Corporate Anorexia
Falling Down the "Leaning Curve"

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Unless it's applied to a corned beef sandwich, I'm swearing off the word lean. While I am a huge fan of efficiency and the productivity that it creates, post-acquisition cost cutting can reduce the long-term stability of an acquisition.

If cost cutting increases profitability, how can the emphasis on leaner operations undermine an acquisition? Let's look at the pathologies-and the cure-for corporate anorexia.

Insight Gaps As I've noted before on this site, the due diligence process contains three critical insight gaps that can lead to flawed understanding of the company being purchased. As a result of these gaps, the new owner of a business can initiate cost cutting initiatives in exactly the wrong place and at a very vulnerable time for the acquired firm.

Land Mines Often, a seller will trim costs in order to improve margins and attract a higher valuation for his company. The buyer of the company will recognize this, but might not be able to tell if the venture is already running too lean to be healthy or sustainable. Further cost cutting after the close can be the kiss of death in such an instance.

Goal achievement In most of the strategic acquisitions I've worked on with clients, the buyers have identified two key sources of returns: first, reduction of duplication in overhead and other functions and, second, filling the matrix by cross-selling products to the combined customer base. Of the two, cross-selling is much tougher, because it requires coordination between sales departments and cooperation among salespeople. Cost-cutting is easier and faster, which makes it appealing to focus almost exclusively on step one of a two-step plan.

Measurement Bias We like benchmarks and ratios, including margins, but we are all human and we invariably fall into the trap of seeing these numbers as more meaningful than they are. Revenue per man hour or average receivables age are symptoms of something else. We can focus on the symptoms, as most cost-cutting initiatives do, but that investment of management and staff time distracts us from focusing on the source of the problems. The problem is reinforced by measurement of whatever variable the new owners seek to address. Staff will almost always increase the time spent tracking and reporting on the cost-cutting initiative and reduce the time invested in building sales.

Motivation Assassination The greatest fear employees have in advance of a sale is that the new owners will slash and burn on the march to higher profits. Every cost-cutting move is magnified in importance in the minds of employees and every person cut is a message that "I'm next." Fear is said to be a great motivator, but it also causes paralysis and bad decisions. Even if margins grow via cost cutting, the view-and response-will be much different on the shop floor than in the corner suite.

One of the great lies clients have told themselves over the years is that, "We'll be sure we only cut the fat, not the muscle." It's a great sentiment that is achievable only in the rarest of circumstances. More frequently, items that appear to be superfluous are, in fact, providing important value somewhere in the organization.

My long-time boss and mentor, Ted Pincus, was fond of telling me that you can't save your way to prosperity. That doesn't mean he wasn't careful with a buck, but it reflects an accurate perception that sales growth, not cost-cutting, is the true path to success.

Rather than dive immediately into cost reductions, acquirers are well served to focus first on the true sources of customer retention and core profitability. As I described earlier in my "Mind the Gap" article on this site, the due diligence process can obscure the greatest opportunities for sustainable, profitable growth.

That's why the I'm such a zealot for incorporating customer perceptions into both strategic and operating plans, and it's the reason that customer engagement is roughly 50% of the work involved in a Quadrant Five assessment. If we don't talk to the customer, we're just talking to ourselves. And any shrink will tell you that people who talk only to themselves are missing a marble or two.

By addressing customers early and effectively, acquirers place more emphasis on building muscle than on trimming fat. And while it is true that more revenue doesn't solve all problems, a stronger and more predictable sales base will create a fatter cushion against all kinds of issues.

About the Author

Michael Rosenbaum is founder of Quadrant Five (www.q5works.com) and a highly experienced consultant to corporate management teams. His newest book, Six Tires, No Plan, chronicles the life and management style of Discount Tire Company founder Bruce Halle.
