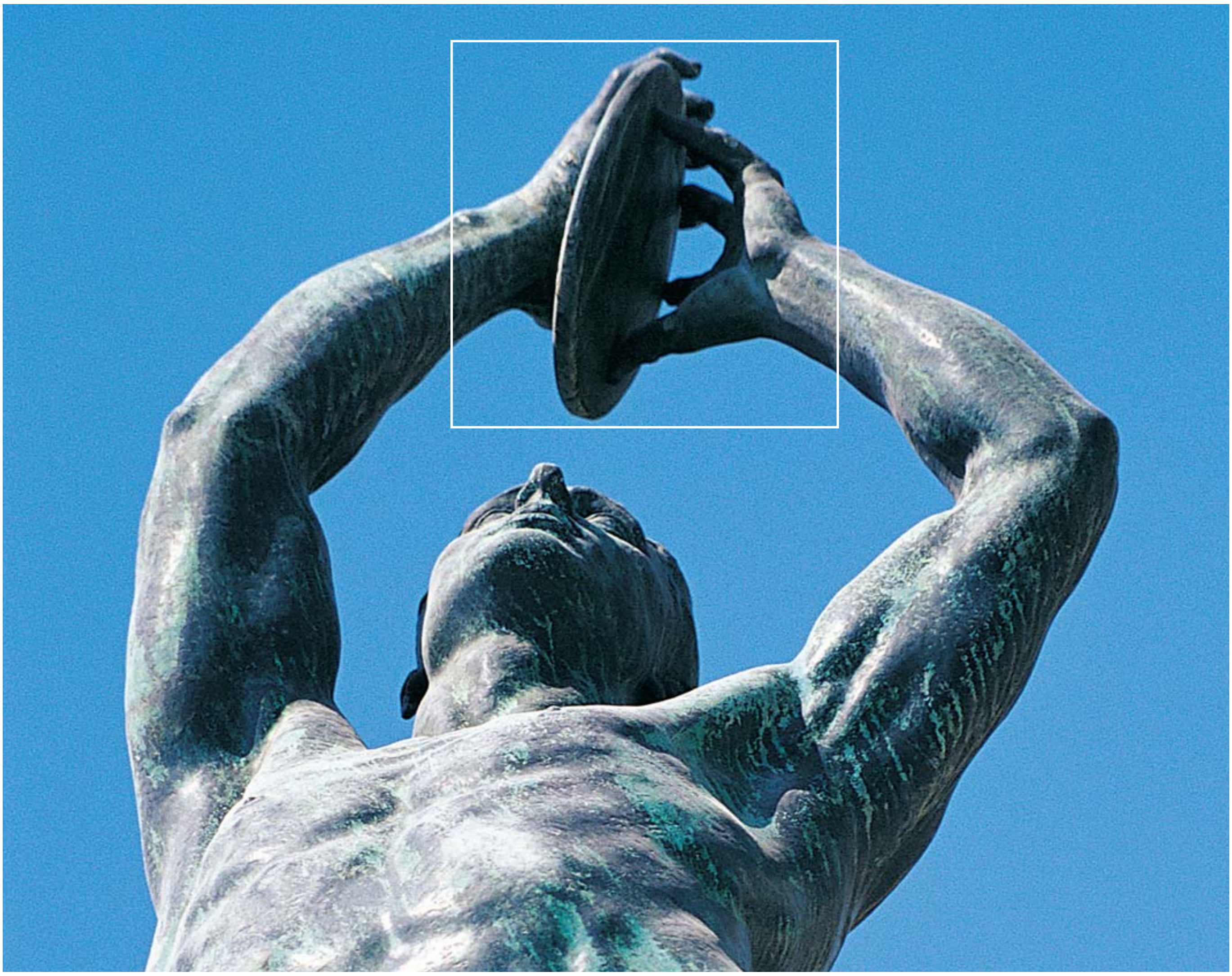
Winning the Merger Decathlon

A Guide to Mastering the Ten Challenges of the M&A Process



Introduction

Mergers have become a common feature of the corporate world and, as a result, understanding of the challenges involved has become more widespread. Nevertheless, many mergers still fail to live up to expectations. Some organizations see their market value fall dramatically following a merger, while others are even forced to perform an about-turn and de-merge. However, if approached correctly, mergers and acquisitions can deliver significant value. Arthur D. Little identifies ten challenges that any organization aiming to complete a successful merger or acquisition must master.

