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TITLE: What Makes a Merger Successful?

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UK-based The Sage Group plc acquired State Of The Art, Inc., now known as Sage Software, Inc., in March 1998. With operating divisions in France, Germany, the U.K. and the U.S., and revenues of more than $320 million for its fiscal year ended September 30, 1998, The Sage Group is the largest supplier of mainstream PC accounting software in the world. Paul Walker is the CEO of The Sage Group plc, and David Hanna is president and CEO of Sage Software, Inc.

With the March 1998 merger between The Sage Group plc and State Of The Art long behind us, and with the new group getting even stronger, we thought we'd reflect on the elements that make a successful combination of two companies and share some of the valuable experiences gained by both sides involved in the process.

A merger is like a marriage--it's all about people and their ability to work together in a way that benefits the combined enterprise. The basis for a successful acquisition/merger includes a common understanding of the reasons for the merger, a considered assessment of what both sides bring to the party, and complementary product lines and geographic markets. In addition, there must be thorough due diligence on both sides, a recognition of potential problems, and the ability to exploit synergies.

In the case of The Sage Group and State Of The Art, we two CEOs had been meeting informally for about four years preceding the merger. Over that time we had developed a good knowledge base of each other's business and strategic objectives as well as management styles. In late 1997, when we began serious talks about a potential merger, the stage was already set for us to move quickly. In January 1998, once we knew State Of The Art's fourth quarter results, our two management teams met, and over the next three weeks we put together the mechanics of the deal. Because it was a cash offer [Sage acquired all the outstanding stock of State Of The Art at $22 per share, or approximately $263 million], the details of the transaction were simpler than if it had been a pooling. Overall, the process went pretty smoothly.

PAUL WALKER: At The Sage Group, we've grown our business through acquisitions in other countries. We've always believed that because all countries have their own characteristics, the most effective way to enter a new geographic market is through acquisition of established local companies. Prior to the merger, one big gap The Sage Group had was in the U.S. market. We believed we needed a strong player with good products and a proven sales and distribution channel. As part of our due diligence efforts, we conducted market research in the U.S. earlier in 1997 to accurately assess the opportunities in the American market and to confirm State Of The Art's reputation as a major player in the midrange accounting software market.

Another reason we were interested in State Of The Art was its approach to product development. Sage is very strong in marketing, but we felt our product and channel development capability could be strengthened and that we could learn a lot in these areas from State Of The Art.

DAVID HANNA: From State Of The Art's point of view, the decision to merge with The Sage Group was based on our belief that the worldwide market for accounting software is consolidating and on our desire to gain a competitive edge through international reach. Also, it gave us an opportunity to access Sage's successful marketing and branding programs. From the beginning of the merger, we've been very receptive to Sage's marketing ideas and practices. Sage has been extremely successful establishing leading market share in the U.K., France, and Germany because of the impact its branding has made. With encouragement from The Sage Group, we completed our own extensive market research in the U.S. last summer, and, based on those findings, we've been rolling out a range of new marketing programs in the U.S. under the Sage brand ever since.

We really believe each of our companies brought complementary strengths to the merger. While both Sage and State Of The Art contributed strong management teams, each organization added its unique strengths--Sage in marketing and branding and State Of The Art in engineering and technology. We've done a good job of establishing the synergies of the two companies with the result that the whole is indeed greater than the sum of the parts.

PAUL WALKER: Another concern we had before the merger was how to manage a U.S. company remotely from such a distance. My team made sure that Sage personnel spent a great deal of time at State Of The Art in the early weeks right after the merger. And, just as important, senior executives from State Of The Art visited Sage in the U.K. This focused interaction was central to Sage's strategy of adopting "best practices" from each of its subsidiaries. The cross-pollination of ideas, strategies, and tactics has been very successful. At the same time, the Sage philosophy is to let the divisions run their businesses without a lot of intervention from the head office. We continue to have very strong, ongoing dialogue, and The Sage Group management team visits the Irvine office every quarter. Bottom line, the positive attitudes of both State Of The Art and Sage people have made it all work.

DAVID HANNA: One question that always comes up regarding impending mergers concerns the apprehensions of employees of the acquired company. In our case, we had always told our employees that we would participate in the industry's consolidation, so they were prepared and confident with the decision to become part of a larger international company. As an organization, we believe the merger gives us an edge in the marketplace, and our resellers see a difference in their ability to compete. I'm happy to say no member of the State Of The Art management team left the company after the merger, which is a very good indicator of a successful and productive merger.

