DANNY A. DAVIS

M&A INTEGRATION

HOW TO DO IT

PLANNING AND DELIVERING M&A INTEGRATION FOR BUSINESS SUCCESS

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PREFACE

WHAT THE BOOK COVERS

In the world of mergers and acquisitions (M&A) much emphasis is put on the identification of targets and the closing of the deal. Integration and consolidation are issues that are often not addressed early enough, if at all.

Organizations put much effort into thinking strategically about what they will buy and why, but the thinking often doesn't flow through into the task of planning how the actual integration will take place. This phase is, however, critical to success. Figures show that 80% of mergers fail. The reasons for this are complex and varied, but failure to pay proper attention to the integration process is often a key factor.

Every business function within an organization is affected by a merger and each will need to think strategically about the implications for their work and the processes they will need to employ to drive the necessary changes forward successfully.

In this book I will take you through the deal process, integration planning (otherwise referred to as 100 day planning) and final delivery. The chapters include tools and checklists that will prove invaluable in delivering the changes and improvements you are planning.

Throughout the book I use the shorthand of "merger" for merger, acquisition, takeover or any sort of joining of entities – be they public, private or third sector. Government departments may refer to these as change or transformation programmes, but these improvement and efficiency drives are essentially all types of mergers which call for a structured approach to integration.

WHO THE BOOK IS FOR

All managers will go through some sort of integration during their career. Whether this is a merger or acquisition, an internal restructure is where we see business units being pulled apart (de-merged), moved around and then put together in a different order (integrated). Managers will also go through some sort of consolidation where there is overlap and duplication; in essence these projects or changes are very similar to the integration or restructuring we may see happening during a merger.

The approach and thinking are appropriate across corporate sectors, government and non-profit organizations.

HOW THE BOOK IS STRUCTURED

The book is split into two parts.

The first links strategically the pre-deal and post-deal activity. It looks at how to move from the strategy through to the realities of delivery, covering the drivers, governance and structure, as well as how to manage the integration. Some new and unique models and checklists are included, together with tools that can be used across the whole of the integration.

The key chapters look at:

- M&A overview
- Integration overview
- Planning for the integration
- Integration drivers
- Integration governance or structure
- Delivery – “integration management”

The second part of the book goes through each of the business functions, starting with high-level thinking and direction, then moving on to look at the strategic drivers of integration, with tools and checklists on how to deliver.

I look closely at the back office functions of Finance, IT, HR and Communications. These are always considered in all mergers, even if the decision is to do nothing. I then move on to look at the other functions, paying special attention to the linkage between them, which is an important factor within large complex integration programmes.

The second part of the book contains the following chapters:

- Finance
- Information technology (IT)

- Human resources (HR)
- Communications
- Sales and marketing
- Supply chain
- Head office consolidation
- Property
- Procurement
- Research and development (R&D)
- Legal
- HSSE (Health, Safety, Security, Environment)

ABOUT THE AUTHOR

Danny A. Davis is a guest speaker at a number of the world's top business schools on strategy and M&A and is a Programme Director at Henley Business School for M&A. He brings a unique background that combines experience as an international sportsman, sales and marketing in large corporations, a strategy consultant and involvement with integration for two decades. This background means he understands the theory but combines this with a proven ability to deliver M&A integration and large transformations in highly complex organizations.

Danny has worked on deals from small to large, with a 100 employee company taking over a 25 employee, through to \$6 bn and \$16 bn deals. His work includes one to two days with a client to set up the integration and mobilization workshops and 100 day plans, through to the planning and running of a \$6 bn deal across 30 countries over three years. He also helped manage one of the largest HR transformations on the planet, showing his level of people understanding.

Danny has just stepped down from being the youngest ever trustee (non-executive director) on the board of the Chartered Management Institute; he also chairs their Marketing and Policy Committee, and currently sits on the "Experts Panel".

He speaks at numerous conferences and recently chaired the M&A integration conference in Europe. He has written articles for Henley Business School, British Computer Society, CFO Europe, Developing HR Strategy, and had a three-page profile written on him by *CIMA* magazine for leaders.

He brings a blend of strategic theory, practical experience and real-life war stories that makes him unique in this field.