A marked absence of merger activity followed the bursting of the internet bubble in 2000. However, from 2002 to 2007, global Mergers and Acquisitions (M&A) activity grew continuously. Several factors contributed to this revival, including corporate restructuring, industry consolidation and opportunities in emerging markets. But, as the level of M&A activity has grown, so have the challenges facing the parties involved. Deals have become larger and more complex, the proportion of hostile takeovers has increased, and a significant cultural gap between organizations has become a feature of many deals. Any organization contemplating a merger or acquisition now needs to ask: "Is this an opportunity to gain a competitive edge and generate significant added value – or simply an invitation to stumble and fall?"

Just as winning the Olympic decathlon requires a combination of strength, speed, endurance and technical skills, so mergers require organizations and individuals to excel in a broad range of disciplines (see figure 1 on page 2). By mastering the challenges of the "merger decathlon", organizations can improve their chance of turning their next deal into a success story.

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10 Steps to Success

1. Follow a clear strategy

Before venturing down the M&A path, every organization needs to undertake a thorough strategy review in order to answer some key questions:

- What are the primary objectives: to buy revenue growth (e.g. through geographic expansion or product line extensions); to generate cost synergies from increased scale; to acquire new technologies, or scope extension along the value chain?
- What are the internal options for achieving these objectives and how do they compare in terms of time and investment required, and risk/return profile?
- What are the most appropriate search and evaluation criteria for identifying and selecting potential partners or acquisition targets?

Not only will a clear and logical strategy make it easier to secure the support of shareholders and management team for any proposed deal; it will also make the subsequent target search much more effective.

2. Pick the right deal

Personal preferences, political considerations and subjective views can sometimes obscure and prolong the target selection process. In such situations, refocusing on a factual assessment based on the agreed selection criteria is essential.

Thorough due diligence goes far beyond the data provided by the seller. Site visits provide a much better feel for the quality of production infrastructure, distribution outlets, etc. Interviews with customers, distribution partners, suppliers and competitors, which can be conducted anonymously through external consultants, complete the 360° assessment.

Organizations experienced in making acquisitions go to the limits to get to know top and middle management through formal management presentations, workshops and one-on-one meetings. Besides giving a better understanding of the quality of people, these encounters also provide useful insights into the degree of cooperation or resistance to be expected during the integration.

3. Leverage the pre-closing period

After the deal has been signed, the period until closing usually extends over two months or more, with the time it takes to secure approval from the competition authorities determining the length of this period. Many acquirers hold back and schedule the integration activities to begin after closing. Indeed, legal restrictions often keep the acquirer from exchanging sensitive data with the future partner as well as from setting up integration teams. However, the waiting period can be used by the acquirer to:

- Prepare critical organization design and people decisions.
- Validate synergy targets and break them down by business and functional area.
- Set up the integration teams and program office and prepare a work plan for the integration.
- Develop a communication plan for “day 1” and beyond.

A third-party “clean team” can, for example, start data analysis in the most promising synergy areas, such as purchasing and supply chain. With the recommendations of the team ready for implementation right after closing, synergy realization can be accelerated by several months.

Figure 1: Challenges of the merger decathlon

4. Adapt integration approach and speed

It is commonly presumed that mergers should involve full integration across the board, changing the nametag and maximizing synergies – and this approach may be the right one in typical consolidation mergers. However, it is not the only one. Where strong brands and well-established distribution networks represent valuable assets, it may be more appropriate to preserve these.

The degree of overlap (geographies, products, customers), the market and financial position of the target, its relative size and the cultural differences it presents – all need to be considered in choosing the most appropriate integration approach.

The original objectives and underlying strategy of the merger should determine which elements of both companies' value chains are to be integrated and/or optimized and at what speed – and which parts are better left alone. Balancing the different integration requirements of various parts of the organizations is what Arthur D. Little calls "Smart Integration" (see figure 2 opposite).

In this context, it is often appropriate for different organizational units, processes, systems, brands, etc. to be integrated at different speeds. So, for two fast-moving consumer goods companies operating in the same markets, integrating and streamlining the sales forces is likely to be a top priority and should be completed very quickly. However, in a situation like this, product portfolio harmonization can usually be addressed at a second or third step of the integration process.

5. Take critical governance decisions upfront

Integration programs typically involve large numbers of people working in teams to shape the processes and structures of their respective business or functional areas. Nevertheless, top management needs to take a number of important decisions very early in the process.

Most of the uncertainties so common in merger situations revolve around job security and career perspectives. Fundamental structural and governance issues such as degree of integration, geographic, business unit or functional organization and centralized or decentralized administrative functions, must be clarified to provide guidance to the integration teams.