WALKER/HANNA: The last aspect we'd like to address is the importance of a shared vision between companies involved in a merger. State Of The Art and Sage Software, Inc. came to the table with the same mission of providing the best products and services to help small and medium-sized companies manage their businesses. For example, together we are constantly seeking ways to help our customers, resellers, and partners exploit the new opportunities presented by doing business electronically. Under our unified branding and marketing strategy, we intend to grow the Sage brand in our current markets as well as continue expanding into new markets around the world. If we can keep the momentum and good feelings going like we have so far, then we should achieve even more success.

ADDED MATERIAL

Paul Walker is CEO of The Sage Group plc, and David Hanna is president and CEO of Sage Software Inc. Paul can be reached at www.sage.com, and Dave can be reached at www.sota.com.

ILLUSTRATIONS: JAMES KACZMAN

PAUL WALKER

DAVID HANNA

JOINED AT THE HIP

When they merged in March 1998, both The Sage Group and State Of The Art were running successful operations. Both were founded in 1981 as developers and providers of small and midrange accounting software, and both were market leaders (or close to it) in their respective countries. Sage went public in 1989 and State Of The Art in 1991. And both had been entertaining the possibility of their merging long before they approached each other.

Dave Hanna and Paul Walker had started meeting informally in 1994 when Hanna took over the helm at State Of The Art for the second time. (He had run the company in the early '80s, then sat on the board of directors from 1986 through 1993 while running other companies. The board asked him to return in late 1993.) He was initiating meetings with several companies, exploring the possibility of partnerships. He liked what he saw in Sage. State Of The Art was strictly a domestic company at the time, except for some Canadian business, and although it was a leading player in the fragmented middle market in the U.S., it didn't have a dominant market share. Hanna thought it needed to be more international in order to add value for its shareholders.

At the same time, Paul Walker and Sage were looking to expand into the U.S. They had the leading PC accounting software in the U.K. and were growing by acquiring companies outside the U.K., mainly in France and Germany, rather than by developing products. Countries outside the U.S. had so many different ways to do accounting transactions that it was more cost effective in the small and midsize accounting software markets, they said, to buy someone else's product rather than try to make theirs work in another country. They liked what they saw in State Of The Art and its products.

So over the next four years the executives continued their discussions and "got serious" in the third quarter of 1997. They announced the merger on January 27, 1998, the day after State Of The Art announced its 1997 earnings, and all work was completed by March. In July 1998, at the Visions Conference for its resellers, State Of The Art changed its name to Sage, and the executive teams explained the merger, the products, the branding, and the marketing. And they have been rolling out products ever since. Some names you might recognize (pre- and post-merger) are MAS 90, Acuity Financials, Business Works, Timeslips, and Sage Payroll. And Sage also produces books on how companies can manage themselves better.

The two executives and the third member of the merger team, Paul Stobart, international business development director of the Sage Group plc, have nothing but compliments for and about each other and their staffs. Dave Hanna says one of the chief reasons for their success is the compatibility of the management teams and the respect they hold for their employees and shareholders. "From my standpoint, Sage was absolutely the perfect fit," he explains, "especially with regard to our vision of where we saw the market going, the compatibility with the management teams--which I felt was very important. Their position in the European market was stronger than any of the other players I had talked to, and I felt we had the best chance of successfully consolidating and accelerating the growth in our worldwide market with Sage. I had been talking to suitors for four years. But Sage had very strong marketing and a very strong brand and had made a big investment in establishing that brand in Europe. We hadn't made the investment, didn't have a strong brand, and the opportunity to take advantage of that brand in the U.S. with a vision that I felt was compatible with ours was a compelling opportunity for our shareholders and employees."

On the Sage side, Paul Stobart says, "When we did our own research of the companies in the marketplace with whom we might merge, it rapidly became clear to us that the best channel was that run by State Of The Art. And their products and their approach to product development was far superior to that which existed in the rest of The Sage Group. There was a real merger of skills. It's very rare in a merger that you can see that one and one are actually adding to more than two. And I think we all feel it's still the same way now, this long after the merger."

Epilogue: Recently Sage plc acquired Peachtree Software, making the U.S. its largest operation.

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