Acquisition Programs : The case of Cooper Industries and Cameron Iron Works

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Acquisitions

- Evidence on acquisitions mixed. Strong suggestion that buyers pay too much in large sample studies of acquisitions of publicly traded firms.
  - Agency problem of managers – bigger is better?
  - Or, “winners curse”?
- What about companies involved in “programs of acquisitions”? Cisco? Others?

Programs of Acquisitions

- Possibly, companies that have acquisitions as a routine for gaining technology or expanding market position, are more successful than average at acquisitions.
- Cooper industries is one such example of a manufacturing oriented firm with a program of acquisitions.
- What do they do to improve the odds in acquisitions?

Cooper’s Corporate Strategy

- Diversification -
  - smooth earnings. Transfer cash between divisions, electricity in late 70’s , oil field products and services in 80’s
- Cooperization
  - one time improvement
  - after 60 acquisitions Cooper has built a capability in doing this

- Cooperization (continued)
  - buys industries that are structurally attractive
  - limited imports competition (distribution intensive nature of products create entry barriers)
  - buys underperforming market leaders
- Complementary acquisitions
  - resource sharing in distribution and brand name
  - consolidation of lines gives broad product range but eliminates weak positions

- Skill Transfer in manufacturing
  - leveraged by corporate manufacturing services function
  - brings best practice to backward companies
- Distinctive Competence
  - systems and structure add value without huge corporate overhead
  - provides services, intervenes in decisions, and structures to facilitate coordination if useful

Cooper Industries

- An acquisition program that creates value
- Distinction between behavior and outcome control (Difference between operating and holding company)
- Requires that corporate management know what is appropriate behavior

Not a Conglomerate!

- track 800 executives
  - no single number evaluation criteria
- internal consistency or fit of various structural elements
  - mgmt. has operating knowledge of businesses it competes in
  - can evaluate divisional managers on decisions they make
  - don’t have to look just at outcomes

Acquisitions

- 3/89 Cooper Industries acquired Champion Spark plug for $800 million
- Moody Downgraded Debt
- 8/89 Cooper Industries acquired Cameron Iron Works – manufacturing and oil services.
- Stock price rises

Cameron Iron Works – A good idea?

- 2 divisions – Oil Tool Division – pressure control equipment used at wellhead
- Forged Products – made forged and extruded metal products, some sold to Oil Tool Division.

Motivation

- Cooper's Energy services division made large compressors that pushed natural gas through pipelines and pumped oil.
  - Opportunity to improve efficiency through consolidation and cost cutting made Cameron attractive.
  - Tax free exchange, transaction for 967 million.

Traditional Criteria

- 1) Companies should be in industries in which Cooper could become a major player.
- 2) Companies should be relatively stable, low tech manufacturing industries.
- 3) Only companies with leading market positions should be considered

Applying “Cooperization”

- 1) Leave the best managers in the acquired business in place and bring in a few key Cooper managers.
- 2) revamp the financial reporting structure.
- 3) put in Coopers fundamental management and control procedures.
- Cooperization is a process of internalizing management control and accounting systems. Not intended to change product market strategies.

Cooperization Process by Activity

- Manufacturing Services – mfg. services corporate group of 15 individuals provided management and consulting services to new acquisitions.
  - Focused on eliminating weak “old fixture” product lines. “Cash is king”. Job is to oversee implementation of modern manufacturing in acquired firms.

- Accounting and Control
  - Aggressive accounting of cooperization process. Estimated liabilities at time of acquisition to be incurred with Cooperation. Anticipated liabilities of restructuring credited to “other long term liabilities” with offsetting debit to goodwill. Growth of intangible assets.
  - Allowed Cooper to spend heavily on improvements soon after the acquisition without a concommitant reduction in reported earnings.

Not Successful - Why?

- All measures of productivity change associated with Cooper’s acquisition of Cameron indicate that it was not successful.
- 5 years later Cooper divests Cameron and three other energy related divisions after writedowns of 441 m to 754 m on a 967 m acquisition.

Failure of Cooperization Process?

- Post spin-off, Cameron managers indicate the following:
  - 1) that Cooperization process and organizational structures were inappropriate for Cameron.
  - 2)Acquisition and divestiture transactions at Cooper took up top management's time at Cooper. In the process management systems became less effective.
  - 3) Cooper's compensation system was "mysterious" and failed to provide strong incentives.

Cameron a Service Firm with a Manufacturing Component

- If Cooperization oriented to manufacturing then maybe the wrong target.
  - Lack of understanding of what the oil field market is about. Cooper missed the marketing and service side of the business and the changes taking place in the market in this direction.
- Also – Cameron had already been through a cost cutting/ rationalization phase. Benefit of Cooperization less valuable.

Organizational Problems

- Organizational Design – By the time of Champion and Cameron, Cooper managers so concerned with control that it was difficult for divisions to make decisions. Internal control process overbearing.
- Inability to understand business and confront strategy problems.

Compensation and Incentives

- Cooper paid bonuses that could reach 20 to 40 percent of base salaries to be determined by executives at HQ. Developed detailed goals and managers evaluated on meeting goals.
- Cameron managers describe process as a “mystery”, “the bonuses were whatever they wanted to pay any individual”.

Sources of Value Creation and Destruction

- Cooper’s process destroyed value at Cameron.
- Even though Cameron operated in same industry as one of Cooper divisions, Cameron’s business was substantially different from Cooper’s.
- The implementation of centralized organizational design and incentives was particularly inappropriate for Cameron.
- Stock market responded favorably due to Cooper’s past successes, but eventually fell reflecting failure of Cameron.

Lessons?

- Shows that even a “good program” which routinizes complexity of acquisitions can run afoul of targets that deviate from the orientation of the program. This can occur even when targets are quite similar to other divisions.
- Are any of these problems of implementation familiar to your experiences with acquisitions?
- In evaluating successful “programs” of acquisitions at firms, how important is the tension between flexibility and routine? (An issue that comes up at Cooper.)

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