As the top levels of the organization chart are being drawn, managers should be nominated for existing and new positions on the chart. In particular, when a merger results in the elimination of management positions, both "winners" and "losers" need to know. Management needs to be clear about which people it wants to keep either permanently or at least for the integration period. Talking to and motivating those people individually is essential to keeping the integration and company performance on track.

Figure 2. Smart integration

Optimization potential		
High	**Restructure** ■ inject own people and know-how ■ move quickly to capture the value	**Joint optimization** ■ "best of both" not good enough ■ use window of opportunity for jumping to a new level
Low	**Leave alone** ■ protect from interference ■ set ambitious targets and track performance ■ involve good people to help out elsewhere	**Integrate now, perfect later** ■ align/integrate processes quickly ■ avoid service disruption ■ go for "best of both", can be optimized in a second step

Low — Degree of integration — High

6. Invest your best resources

Integration is usually seen as a burden distracting from daily business. Whether it is taken seriously throughout the organization depends to a large extent on how top management support for the program is perceived.

This means, first, that top management must invest time in holding regular Integration Steering Committee meetings and communication events such as road shows, as well as in talking to key people individually about their future roles in the merged entity. Secondly, the organization's best managers must be freed up to dedicate a large amount of their time to the integration program, either as integration manager or as leaders or members of the various integration teams.

While the rewards of investing time, money and emotion during the integration process may not always be apparent in accounting terms, they undoubtedly make a strong contribution to the success of any merger.

7. Keep your eyes on the ball

While the integration requires commitment and dedicated resources, the ongoing business must not be neglected either. After a merger, this job is complicated by two additional challenges. Internally, the integration program is likely to cause many changes, thus disrupting processes and distracting people. Externally, smart competitors will seize the opportunity to target the merging companies' customers and to lure away some of their key people.

Management must therefore protect existing processes by implementing a strict change approval process. New processes should only be cleared for implementation when they have been properly tested and a detailed changeover plan prepared. Similarly, measures to retain key clients and people should be prepared and implemented. Realistically, not all risks can be anticipated and eliminated. To identify unforeseen risks as they emerge, the new company should define early warning signals and implement a process to monitor these closely.

8. Capture synergies in the bottom line

Synergy expectations usually have a big impact on the valuation of the target. Cost synergies are easier to assess but often not sufficient to justify the price required to close the deal. Revenue or growth synergies, in particular from cross-selling, once added into the equation, often account for half or even more of total synergies.

Valuation results clearly set the expectations of shareholders regarding synergy realization and payback on the purchase price. An effective strategy for meeting expectations is to divide the total synergies expected into separate synergy areas and to secure the buy-in of those people who will eventually have to deliver them. There is a natural tendency to use synergy expectations to fill holes in the budget. To avoid this trap, the sum of the stand-alone mid-term plans of both companies must be taken as a baseline. Adding the synergies and integration costs will then produce the new mid-term plan of the merged entity.

Finally, detailed action plans, including timing and responsibilities, must be established to allow each synergy item to be monitored, even after the integration teams have been dissolved and line management takes responsibility for achieving the synergy targets.

9. Communicate!

Awareness of the importance of communication in the merger process has grown significantly, yet insufficient or flawed communication is frequently cited as one of the top five reasons why mergers fail.

Under pressure to meet the external communication requirements related to signing and closing, companies sometimes overlook the need to communicate with their management and employees first. Similarly, management tends to wait until a final decision has been made before making an announcement. If this takes some time, rumors emerge with potentially detrimental consequences. If management cannot communicate decisions, it should at least communicate information about the process and provide reassurance to people that they will be kept informed of developments.

Merger-related communication should leverage all available channels. Personal communication is the most effective of all channels, and road shows to all sites provide the perfect opportunity for top management to demonstrate their commitment and gain a first-hand impression of their employees' concerns and emotions. A dedicated merger site on the intranet, ideally incorporating some degree of interaction, is also an essential component of the communication mix. In addition, a weekly (e-mail) newsletter is an excellent vehicle for providing regular updates.

10. Address the cultural differences

The last of the ten disciplines of the merger decathlon ranks very high in terms of importance. In most cross-border mergers, cultural differences are likely to be very significant, but they are also a feature of national mergers. Differences in size, growth, technology orientation or degree of centralization are typical indicators for differences in corporate cultures.

While some cultural differences may be obvious, others can be subtle and difficult to detect. A systematic assessment of each merger partner's culture, using Arthur D. Little's Unwritten Rules Of the Game (UROG™) methodology, brings all cultural aspects to the surface and provides a basis for identifying the main differences. Eliminating all differences to establish a single unified culture is not a must, however. Tolerating or even encouraging unique regional or business unit cultures may be part of a company's strategy, but this should be the result of a conscious decision and all parts of the organization must share a common set of core values.

