Post-Merger Integration

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Mats Larsson, September 10, 2018

Post-Merger Integration

Caveat emptor – Latin for let the buyer be aware

The historic evidence is quite clear, listed corporations' acquisitions on average destroy value for their shareholders. And companies that make large and infrequent acquisitions are especially efficient in transferring their hard earned wealth to the purchased company's shareholders. Basically, all the value of the generated synergies and then some - on average – accrue to the target.

Overpaying and…

Why is this and what do the companies that after all get it right do? As we see it there are two problems. The first is overpaying. Caught up by the intense drama and tension of making an acquisition the process could become too focused on closing the deal, clouding clear thinking about realistic synergies and the value of the target. Just like at an open outcry antiques auction, the logic of the process if foremost to close a deal - preferably at the highest possible price as it generates the highest fees for the auctioneers. Pricing is however not the topic of this text.

…no synergies due to poor execution

The second problem is that expected synergies too often fail to materialize. Our own rule of thumb is that the cost synergies that companies announce should be discounted by about a quarter and revenue synergies should be discounted by three quarters. Partly this is due to overly lofty expectations of the synergies to be had and of the state of the acquired company – the grass is always greener in the other company syndrome. Partly it is a matter of poor execution of the post-merger integration process. This is also why infrequent acquirers fare more poorly with M&A; they are simply not as well trained for the job as the serial acquirer with his bolt-on strategy.

PMI – Post-merger integration

The topic of this text is post-merger integration (PMI). In the report we try to cover parts of the answer to the above question of what those that get it right do. Most of the shareholder value creation in companies is painstakingly slow. Strategic choices are executed in small

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increments over years in everyday environments; investments are made to pay off over long horizons etc. M&A is totally different. In one instant glorious moment huge shareholder value can be either created or destroyed. It is therefore vital to get everything right and PMI is an important part of this.

Understanding corporate practices

The previous texts in *Those Other Pages* have targeted a number of topics directly related to investment practices; selection strategies for portfolio holdings, valuation multiples, investment check lists and accounting warning flags. This time we instead write about corporate practices. However, understanding what companies do is surely core to the fundamental investor so we feel that the detour is warranted. We'll probably present a mix of the two perspectives in future *Those Other Pages*. This text draws on the work of Boston Consulting Group, Baker & McKenzie, Bain and McKinsey as well as published literature on the topic and discussions with corporate managers.

If you could go back in time, what would you do differently?

Picture 7.1. Call for Dr. Who?

Source: cartoonstock.som

Focus on shareholder value

All activity in a corporation should be dedicated at creating long-term shareholder value, mainly through creating customer value. Due to the wide spread of possible negative or positive outcomes in M&A it is even more important to keep the pursuit of value creation highest on the agenda. It is not only the management execution that matters but also the environment. The success ratio of M&A will be higher in fragmented industries in early phases of consolidation – especially when there exist scale economies or the consolidation can give pricing power.

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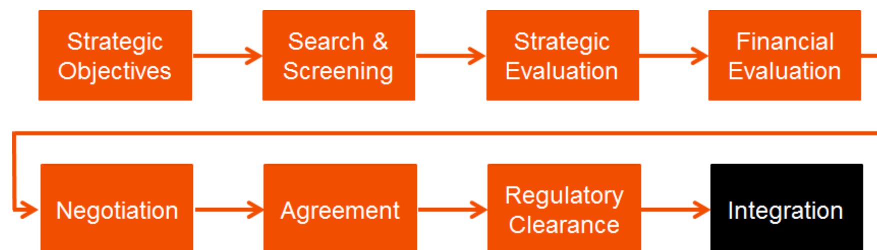
To do this the management in the acquiring company must have a clear investment case for every acquisition they make. "How will this specific acquisition create long-term value for our shareholders?" Acquirers should have a strong sense of the main cost savings and growth opportunities well before they ink a deal. Further, without a clear investment case the company will not know how to structure and focus the post-merger integration process.

Have a clear investment case for acquisitions

The conventional view of acquisitions focuses on the deal making and ends with the integration as a black box. In reality the processes are highly integrated. The integration depends on what is being acquired and what the plan is to achieve by the purchase. The integration is what will deliver the results that the deal looked to accomplish.

Plan for the integration from start

Picture 7.2. Conventional View of Acquisitions



Source: Haspeslagh, Philippe C. & Jemison, David B. - Managing Acquisitions (1991)

So called "strategic deals" where an acquisition in isolation isn't value enhancing due to a high price or poor fundamentals of the target, but creates a platform for further actions which in total create value could in theory be in the shareholders' best interest. However, given that most acquisitions fail to create value, to further raise the bar by starting with initial and intentional value destruction will lower the prospects even further.

Wise to worsen the odds by purpose?

Deals done for defensive reasons, i.e. to protect from value destruction instead of having the intent of building long-term shareholder value could also in theory be okay. However, as we will never know the outcome and extent of the potential value destruction if the acquisition hadn't been made, investors should be quite skeptical – what is management protecting, the shareholder value or themselves?

Merger integration are among the most complex projects corporate managers will oversee and especially if acquisitions are only made infrequently it will be of great benefit for the CEO if some of the board members have previous PMI experiences. Now, let's start with the planning phase. And it's not the planning of the acquisition in itself but the planning of the integration of the two businesses.

Practice makes perfect

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Part One – The Planning

"*Chance favors the prepared mind*." — Louis Pasteur

Type of Acquisition, Goals and Method

Take a step back and plan ahead

To a large extent it is the strategic, tactical and practical choices made prior to the deal is closed that determine whether the integration will succeed or not. The general advice is therefore to think and plan as far ahead as is possible at every stage.