Danny A. Davis (MBA, BSc(Hons), DipM, MCIM, MCMI, Cmgr, Chartered Marketer) is a partner with DD Consulting, Henley Business School's Programme Director M&A and helps a large investment fund.

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INTRODUCTION

All organizations around the world will at some stage go through some sort of splitting apart (“de-merger” – which is integration done backwards) or integration (joining together of parts).

Charities and NGOs around the world are merging together. Government departments in most countries are undergoing some sort of change, improvement or efficiency. These are often called “change programmes” or “transformation programmes” but are all essentially types of mergers which involve integration.

Organizations go through restructuring to become more efficient or cut costs. These exercises often include consolidations, i.e. the coming together of process, departments or IT systems. These are all slightly simplified integrations and are all covered within this book.

Every merger that happens around the world needs some strategic integration and delivery thinking. You will learn how to integrate anything – a department, sales force, business unit, government department, charity, company or corporate. In doing so, you will learn how to restructure, consolidate, reduce costs, create efficiencies and perform mergers from small to mega mergers.

PART I

THE STRATEGIC DRIVERS

CHAPTER 1

M&A OVERVIEW

CHAPTER SUMMARY

This chapter looks at the different types of M&A and the drivers behind the decision to purchase. It discusses the factors that need to be taken into account in deciding how much to pay and highlights the importance of setting the criteria for success early on.

There is also an overview of the M&A deal process, which sets out the key stages. It is surprising how few people know and understand the overall deal process, but without this understanding they cannot plan or deliver. These sections provide a starting point for the topics, with more detail following in later chapters.

Later in the chapter, we discuss the importance of reflecting the overall business strategy in the integration plan and of ensuring that the learning derived from the process is not lost when the deal is closed.

WHAT TYPES OF M&A ARE THERE?

> *"First, have a clear organic growth strategy and a clear investment strategy, then buy where we need to augment growth."*

John Peace, Chairman, Experian

Organizations looking for growth can go down one of three paths – organic growth, joint venture (JV, or partnerships) and M&A. All companies should constantly be looking at all three. Organic growth must be the first and main area of priority. Businesses then need to look at the other two and move forward depending on their skill set, cash flow and aims. Many companies do all three. Some decide they don't want to do M&A now because they don’t have the funds or the skills/capability to move forward. Some decide M&A is the only way forward and that owning part of a company does not provide them with the control they need to move forward fast enough.

There are a number of different entities available to buy. In a mature marketplace one strategy is to consolidate the market by buying competitors. There will be a large overlap in what the two companies do, but this can be removed, reducing the overall cost base. These are what we refer to as the cost synergies.

Some companies are looking for geographic expansion – they are keen to enter into a growth sector or economy, like India, Brazil or Russia, for example. This type of purchase will bring the business new contacts, knowledge and skills and the aim will most probably be to keep everyone and everything. There may be very few cost synergies. The main aim of the merger is to invest, to cross-/up-sell and to reap “revenue synergies” thus creating more profit.

Other reasons for purchasing a business can include the desire to bring a new product or service under the company umbrella. The product may be complementary to the buying company’s range and can easily be sold to existing customers through established sales channels.

The need to continually keep ahead of the game is another common driver for acquisition. R&D is very costly, so an option is to let others in the market create the new technology then buy it at an early stage with a view to developing and exploiting the potential in-house.

The strategic reason for the purchase must be reflected in both the communication and integration process if the M&A is to be a success (Table 1.1).

Table 1.1 M&A strategy

M&A strategy	Integration thinking

M&A strategy	Integration thinking
Market overcapacity	Standardize processes – deliver cost synergies Understand cultures and move towards one Restructure
Geographic expansion	Roll out key processes and products across new regions
Product, service or market extension	Understand new product, service or market Deliver revenue synergies
Buying R&D	Move quickly to retain knowledge and people Create a new culture
Buying competence or technology	Move quickly to retain knowledge and people Incentivize people to stay Great communications during integration

Buying R&D or technological expertise, for example, may contain large amounts of cost and revenue synergies, though the aim is growth. The business is integrating for revenue and profit improvement.

A different reason for purchase calls for a different strategy and also a different way of approaching the integration. The process may be similar, but the activity, action and outcome will be very different in each case.

HOW MUCH SHOULD WE PAY?

