions did.

Second, companies often behave in counterproductive ways. Fewer than half as many companies in the segments studied made acquisitions in downturns rather than in periods of economic growth. Significantly more divested businesses in those market segments in downturns than in upturns.

What is ironic but very natural, are executives, in downturns act like human beings normally do. They want to protect what they are responsible for, which is their business environment. In downturns, as revenues slow putting pressure on fixed cost spreads and margins, management switches its center of attention to reducing costs to maintain earnings protection.

This tactic, while a normal "knee-jerk" reaction, is aimed at protecting the balance sheet, which leads to the deferral of growth and low-priority investments, the shelving of large acquisitions and sale of assets. As Baghai, Smit & Viguerie observed, many companies simply freeze. Sixty percent made no portfolio moves at all in downturns. Forty percent made no moves in upturns.

The best growth companies take a very different approach. They view a downturn as a time to increase their leads in market share and value enhancements and make acquisitions. They aggressively seek out and with great zeal, concentrate on the assets they strategically need to grow rapidly and certainly, with much greater speed than competition. Henkel's very quick acquisition of the National Starch business from AkzoNobel in 2008 is an outstanding example of a strategic acquisition in a downturn economy. **CW**