Think large but don't be overoptimistic

The concept of revenue synergies has a bad name since so few realize what they aim for. Companies are almost reluctant to discuss anything else than cost synergies with investors. Yet, it's still important to understand and think about both combinational cost based synergies and the transformational and potentially revenue enhancing effects. The ways to create value with an asset is perhaps not only through rationalizations and with the big numbers at stake it would be a waste not to think very hard about the issue.

McKinsey have identified six deal types that all require different integration processes and that have prospects for very different value creation:

Deal types

- Improve target company performance
- Consolidate to remove excess industry capacity
- Create market access for products
- Acquire capabilities or technologies quickly
- Pick and develop winners early
- Transform both buyer and target

1. Improve target company performance. The idea is that the acquirer has some kind of capabilities that the target lacks but could benefit from. The process becomes one of transferring these capabilities. Drivers for synergies will be leveraging best practices, reduce R&D overlap, eliminate excess capacity and economics of scale, cross-selling, entry into new channels etc.
2. Consolidate to remove excess industry capacity. This is more of a pure cost synergy project. The focus will be on prioritizing which capabilities to keep, on gaining scale economies and cutting overhead. Key value drivers are streamlining, better utilization of assets and removing overlaps.
3. Create market access for products. Here one company with competitive products or capabilities (the buyer or the target) can benefit from one company with established access to a market or geography. Value is delivered through entry into new markets or new sales channels, through cross-selling and filling in "white spaces" plus by transfer of best practices in sales and marketing.
4. Acquire capabilities or technologies quickly. The acquirer gains quick access to technologies through M&A instead through slower internal development. The key driver is to increase overall effectiveness with the added technology or capability such as a R&D pipeline, a sales force etc.

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5. Pick and develop winners early. The acquirer acts like a venture investors and helps the targets to succeed. The acquirer can add value as he supplies resources for development or provides access to customers and markets.

But there are other types!

6. Transform both buyer and target. A deal that transforms the new combined company into a superior competitor. The value is created by combining and transforming parts of the operations to form a combined merged company better equipped to compete in the business environment.

The PMI project must mirror the type

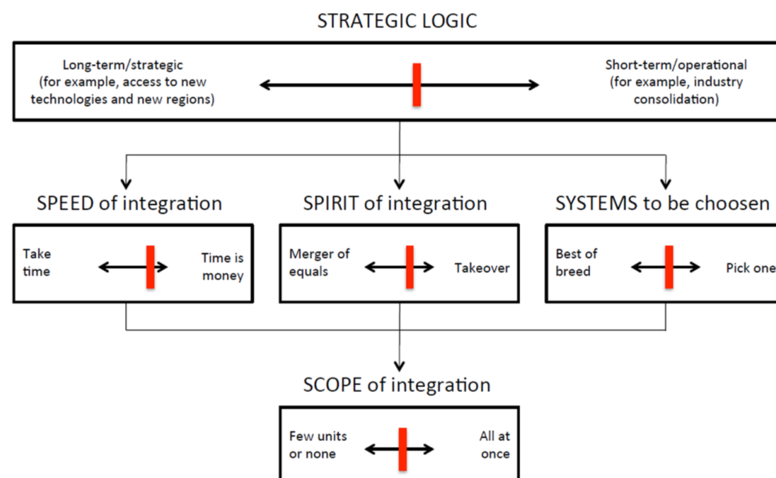
There are clearly other types of acquisitions and strategic logics for a deal but on a broad scale most can be divided between those centered on long-term revenue opportunists and those focusing on cost and capital efficiency. As is evident from the list above the types of value drivers are different and naturally then the shape of the integration project will differ. For successful organizational integration there are further a number of decisions the acquirer will have to ponder and then make as they affect the mode and ultimately the success of the PMI that is supposed to deliver on the strategic logic.

The strategic logic is as such an integral part of the investment case of an acquisition while the other factors in the picture below from BCG are vital for the planning of the execution of the integration project. So, is the best way forward a fast integration or a slow one? Is the spirit of the integration a merger of equals or a takeover? Should the systems chosen be best of breed or should the target use the acquirer's technology? Will the scope of the integration simply involve a few units or the entire companies?

The 5 S's of PMI

- Strategic Logic
- Speed of Integration
- Spirit of Integration
- System to be Chosen
- Scope of Integration

Picture 7.3. The Five S's of Post-Merger Integration



Source: Boston Consulting Group Analysis

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Combine the five above factors differently and the integration projects will look very different. In case of clear overlaps between the two merging companies the process should be speedier than if there are none. A consolidation merger has to have an aggressive timeline as it is probably not healthy that two units now working in the same company compete and also since employees are only open for change during a certain limited period. Cost synergies should be delivered during the first 12 to 24 months or they will probably not materialize. Also, a smaller target can naturally be integrated faster than a larger one.

Or less integration?

A gradual integration is more fitting when the acquirer mainly tries to retain and nurture the talent, know-how, innovation etc. in the target. Growth acquisitions require a more arms lengths approach and instead of functional integration it might be sufficient to make the acquired company use the same financial systems and perhaps merge ERP-systems over time. All integration should be planned with set goals, milestones and advances should be communicated, but with growth acquisitions the KPIs will often have to be less numeric than when it comes to cost synergy projects.

The integration plan

Successfully merging two organizations requires careful planning. The plan will potentially address aspects that often can be determined before the deal like who will be CEO? What will be the company name? What is the strategic intent of the acquisition? But mainly the merging will be down to a project plan for the execution of the PMI over a period of time – an integration plan.

An integration project team

As such successful PMI is to a large extent a matter of first class project management. Those who fail at PMI don't plan and execute an end-to-end integration process well enough, they don't put the right leadership in place or they are unwilling to dedicate enough resources to succeed. It is generally a mistake to try to execute the integration through the existing normal management practices and processes as PMI is management of a project with a finite life and with a very compressed time horizon that requires a dedicated PMI project team.