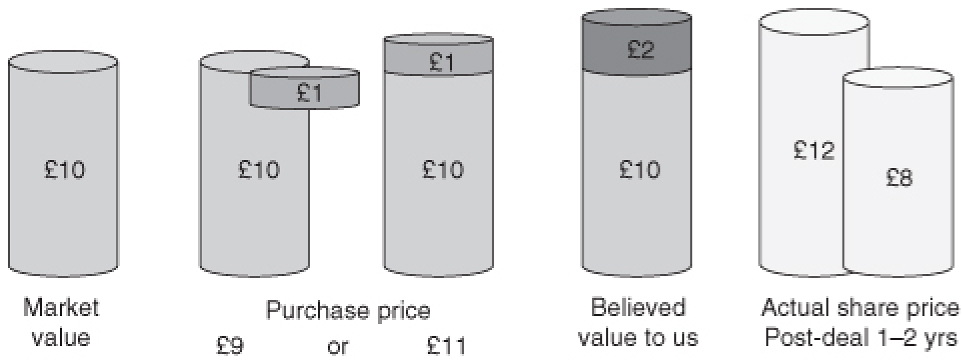
"Don't buy unless you're clear on why and on the return."

John Peace, Chairman, Experian

Companies acquire other companies so that they can bring in new technology, new skills, new products and new customers. Acquiring another business helps them consolidate their position in the market, increase revenue and ensure future stability. Getting the price right at the outset is critical if the M&A process is to succeed. Often companies pay a 40% premium for publicly listed companies, sometimes more.

Figure 1.1 shows the company we want to buy, company A. Its share price is £10. We decide to purchase it. Negotiations start and our aim is to buy at £9, but the seller wants a premium for it and tries to sell at £11. Value is often dependent on your view and in due diligence we must always understand why the company is for sale. What does the current owner know that we don't?

Figure 1.1: Company value depends on who is looking at it



If we owned company A, it may be worth £12, if we follow a strategy of helping it grow faster by injecting cash or knowledge and cutting costs in a way it cannot do by itself. For example, after purchase there will be two head offices. Cutting one will save money, so company A will be worth £12 in two years' time once it is under our group ownership.

There is a discrepancy between the current £10 valuation and ours of £12. Who is right? This discrepancy causes a negotiation and purchase at £11 where all parties win. An acquisition occurs and integration starts.

Of course the company may not actually be worth £10. We may find we have bought a dud, and it's only worth £8. This could be because our initial valuation was wrong, because there were some surprises along the way or because the integration did not go well and the value has been destroyed. Whatever the reason, the deal has been a failure.

Integrate well, however, and some companies are able to find an extra £1 and make the company worth £13.

Some deals are wrong from the start. A company pays £20 for a company worth £10 because they have not done enough due diligence (pre-deal investigation). The merger between Quaker and Snapple is the biggest identified loser (bought for $2.4 bn, sold shortly afterwards for $300 m due to an inability to extend an existing distribution system to a new product line), while the Chiron/Cetus merger in health care is the biggest identified winner.

> *"Be clear on strategic fit, clear on where the value is and clear on the integration plan all before the deal."*
>
> **John Peace, Chairman, Experian**

MOST MERGERS FAIL

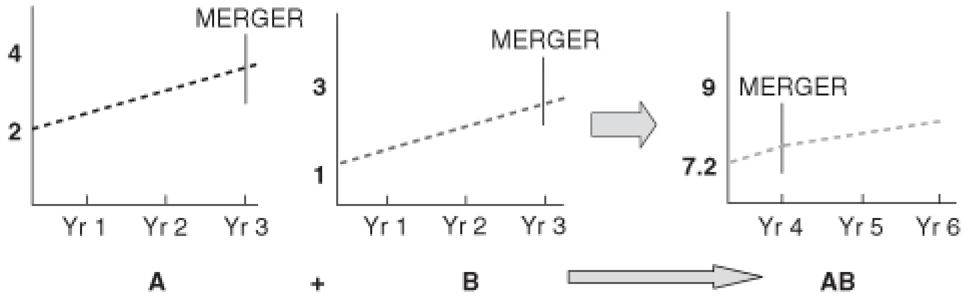
Eighty per cent of mergers fail!

