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Mergers offer small businesses a road out of financial troubles

But conditions must be just right to turn competitors into partners

STEVE ABDALLA
FINANCE STRATEGIES

Tough times have arrived for Hawaii businesses, and they're not leaving anytime soon. A recent report from Moodys.com says Honolulu has just entered a recession. Hilo Hattie and Hawaii Medical Center have filed for bankruptcy, and thousands of other firms are struggling and on the brink.

One of the most successful — and least used — strategies for surviving a recession, and indeed even thriving during one, is to merge with a competitor.

Mergers within an industry can enable firms to slash costs in numerous areas, including rent, transportation, purchasing, manufacturing, accounting, human resources, sales and marketing.

Revenues can increase as well, through offering a more complete set of products or services, cross-selling and improved pricing power.

Nonfinancial benefits for owners include a strengthened management team, perceived market leadership, injection of new personnel, energy and ideas, and enhanced lifestyle, as a partner can share ownership burdens.

Two Honolulu-based Portuguese sausage makers, Rego's Purity Foods Co. and Gouvea's Inc., recently merged to create a stronger combined entity. After more than 50 years of spirited competition, they finally concluded that "It just made sense to merge."

During the last downturn, two nonprofits, the Honolulu Symphony and the Oahu Choral Society, merged in part to capture more than $50,000 in operating cost savings. Ironically, they had split eight years earlier following a labor dispute.

So, why aren't there more mergers? There are substantial challenges that need to be overcome, including:

- Lack of awareness. Most business owners simply never consider the option.
- Lack of knowledge. Most entrepreneurs have no idea how to approach a merger partner, estimate merger synergies or value, negotiate a deal or integrate operations.
- Desire to retain control.
- Distrust and/or hard feelings toward competitors.
- Incompatibilities, e.g., in equipment, technology and culture.
- Difficulty reaching agreement on valuation, ownership and post-merger responsibilities.

The potential benefits of a merger vary considerably by industry and company. Benefits are greatest in the following situations:

- Certain industries, such as manufacturing, distribution, transportation and technology.
- High fixed costs, as increased volume reduces per-unit costs, or excess capacity.
- Limited number of competitors, which enhances price leverage from a consolidation.
- Significant economies of scale in any important aspect of the business, such as purchasing, advertising or even recruiting.
- Specific companies with complementary product/service offerings, geographic coverage or resources.

Mergers tend not to be particularly beneficial in retail or restaurant industries, as the brands and operations are generally too distinct to combine effectively. Businesses that are highly dependent upon the personal skills and reputation of a key principal, such as small legal, medical, advertising and other professional practices, tend to see few, if any, merger synergies.

Unlike with acquisitions, little or no cash is typically needed, and both owners generally stay on. The firms combine, rather than one buying out the other. Differences in value can be accounted for by varying post-merger ownership stakes and/or salaries.

Mergers are not without risks. Failed merger negotiations can result in a leak of confidential business secrets, loss of personnel or litigation between the parties. Even if a deal is reached, the companies may have trouble integrating operations, leading to a decline in service and lost customers. Or the owners may simply not get along. For a merger to succeed, there must be strong potential operating synergies and compatible owners and company cultures. The parties need to be flexible and willing to seek win/win agreements.

It's critical to engage professional, experienced advisers to facilitate the process and resolve potential disputes. Without an impartial intermediary focused on making the deal happen, merger discussions almost invariably dissolve amid complex and protracted negotiations and an inherent lack of trust.

A decision to merge is one of the most momentous decisions a business owner will ever make. The potential benefits are extraordinary, but so are the risks.

The economic challenges facing Hawaii businesses are sizeable, and many firms will need to take drastic actions to survive. As an experienced venture capitalist once said, it is better to own a piece of something big than 100 percent of nothing at all.

STEVE ABDALLA is president of the Hawaii office of VR Mergers & Acquisitions, based in Honolulu.