General Project Management

- Define
- Plan
- Manage
- Communicate

Key elements of project management in general are often labelled as 1) Define – establish clear and achievable objectives, 2) Plan – detail the specifics, 3) Manage – keep the schedule, don't overspend resources and deliver on the targeted outcome and 4) Communicate – keep stakeholders informed. Time, quality and cost are often named as "the triple constraints". Naturally all want the outcome to overdeliver on targets such as synergies or market shares, at a low project cost, as soon as possible. Often however these targets are in conflict. Speed can impede the quality of work, fast delivery can require more

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resources but more resources will increase cost etc.

The Integration Team and Its Processes

A PMI project involves people in several different roles: 1) the "client" is the executive management of the acquiring company or possibly of the both companies in the case of a merger of equals. Usually a steering committee with select senior managers is set up to oversee the integration work and act as the key decision-making body. Depending on the size of the deal either the CEO or a functional manager should head up the steering committee. 2) the project manager who is to lead the work, keep the project on track and deliver the project outcome.

Roles in a PMI project

- The Steering Committee
- The Project Manager
- Project Team Members
- Line Team Members

3) there will be further project team members with specific expertise in various relevant areas such as law, finance, HR or communication and 4) finally, there will be members of underlying line teams where most of the implementation will happen. The members of the line teams are the interface with the organization and they don't only execute but also analyze, develop options and recommend courses of actions. In really large integration processes a full project management office is set up for the effort. This office is sometimes named the integration management office (IMO).

IMO – Integration Management Office

The key role is clearly the project manager and the wish list for his skills includes leadership, communication, time management, problem solving and conflict resolution. He should know when to delegate and how to closely monitor the project progress. Softer skills like team building, motivating personnel, trust building, understanding of organizational compatibility, negotiation and conflict resolution will have to be used in parallel with hard skills like analysis, forecasting, scheduling, tracking and holding people accountable. Apart from developing the plan for the integration, managing the process with its transitions and problems the project manager must also manage the relationship with the steering committee. The integration manager should become involved in the project as early as possible and it is vital for the success that he receives the full support from the CEO.

Both soft and hard skills required

The role of the project manager shouldn't be delegated too far down in the organizational hierarchy as he will have to deal with the leaders of the entire organization and in many cases will take on the role as the CEO's proxy in many meetings over the course of the PMI-process. He will play a key role in shaping the integration process and the realization of synergies. It is a position that requires a person who knows the acquirer's organization, culture and systems. An experienced and proven general manager is often a safe bet. On the

Old and trusted or up and coming?

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other hand the project can be a vehicle to test the up and coming leadership ranks in the company, but in this case there must be evidence of well-developed general managerial potential as the work will be highly cross-functional. The temporary nature of the task and the many changes that will happen during a PMI-project makes the role as integration manager a bit uncertain. Ideally the integration manager should know his position after the project unfolds.

Temporary or permanent resources

Most companies have limited permanent merger integration resources standing by and instead choose to boost the resources at the time of an actual merger. It has the advantage of underlining the urgency of the process during the limited time period. On the other hand those on the project team will not be experts on PMI and even if they have done some similar work before there is a risk that the specifics of the previous project is seen as more generalizable then they actually are. By building permanent PMI capabilities a company can learn from other companies' experiences and build up specific PMI toolkits, perhaps summed up in a handbook together with learning from past M&A experiences. The risk with the latter practice is that it becomes too theoretical and that the PMI staff becomes too removed from the acquirer's culture and the organization doing the day-to-day work. Some middle road approach is probably advisable.

The PMI project could be seen as a process with four phases:

Phases of PMI Project

- Initiating
- Planning
- Executing
- Closing

1. Initiating – This is where goals and objectives are formulated, where scope and boundaries are determined. The initiation not only defines the desired outcomes with the major project deliverables but also the time frames and the resources. The steering committee will drive this phase and it should also establish a schedule for the communication between the project group and the committee. It is paramount that the objectives are crystal clear upfront. Lack of agreement of priorities is a major source of later conflict. Lack of agreement over the budget to achieve the objectives is the same. It is probably wise to document how the project is defined and have everybody sign off on it. What is to be done? How will it be done? Why will it be done?
2. Planning – Deciding on the specifics of what needs to be done, how it should be done, by whom, when and in what order, where and at what cost using which resources. This phase identifies all the tasks that will need to be accomplished to complete the project. It breaks down the project into pieces with subsidiary plans for practical execution by the line managers and assigns responsibilities plus deadlines. Two key components of the planning of the project are to establish milestones to provide an

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indicator of the progress and to decide on a communication strategy. Milestones should be binary – "is it done? (Y or N)". The trick is to set small enough milestones to give visibility of the progress. The planning often makes use of tools like a responsibility matrix and Gantt charts.

Keep milestones binary

3. Executing – Here it's up to the project management to do what is the plan, monitor the progress and update and revise the plan as needed. Much of the work will be done through team groups involving employees from both the merging companies.
4. Closing – It's important to close the project, agree on what the project has delivered, try to note lessons learnt for a more effective PMI the next time, release resources and signal that the "emergency state" of a merger integration is over.

Timing and "day 1"

The initiation of the PMI project is generally done at the time of the signing of the acquisition agreement, the integration planning will start with the regulatory approval and run until the deal closes, "day 1", when execution begins. Most integration projects will close within 2 years. Naturally there will be overlaps of the phases and planning is not always fully finalized at day 1. As noted above, the further ahead it is possible to plan, the better.

Picture 7.4. 50 to 70% of all Acquisition Destroy Value*

A turf war could kill any integration process

*Source: bhcorpoaratefinance.co.uk, * Source: McKinsey and Boston Consulting Group*

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The goals of PMI-projects are generally first and foremost to protect the day-to-day core business of the organizations involved and the second to capture – in McKinsey's lingo – traditional combinational synergies plus seeking select transformational synergies. Combinational synergies are mainly cost synergies while transformational synergies come from "unlocking one or more long-standing constraints on a business". As in any corporate venture value can be created by higher revenues, more efficient use of capital and costs and through reinforcement of competitive advantages that increase their duration.