> *"Success or failure, defined by the academics: The existence of synergy implies that the combined firm will improve its performance, at a faster rate after the merger than when the firms are operating separately."*
>
> ***The Value of Synergy*, Aswath Damodaran, Stern School of Business, October 2005**

There is a database with the share price and financial information for companies and deals. The only sensible way to measure success from an outside view is to see if the share price increases because of the purchase.

In Figure 1.2 both companies have an upwards share price graph, with improvement at the same rate (similar gradient). If the first buys the second the resulting share price should be the two added together with continuation at the same growth rate or better. This example shows a merger that did not create value and so would be considered a failure.

Figure 1.2: Success depends on your viewpoint

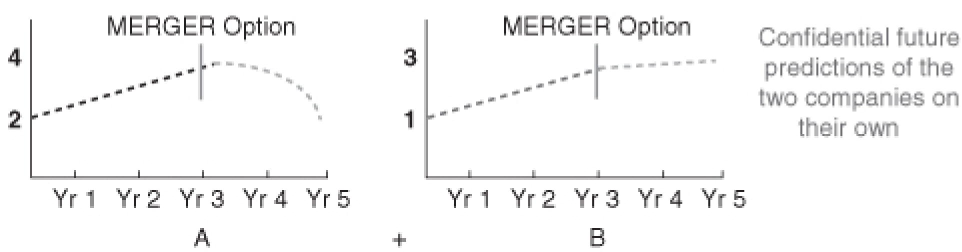


The premium paid by the acquiring party does not necessarily have to be higher than the costs of internal growth or the costs for establishing increased profitability.

This is viewed externally as a failure.

Again, there is an M&A failure in Figure 1.3. A FTSE 100 company has a strong growth rate but can see its demise in the near future (five years). It goes out to buy a company to fill the strategic or profit gap it foresees. The public at large would not be told of this future impending doom and so will see this purchase and subsequent integration as failing to deliver improved or increased value, i.e. no shareholder price improvement.

Figure 1.3: M&A failure



When asked how to judge success or failure, shareholder view is clearly the only way to go. However, looking internally can provide an improved understanding of the purchase.

"Many mergers fail. Why? I believe it is because:

- *There is a lack of knowledge of what fundamentally makes the company valuable and whether this can survive a merger, e.g. an entrepreneurial culture. Due* *diligence is often legal and financial as opposed to commercial, strategic and cultural.*

- *The acquisition is defensive in nature, i.e. it is an opportunity to cut costs but is presented to shareholders and investors as a growth deal. Expectations are not met and the deal is considered a failure.*
- *The integration is not properly planned. People are unclear about what should happen – and can thus destroy the very thing they have bought, e.g. by dismissing the very management that made the business valuable in the first place, in favour of their 'own' staff."*

Matthew Lester, CFO, ICAP

Some Are Doomed to Failure

Some mergers are doomed to failure. Pay too much, and there is nothing that can be done to rectify this. Pay the right amount (or close to it), and suddenly the integration becomes very important, for the short- and long-term growth of both companies.

Making good estimates of the synergies and how much these will cost to implement will enable improved pre-deal pricing. The pre-deal cost/synergy model stays through the merger and dictates the direction, together with the strategic pre-deal rationale.

There is a pot of money for integration. Decisions must be made on how and where to spend it to deliver most benefit. The key is to evaluate what to do and don't try to do everything.

DEFINE SUCCESS

"What is success:

- *Commercial success: Creating long term value.*
- *Integration: Did we keep the people we wanted to keep?*
- *Products: Did we get all of our new products (acquired and legacy) to market? Did the merger slow this process?"*

Brent Stiefel, Executive Vice President, Global Corporate Development & Global Product Portfolio, Stiefel Laboratories, Inc.

There are many ways to define success in a merger. Create a yardstick to be measured by; don't let anyone else say what success should look like. Come to a clear set of criteria, laying them open for all to see. These will then be used to guide the integration director and managers in both companies.

THE M&A PROCESS

"Structure of the integration: we involve the business teams in the front end of the M&A process, they own the numbers and have responsibility for delivering the forecasted performance in the integration. I believe this is key to ensuring that management energy is focused on the integration exercise."

Ian Lambert, Director M&A, Smiths Group

Figure 1.4 shows the M&A process.

Figure 1.4: M&A process