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Making good deals in bad times

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After Taiwan's Fubon Financial group acquired its subsidiary in Hong Kong more than four years ago, it set its sights on the potentially lucrative banking sector in China. When Taiwan allowed its banks to invest in China through offshore subsidiaries, Fubon Financial was finally able to make its move, buying nearly 20 percent of China's Xiamen City Commercial Bank through its subsidiary Fubon Bank.

Though small, the US$34 million deal was a landmark one: It made Fubon Bank the first Taiwanese banker to enter China and get a toehold in one of the world's biggest and fastest-growing economies. One of the possible prizes that beckoned: The 2,300-odd registered businesses from Taiwan in the port city of Xiamen, where the Chinese bank is based, constituting a huge potential client base for Fubon Bank.

But given the economic headwinds hitting China — slowing GDP growth, worrying signs that non-performing loans may be rising again, tighter credit and high inflation, as well as the wider turmoil in the global financial markets — is it the right time to make such an investment? Some companies spend years putting together a deal, only to walk away when economic conditions become uncertain. Fubon stuck to its plan. Was that wise?

Making bold investments when economic turbulence is intensifying might seem reckless to many managers. But our analysis of more than 24,000 deals between 1996 and 2006 in the US reveals that companies that acquired through the last downturn (2001 to 2002) generated almost triple the excess returns of companies that made acquisitions during boom years.

While the jury is still out on the Fubon deal, our research shows that with the right combination of readiness, prudence and guts, economic uncertainty actually presents some of the best opportunities to fill capability gaps, gain market share and change a company's competitive position.

Among industries, the largest increases in excess returns occurred in healthcare and consumer products; the smallest gains in the utilities and telecommunications sectors. But, significantly, the finding of good deals in bad times — higher excess returns on deals completed during the downturn — held true across all industry segments.

As a staging ground for improving competitive position through mergers and acquisitions, the current economic volatility has several things going for it. True, credit markets are tight, but even in the US, the epicenter of the subprime crisis, corporate balance sheets are generally strong. With last year's S&P 500 cash-to-sales ratio almost three times what it was 20 years ago, corporate cash balances are flush and equity is a viable deal currency.

Moreover, with global private equity deal value down 73 percent in the first half of this year against the same period last year, even the big private equity funds are less likely to bid up prices. Indeed, the global merger and acquisition deal count was down 17 percent year-on-year in the first half and value off by 37 percent.

Amid widespread economic uncertainty, it is hard for most executives to be contrarians. Funding constraints and the lack of operational and financial leverage can turn aggressive chief executives wary. Yet, as Novartis showed with its installment purchase of Alcon, creative financing can enable a strategic acquisition — especially when there is no immediate need for cash.

The necessary precondition to a successful deal in periods of turbulence is a well-calibrated compass that shows the long-term direction of the company and a thoroughly analyzed set of options to get you there.

To do such transactions, managers need equal measures of confidence and thoughtfulness. Spectacular failures occur when companies attempt to buy false bargains. Think of Dynegy's proposed acquisition of Enron. In 2001, market turbulence and fraud had brought Enron low. Dynegy thought it could buy a distressed asset cheap. Fortunately for Dynegy, the deal was never consummated.

The best turbulence deals allow companies to buy capabilities or market positions that would take years and major investments to create. Consider the value of Xiamen Commercial to Fubon Bank. It allows the Taiwanese banker to have closer ties with its Taiwanese clients operating in China and to offer its services to the lucrative small and medium-scale sector in China.

But deals amidst turbulence can be bumpy in the short term. Fubon's share price on Hong Kong's Hang Seng Index has plummeted more than 52 percent since late April after the bank received permission from Taiwanese regulators for the Xiamen deal: This fall has taken place against the backdrop of a 25 percent decline in the benchmark stock exchange itself since the beginning of the year.

But globally, recognized brands like General Dynamics and Johnson & Johnson have also built strong competitive positions by buying throughout the business cycle.

More than impeccable timing, these firms have developed a well-articulated corporate strategy, coupled with an in-house capability covering the four major steps in the deal — strategy, negotiation, diligence and integration. More and more, companies are adopting this pattern to become serial buyers.

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