Aim of PMI Projects

1. Protect core business
2. Capture synergies

The planning may require additional data and analysis before decisions can be made. Further, the original plan will never be fully followed but instead it will be adjusted over time. The real benefit of the plan is to gain a roadmap of what needs to be done to work from and communicate around. Potential problems can be identified and ways to address them thought of. The sequence of events becomes clearer where some things can be done in parallel but others cannot. Priorities and trade-offs can be discussed and decided on.

"*If you are failing to prepare, you are preparing to fail.*" /Benjamin Franklin

It will be the project manager that prepares the plan but it must be done in cooperation with functional managers as they know their businesses and it must also be signed off by the steering committee in an iterative top-down, bottom-up approach. It is critical to determine resources needed, effort levels and costs and to get everybody at all levels to agree on these.

Get everybody to sign off

For a truly successful PMI it is probably even paramount that the original plan will not be followed literally as new insights and opportunities will reveal themselves during the execution phase. It might even be worth the effort to make a larger revision half way to see if the definition and goals of the project should be adjusted. There may be more synergies than originally expected? Can the targets and aspirations be stretched further?

Be flexible

To sum up, according to BCG the project management team has five core missions: 1) plan and prioritize initiatives, 2) roll out synergy identification and implementation process, 3) coordinate across PMI initiatives, 4) facilitate communication and 5) identify and resolve issues. The many projects and sub-projects will have to be handled in parallel making the PMI experience very intense.

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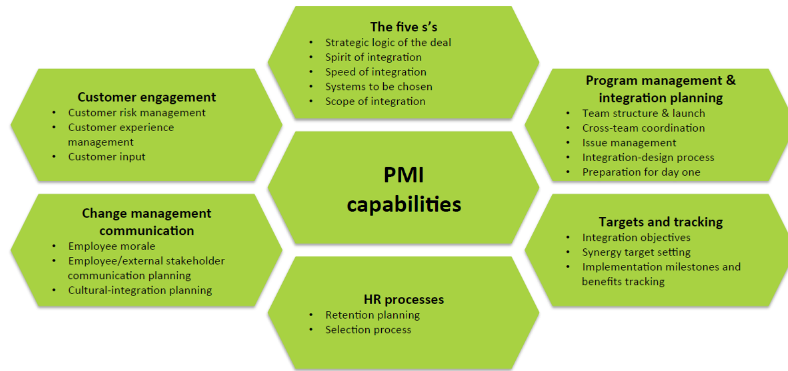
Picture 7.5. The Project Team Has a Full Plate

Core Missions of Project Team

- Plan and prioritize initiatives
- Synergy identification and implementation process
- Coordinate across initiatives
- Communicate
- Identify and resolve issues



Source: Boston Consulting Group Analysis

In many integration processes speed is as noted above vitally important and the full extent of value creation opportunities cannot really be quantified from the outside. It is then a problem that the detailed planning legally cannot start before the regulatory approval. Competitors cannot share sensitive information without risking breaking the cartel prohibitions. Hence, it would be beneficial to start the work earlier than what the law allows.

A consulting cliché: "Hit the ground running"…

The solution often used is to establish a so-called "clean team", i.e. a group placed in a safe zone, with clearly defined rules and safeguards that ensure regulatory compliance during joint planning. The members must be carved-out of their respective organizations, meetings held at a physically and electronically separate location – a "clean room" and the work would have to be documented and supervised by antitrust lawyers. Everything that goes into the clean room stays there until the transaction is approved. The only reporting back to the executive management of the acquirer that is allowed is a checklist where issues are ticked off but without any conclusions.

…by a clean team

The early joint planning with privileged access to both parties data can identify challenges that had not surfaced in the due diligence, explore further value creation opportunities not visible from the outside and aid understanding of each company's culture and processes. The clean team's work allows for early identification of talent in both organizations, it can through their preliminary work potentially make sure that the planning will be finalized at day 1 and it can lower uncertainty among staff by identifying quick customer wins soon after the deal's closure to kick-start the momentum of the new combined company. Without full access to line managers the clean team can never do more than give the PMI integration project a head start. The finalized plans must be decided later.

Early preliminary planning giving a head start

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Although it could seem logical for an acquirer to assign the same internal managers that will later make up the PMI project group to the clean team this could be complicated. If the deal doesn't go through the managers who have been exposed to their competitor's data cannot go back to their old positions. The best solution is often to staff the clean team with retired company executives with deep industry and company knowledge and then add one or two external persons (dare we say consultants?!) with analytical and financial modeling skills.

Senior pastimes instead of feeding the doves?

Part Two – The Execution

"*Vision without action is a daydream. Action with without vision is a nightmare*." — Japanese proverb

PMI is not complicated in theory and most executives are aware how to integrate properly. With the alluring prize of a pot of synergies at the end of the rainbow they generally devote sufficient resources and management attention to the process. Yet during the stress and strain of the complex and lengthy process the ability of the organization to "lock in" in the execution of all the multifaceted issues too often falters. The corporate management, the project team and the functional integration teams must have the passion and grit to follow through on the execution of the integration.

Have the grit to follow through

Protecting the Base Business

One of the main risks of a PMI process is the merger dip, i.e. that the organization turns its focus to internal issues and loose its focus on customers. If first priority is to protect the day-to-day core business during the PMI project then little matters more than to informing and reassuring stakeholders that they will benefit from the change – or at least that it is business as usual. The key stakeholders are critical suppliers, important customers and key employees. In some instances any one of these might even be so important that they practically can veto the merger and then they will have to be briefed prior to the official announcement. Naturally, in some businesses there will be other key stakeholders like regulators or joint venture partners etc. The handling of all these stakeholder groups will usually be set up as sub-projects in the PMI process.