The integration program provides a good testing ground for cultural integration. The members of the Steering Committee, Program Office and Integration Teams are the first to work together closely. They can be used as a pilot group for assessing the significance of cultural differences and for testing various measures for harmonizing cultures.

Conclusion

Mastering the ten disciplines required to achieve a successful merger is possible, but it does require focus and commitment. From the creation of the M&A strategy to the last milestone of the integration program, a successful merger will require the input of many individuals from both organizations. But ultimately, it is top management that holds the key to success, by providing a vision and strategy, demonstrating leadership and personal commitment, setting the right priorities, investing the necessary resources – and by meticulously chasing results.

Case Studies

Casinos Austria and Österreichische Lotterien

Having gained a majority stake in Österreichische Lotterien (Austrian Lotteries) at the end of 2007, the Austria-based international casino operator, Casinos Austria, decided the time was right to expand the long-standing cooperation between the two organizations and pursue cost synergies, primarily at headquarters level. In early 2008, with the support of ADL, Casinos Austria launched a project named "Strong together!". The project was based on the clear strategy that the two companies as well as their six business units should continue to operate independently in their respective markets.

The joint management team, consisting of the Executive Boards of both companies, took critical decisions early in the project. Following a series of organization workshops, the team decided on the target structure for the Group. This would see the administrative and support units of both companies merged to form centralized Group Functions. Managers for some of the Group Functions had already been selected; the remaining ones were determined during the course of the project.

The main focus of the integration project was to set up and detail the Group Functions and, through this process, to identify opportunities to improve efficiency. Key people in each Group Function took part in workshops based on a detailed analysis of activities in both companies. The workshops aimed to find opportunities for reducing headcount, exploiting efficiencies of scale, harmonizing processes on the basis of "best of both", eliminating unnecessary activities and outsourcing. Potential savings of over 10% of the combined base were identified. The new Group Functions were put in place by the end of the project and physically located in one joint headquarter six months later.

A culture audit showed that, with few exceptions, the corporate cultures of the two organizations were very similar so that one-day "get-to-know-each-other" sessions were considered sufficient to achieve cultural integration. Project-related communication included a special "town hall meeting" for all employees as well as information of managers and the workers' council about interim and final results.

Throughout the project, the business units were largely unaffected and maintained their focus on the market and on day-to-day operations.

Post-merger integration of two university hospitals

In an initiative to reduce spending and consolidate highly specialized healthcare, Stockholm's regional government decided to integrate two university hospitals, Karolinska and Huddinge. Between them, the two institutions had a combined budget of over €1.1 billion and 15,000 employees.

Arthur D. Little was asked to manage the integration. The ADL team provided support to the management team throughout the process: our consultants led the program office and undertook both top-level and in-depth planning for the merger, which covered more than 100 clinics and support functions (e.g. finance, IT, HR, communications, logistics, administration).

To prevent any uncertainty regarding management and authority during the integration process, the ADL team ensured that a new management team was appointed at the outset. Similarly, an organizational structure for the merged hospitals was quickly put in place. Arthur D. Little consultants also established the starting point for each division in terms of combined budget, headcount, production and organization, and secured agreement on these figures and on targeted savings for each clinic and support function. As a result, the client avoided the pitfall of a moving starting point and moving targets.

To guide the integration process and realize targeted savings, Arthur D. Little prepared detailed templates for the merging entities. These templates helped ensure integration activity was aligned and also created a structure for following up and gaining feedback on integration performance. Our consultants also provided integration coaching to heads of clinics and support functions, and collaborated closely with the trade unions.

Effective communication was crucial to such a substantial merger, which affected a large number of employees, students and patients. Working with the client's communications specialists, ADL developed and executed a communication plan, incorporating a wide range of internal and external activities, including management workshops, auditorium presentations, intranet surveys and trade union meetings.

Within one year of ADL's appointment, the new organization and strategy for the merged hospitals were in place and the new entity had achieved its operational and financial targets, having maintained its patient focus throughout.

Discobolus Statue of Olympic Thrower

The Discobolus statue olympic discus thrower was made by Myron, one of the best sculptors of ancient Greece, who lived in Athens in the 5th century BC. The original Discobolus statue was never recovered, an exact copy of the statue however is placed at the entrance of the Panathinaikon Stadium in Athens, where the first modern Olympic Games were held in 1896 AD.

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