Keep all key stakeholders happy

In some cases a merger can result in that revenues drop as skeptical customers react defensively. The sales force and the customer support staff is the primary interface with the customers. It is important that they act as ambassadors of the merger at the same time as there might be restructuring of the sales force organization to fit the new geographies, product range and budget. The CEO should personally visit the major customers to discuss the merger as soon as possible to

Manage the customer interface…

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remove any uncertainty and the risk of customers starting to investigate alternative sources of supply. The CEO roadshow will naturally also need to include the key suppliers. Further, the project team must early identify essential sales reps, support people etc. and they (or representatives from the executive management) should assure them of their importance for the new organization.

Picture 7.6. Avoid the Merger Dip

…or lose business

Source: epromolux.askzak.com

Information about the integration process should be shared both with the internal sales force but also with customers. It is standard PMI process advice to "overcommunicate", but even tired platitudes can be true. In the absence of information employees, suppliers and customers will speculate and the pictures painted will generally reflect their worries rather than actual facts. Communicating openly and involving customers in the process makes them feel that their needs and opinions are valued and makes them captive to the success of the process. Customers might even supply vital inputs of which choices that should be made in the PMI making them even more important to the process.

Overcommunicate

Further, without the need to speculate about the future of the organization, about compensation, who gets which accounts etc. the sales reps can refocus on selling (and cross-selling the new products, potentially lifting their productivity) otherwise their attention will wane. An early commercial win will do wonders for the internal confidence in the merger. Try to get the executive team to give an extra push to close an early important deal.

Early wins to boost moral

At the same time a merger creates a chance to take a critical look at the customer and product portfolio and take decisions on who/what merits new investments and who/what that should be treated as run-

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offs or simply eliminated. To a large extent, important and working personal relationships between key account managers and clients should be kept but the most profitable or promising accounts should probably on the other hand be allocated to the most skilled sales personnel. A balance will have to be struck. Customers that aren't sufficiently profitable should be approached – discussing terms and conditions, pricing and anything else that affects account profitability.

A chance to review

Managing Human Resources

To employees a merger is in essence about change and as such a personal and emotional experience rather than something focused on the corporate rationale behind an acquisition. Also, synergies often equal staff reductions and reorganizations. Questions about how the change will affect the status and security of the employee's position and if this is still a company he would prefer to work for will surface almost immediately. Headhunters will quickly zoom in on the most promising star employees to snatch. In many types of deals – say when a larger company acquires a small technology company – the personnel in the target company is the value in the deal.

Employee status and security

Thus, how these human resource issues will be handled can easily make or break an integration process. Very early, and long before any formal appointments, the project group and top management will have to identify and assure the best people of both the acquirer and the target that they are important to the future of the merged company. Members of the executive management will quickly have to go through a series of meetings with key employees, so the identification of these and an idea of what prospects that can be promised them must be ready at day one or soon thereafter.

Assure the key talent that you value them

In a consolidation merger, where painful employee cuts generally have to be made, they should be done as early as possible since any prolonged uncertainty will result in an exodus of the best employees who will have an easier time finding employment elsewhere. During the cuts it is important to show positive progress regarding for example growth synergies or commercial wins to focus the staff on the future prospects rather than the painful present.

Handle painful stuff early

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Picture 7.7. Post-Merger Employee Stress

Source: andertoons.com

Rumors will fill any void

Again, communication will be paramount in uniting the personnel behind the idea of the merger – and after all, the employees are the ones that in the end will have to pull it all off. Any radio silence from the company will be filled with rumors and misinformation that tend to spread and stick. Also, what isn't said carries a message that employees try to interpret. It is customary to kick off the communication with the staff through a number of large-scale presentations and webcasts describing the rational, goals and process of the merger.

Presentations but then talk face-to-face

These very general presentations cannot answer the more personal questions of most employees. Here informal, face-to-face dialogue is more powerful. One of the main tasks of the project management group will be to make sure that there is a process and organization for periodic information consistent with the merger's goals to trickle down through the ranks. They will have to supply briefing packages, background material to the headline messages and host communication prep sessions. Most companies also try to send an electronic letter periodically to inform employees of the progress of the integration process. The possibility to anonymously pose questions to the IMO should also be a appreciated tool.

Monitor moral and confidence

Another important task of the project management group will be to regularly monitor the moral and employee confidence in the merger. Doubts and concerns will inevitably pop up now and then and it is important to be on top of what they relate to and where they surface to be able to address them. Surveys are useful tools as well as discussions with opinion leaders and networkers in the organization. According to BCG the key employee concerns over the potential

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barriers to the success of PMI six months into a project is in order: unclear responsibilities/accountabilities, different corporate cultures, internal competition, lack of understanding of the strategic vision with the merger and ambitious savings targets.

Emotional phases

In the book Mergers & Acquisitions by E&Y (1994) a number of emotional phases are discussed. In the phase one uninformed optimism rein as people are excited about the new venture and the complexities of the integration haven't come up yet. In the second phase there is informed pessimism as all the issues and disruptions have surfaced and a lack of information often results in rumors. Although employees are generally cooperative at the beginning, goodwill now quickly erodes. This is the time for the IMO to be vigilant. Without timely execution of a systematic plan with plenty of communication pessimism threatens to establish itself as long lasting. Well executed at a high tempo the process will overcome the disruptions and disputes, rumors will fade and this gives way to a fourth phase of informed optimism as long-term benefits start to be possible to visualize.

A window of opportunity

An integration project isn't just about human resource risk management however. At the same time as key employee retention is a focus, managing the projects where employees merge into newly formed organizational units is also very much a part of the synergy generation process. During PMI there is not only an acceptance for change among staff that is hard to find otherwise but there is often also resources set aside to fund changes. As such PMI is a golden chance to fix long-standing problems in the acquirer's own organization. As Sir Adrian Cadbury expressed it: "A merger provides a window of opportunity when change is expected and accepted. Push everything through that window that you can." Some employees will embrace it – as long as they feel that their jobs are secure.

Managerial appointments

One of the most important changes during a merger will be appointment of managers as this sends powerful signals about the future of the company down the hierarchy. Only appointing well-known cost cutters will send one message and to only pick persons from the acquirer will send another. The merger is an opportunity to audit the capabilities of both companies' managers and do adjustments while change is accepted. At the same time prolonged periods of uncertainty must be avoided to prevent employees from second guessing the outcome. The best is to early clarify the timetable and selection criteria for the top three to four hierarchical layers as soon as possible. This might buy some time to perform the audit.

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The process in itself should be relatively swift. Once the senior team is in place it should only take a few weeks to nominate the next layer and so on.

Be fair and…

It might seem obvious but it is important that the appointments of managers and the process around them are seen as fair. Although time-consuming interviews should be held with all contenders for positions and the criteria for who's to be chosen for the posts should be clearly spelled out. For similar signaling reasons the acquirer should also early on decide on appropriate systems, criteria and KPIs for recruitment, incentives and future promotions.

… make them see the light

The process of integrating the employees into newly formed units must very soon move from a focus on putting the basics of the operations in place and ensuring staff of their safety to instilling a new sense of purpose and belonging with the changed organization. For those acquirers who haven't upfront formulated the investment case and the strategic intent with their deal this will pose a problem.

Cultural Integration

Corporate Culture – long-standing, largely implicit shared values, beliefs and assumptions that influence behavior, attitudes and meaning in a company

The above top concern of employees apart from the immediate question of unclear responsibilities ("what will my job be and who will be my boss?"), was differences in corporate cultures. It's almost a cliché among corporate executives that mergers fail due to culture clashes – and yet that is exactly what they continue to do. Companies generally hold a number of integration workshops to make the organization into a merged unit by discussing how high level goals should be implemented on lower levels, but too few companies engage as systematically and aggressively with the vague cultural issues (as they do when it comes to realizing synergies). Especially in service companies that increasingly dominate economies this can prove fatal as the key assets can start walking out the door.

Corporate cultures are more different than the managers think

Cultural differences are the default even for companies in the same industries and the corporate culture is often stronger than the country culture. Hence, for a PMI process to succeed in capturing the value of the deal and retain talent the cultural differences must be understood and addressed. In a survey by McKinsey 70% of the respondents at a PMI conference answered "Too little" to the question "In your experience, how much effort is typically focused on culture during integrations?" and 92% agreed that the mergers they had experience of would have benefited from better cultural understanding prior to the merger.

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The cultural implications of a merger integration process will vary depending both on the degree of cultural differences and the targeted degree of integration. In some acquisitions the employees of the acquirer will hardly notice the existence of those in the target and vice versa. In some acquisitions there will be a full merger of all levels from the board of directors to the front line of the sales department. Both approaches can be the rational way for the acquirer to benefit from the deal depending on the type of acquisition he has made.

Less integration, less worry

If the targeted degree of integration is low and the differences are small this probably means a cultural status quo. When the integration need is small while the cultural differences are large it will mainly be the management of the units that meet and it is then up to them to respect the way of the other party. The situation when cultural differences are small and the degree of targeted integration is high should allow for relatively simple employee absorption. The really tricky situation is when two very different cultures are still required to integrate to a high degree. This will require a very cumbersome cultural socialization of the target's staff. If the merger is the result of a contested hostile takeover of a company that values the preservation of their culture rather than the opposite the mission of a full integration will be even more daunting.

Integration of the unwilling will be hard

Picture 7.8. An early Indicator?

International mergers add to the culture differences

Source: businesscartoonshop.com

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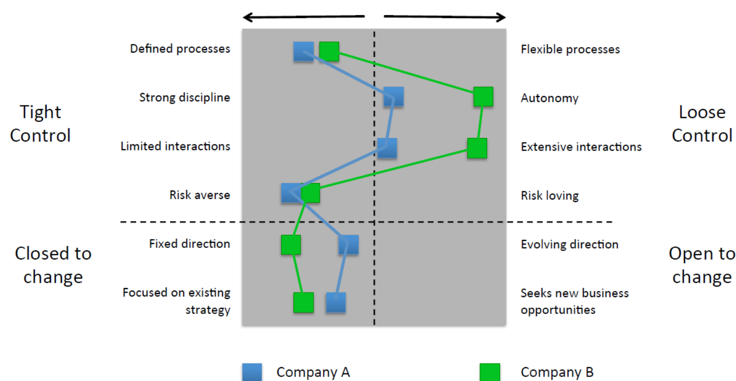
Try to quantify…

To try to systemize the concept of corporate culture BCG have created a diagnostic tool (see picture below) that tries to identify and quantify the critical aspects of the culture of both the acquirer and the target and how they practically manifest themselves in behaviors, processes, systems, choices of financial metrics, management practices, remuneration and promotion criteria etc. – that is "the way we do things around here". For example, to avoid future conflict companies should address questions like: How are decisions made in the target organization and in ours? How does the target company conduct meetings and how do we? How does the target company communicate with its employees and how do we?

…and address

Picture 7.9. Mapping of Corporate Culture Differences



Source: Boston Consulting Group Analysis

Cultural audit

BCG recommends that companies do a cultural audit as early as possible, preferably a preliminary one interviewing top management and using public sources already during the due diligence phase and then broader and deeper employee surveys early in the integration process, breaking down the companies into divisions, geographies etc. The mapping gives the organizations an important language and framework to discuss the otherwise intangible cultural factors during an integration process. In some cases the preliminary audit might even cause deals to be cancelled as the cultural differences are deemed impossible to bridge.

Integration of migration?

The management of the acquiring company must decide on what the desired culture is. Sometimes it is preferred that the two different cultures are kept but most often the acquirer's culture will be imposed on the acquired company. However, the merger process potentially also offers an opportunity to migrate to the target company's culture – or at least nudge the whole in one direction. This effort to find a "third way" can potentially be the most rewarding but requires a major commitment of management effort.

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The result of the culture audit and the targeted culture will be a key item of the integration workshops. The key cultural differences must be addressed early and with frankness preferably in face-to-face group discussions. To address them it is important to drill down in order to understand the key obstacles to cultural alignment/change. Some items are probably non-negotiable from the buyer's perspective while others can be discussed and this should be made clear from early on. Clarity is crucial, as issues left to hopefully work out by themselves tend to linger and create conflict.

Start with the behaviors that reflect culture

Since a corporate culture is made up of a large number of interrelated factors it is usually too big a task to take on to make quick and radical changes. The practical way is instead to gradually start changing some key practices towards what is more fitting in the targeted culture. If rational justifications for the changes in behavior are clearly communicated this will, with a lag, start to nudge the culture in the targeted direction. It is vital that the overall message communicated around the merger is consistent with the culture change and that managers "walk the talk". Any discrepancies will quickly erode the will to change and moral will plummet. To further reinforce the pace of cultural transformation the firing and hiring of the new organization should clearly signal that it pays off to embrace the new behaviors.

Keep a watching eye

The progress of the journey towards the targeted culture should be measured and analyzed by the project manager using agreed on KPIs. The cultural alignment process might be the most important of the many projects that the integration team overseas and it would be a shame to have it fail due to poor tracking.

Execution of Synergy Capture

What it was all about

If the first priority in PMI is to protect the day-to-day base business by interacting with stakeholders like suppliers, customers and employees then the second priority is to capture the synergies and realize the investment case that were the rational for the deal to start with.

Combinational synergies and transformational synergies

The way to realize synergies differs depending on the type of acquisition and the type of synergies. When perusing combinational synergies the focus is on simplification, speed, hitting announced (often conservatively estimated) cost and capital usage synergy targets, securing scale benefits, optimizing inventory management and deploying best practices over the entire organization. When it comes to transformational synergies the time frames are longer, the target criteria are not as clear and success hinges on locating opportunities ("Now when we own this asset, what are all the ways we could create value with it?"), setting bold and inspiring goals and providing

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incentives for breakthrough performance.

The below picture from McKinsey depicts the targets of protecting the base business, capture combinational synergies and transformational opportunities, split up over the three interdependent value drivers of increasing revenues, improving capital efficiency and lowering costs. The green boxes tend to be the (official) deal focus in most acquisitions while McKinsey argues that this defensive stance is myopic and ignores the opportunities to radically transform functions, processes or business units thanks to the new combination of assets owned by the company. As consultants they would say that and they don't have to shoulder the bill of all the failed attempts to generate revenue synergies but they have a point that any routes to create a more efficient company or a company better equipped to compete in the market should at least be thoroughly investigated.

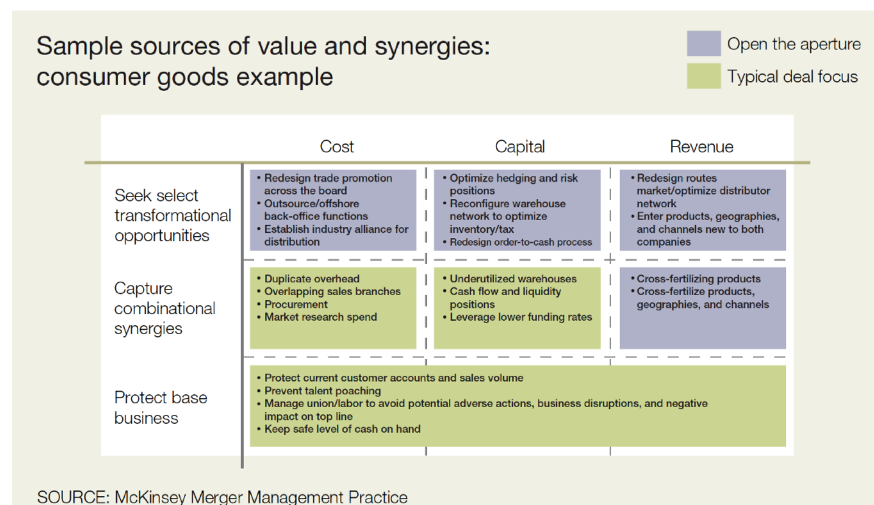
Value Drivers

- Increase Revenues
- Lowering Costs
- Lowering Investments…

…and increase competitive advantage…

…at the same time, phew!

Picture 7.10. Example of Value Creation Sources



Don't focus too narrowly on the green

The way to in practice capture the synergies of the merger will be an iterative process involving the steering committee/the executive management, the team members of the IMO and a large number of functional teams in the various business units. Already prior to the closing of the deal, management will have set up preliminary estimates of synergies that serve as the foundation of the externally communicated synergy targets. Depending on the amount of information that the acquirer has when the deal closes these targets will be more or less educated guesswork. The integration project manager will be responsible for outlaying a more detailed plan for opportunities to create value, assigning them to appropriate owners, setting targets and planning ways to execute on the targets and to track and steer the process.

The synergy realization process

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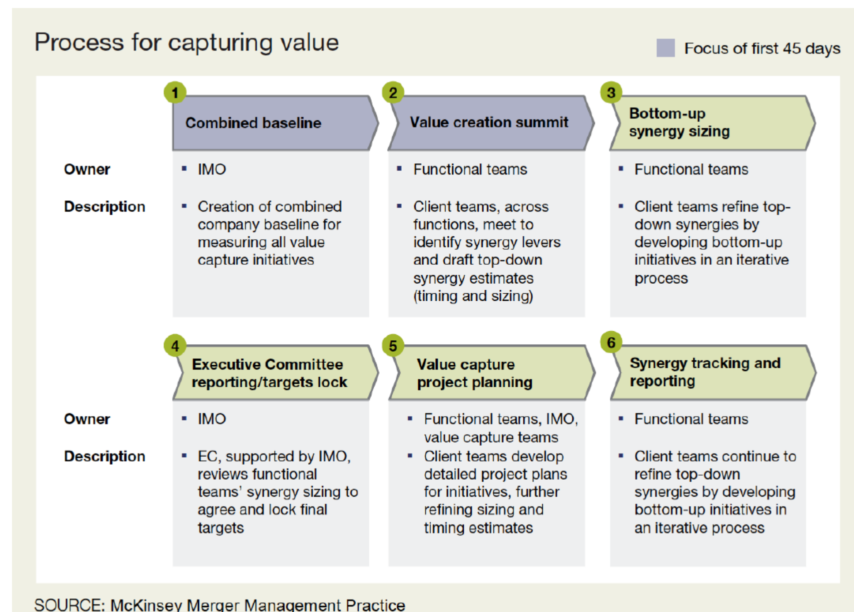
Value creation summit

The top-down planning usually meets reality for the first time during a value creation summit where functional teams meet to discuss the opportunities and levers for synergy generation. The summit brings together executive managers, the integration project team and the leaders and experts of the functional teams of both the acquirer and the target. The project manager leads the exercise and it is vital that he encourages people to have an open mind for the various ways to generate synergies. Sessions to be held during the summit generally circle around idea generation, sizing and prioritization and planning and timeline. The IMO provides templates for the functional teams to ensure consistent handling. The summit in the end generates a list of opportunities ranked after their relative size and a high-level implementation plan that specifies the timing of capturing the synergies and the milestones to be reached along the way.

Picture 7.11. Synergy Creation Process

An iterative process



Functional teams for realism

The many synergy projects are allocated to the functional teams so they can refine them further and give them detailed estimates and also specify key sources of the value creation with the benefit of looking at their own bottom-up financials. After this step the initial planning for synergies by management and the IMO will have morphed into a more detailed and realistic plan. This doesn't mean that the current state of the plan looks like the steering committee wants it to look when it circles back for review. After some more bottom-up, top-down iteration the steering committee will however decide to accept the plan and lock the targets stated in it.

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Execution

The focus now shifts from planning what synergies to capture and who will own all the sub-projects, to executing on how to do it within the set-up timeframes. The integration team plays a key role in overseeing the functional teams, aligning priorities, solving conflicts, handling cross-team dependency and timing issues and creating dashboards to monitor the progress making sure project ownership is honored and targets are being met. The project team and the steering committee will have periodic meetings to monitor the process and keep up the tempo.

Hang in there!

After the initial fear and excitement around the merger integration process are starting to settle in the organization, the demands of the day jobs of the members of the functional teams will start to compete more fiercely for their time and attention. It is now that it is important for the IMO to keep the pressure up with timely and systematic reviews of the progress to ensure the full value realization from the deal.

And much more

Depending on the specifics of the business there will be further sub-projects for the merger integration team to handle. We haven't discussed decisions on the product range much but they will have to be made, accounting systems will have to be merged, IT-security policies set, there is generally a need to make a number of legal transitions and to change legal documents after a company merges into another etc. etc.

A clean break

When the PMI project closes it is important to communicate this to the organization. Before the project resources are released the project group and the steering committee should try to agree on the project delivery and also note lessons learnt for a more effective future PMI.

Picture 7.12. The True Rationale for M&A?

The social manager

Source: janto.com

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Wrap Up

Go by the book but be flexible and you will be fine

We have tried to specify a well thought out and rational PMI process above. It is important to be clear on why the merger takes place in the first place, to develop a plan in sufficient detail early on, committing needed resources for the integration, taking tough decisions early and decisively, communicating effectively to all stakeholders during the project and implementing with discipline, keeping the rational for the deal clear even when the complexities of details and the weight of day-to-day tasks threaten momentum of the process.

If the planning in a thoughtful manner decides on the right amount of integration, if all the practical integration issues are executed with good speed and the deal takes place in an industry where consolidation has the potential to create value then the significant values can be created. If however, empires are built by large and infrequent acquisitions cheered by investment banks then the odds stacked are against the acquirer.

We end this text with two best practices lists for merger integration.

Picture 7.13. Best Practices for Post-Merger Integration

Focus on value creation	1. Anchor integration architecture and approach in deal rationale.	1. Have a clear investment case for every acquisition.
	2. Look beyond due diligence and open the aperture to exceed traditional synergies.	2. Plan very thoroughly and allocate sufficient project resources.
	3. Selectively transform parts of the business.	3. Focus even more on business-as-usual during the integration to avoid a "merger dip".
	4. Protect business momentum to avoid typical loss of revenue.	4. Make sure management is available to ensure quick decision-making.
Prepare well	5. Define a comprehensive, tailored integration approach and stick to it.	5. Keep up the tempo if it's an overlapping business that has been bought.
	6. Empower a value-added IMO that attracts top performers and line leaders.	6. Have the grit to follow through and see to that the project plan is executed upon.
	7. Don't underestimate culture; use a scientific approach to identify issues and intervene as needed.	7. Look for further synergies during the project.
	8. Build momentum by making critical decisions well before close and completing key activities within 100 days.	8. Handle issues like values, attitudes and professional respect between colleagues.
Execute rigorously	9. Don't make day one bigger than it needs to be.	
	10. Track activities and operating metrics in addition to traditional financial measures.	
	11. Overcommunicate, with messages tailored to every stakeholder group.	
	12. Build capabilities for future deals.	
	Source: McKinsey	Source: Sweco

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