Merger & Acquisition
Integration

A business guide
Mergers and acquisitions are today more sought after than ever before. The record numbers and total aggregate value of M&A deals tell the tale.

**The current annual global value of deals is over $2,000 billion.**

The recent series of “mega-deals” announced between some of the world’s largest companies highlights the growing importance of M&A’s in the implementation of globalisation strategies. And, within Europe, sector consolidation, combined with political, regulatory and monetary unification factors, are only likely to speed up the gathering momentum of cross border activity.

It has been common for companies to acquire without fully integrating targets into their own business and processes. Acquirers have often bought the inherent value of the target, its historical performance and asset base as a stand alone entity. Yet only one third of all transactions are deemed successful, therefore realising the synergies in a merger or acquisition and understanding the strategic value generated by the deal is vital. The issue of value realisation through acquisition is explored in Section 1.

Knowing what to integrate to deliver the anticipated benefits is one of the biggest challenges faced by acquirers, and management of the implementation will determine the overall success or failure of the transaction. This business guide includes:

- a guide to pre-deal planning (set out in Section 2)
- the 10 golden rules for handling the first 100 days post-completion (outlined in Section 3)

In spite of all the research and development of management thinking in this area, and recognition of the reason why so many deals fail, KPMG highlights the three areas it finds to be fundamental to success in Section 4.

There is no, one size fits all solution to the post-deal integration process. However, based on its extensive pre-deal and post-deal transaction experience in this area, KPMG has developed the best practice guidelines set out in this guide to help managers successfully deliver value from their mergers and acquisitions.

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For 30 years now industry commentators and major corporates have recognised that transaction success or failure is heavily dependent on effective post-deal management. So why is it that the failure rate remains so high?

This guide aims to:

- understand the reasons for deal failure;
  and
- provide a framework for making a success of the pre- and post-deal periods.

What do we mean when we talk about deal success or failure and how do we measure it? Success is actually about ‘benefit’ or ‘value creation’. A deal is deemed ‘successful’ when the acquirer believes and can demonstrate that it has made a good investment when viewed three years later.

‘Study after study of past merger waves has shown that two of every three deals have not worked’

(The Economist 9 Jan 99)
Stage 1: Strategic Evaluation

An initial value is arrived at as soon as the acquirer has completed its evaluation of strategic options and selected a target company. At this stage, value will be assessed based on a series of assumptions and a limited amount of publicly available information about the target.

There are many reasons why a target may be attractive and ‘buying turnover or profit’ is just part of it. Market positioning, access to a better management team, addressing IT issues, access to product range, customer base or complementary culture may all be part of the rationale for the deal; but fundamentally, the valuation has three key components:

Intrinsic value
The underlying future profitability of the business on a standalone basis.

Synergistic value
Based on the benefits which may be derived from putting the two businesses together. These might relate to:

Revenue enhancement: are there opportunities for cross-selling product across stores/branches? Does this give us access to a new customer base for our products?

Supply chain issues: eg. is there scope to consolidate manufacturing sites?

Procurement: what economies of scale can we derive from the combined buying power of these two businesses?

Elimination of overheads: Closure of departments/offices to avoid unnecessary duplication (eg. no longer need two HR, Finance, IT functions and two Head Offices)

Financing: eg. a mature steady cash generating business acquiring a fast growing investment intensive company.

Strategic value
There are a number of ways in which the acquisition may be considered to be of strategic benefit, for example:

Leadership: the deal enables you to become market leader, therefore allowing benefits of being number 1, eg. price, brand value etc.

Defensive: if you do not make the acquisition, your main competitor will, and your brand will be forced into third place.

Vertical integration: the acquisition will secure your ability to supply the market by providing you with a ‘ready-made’ customer base.
**Stage 2: Due diligence**

Having arrived at an initial value, made first approaches to the target, and put forward an initial bid, the acquirer embarks on a period of detailed investigation. This period enables the acquirer to gather more information about financial and commercial aspects of the target business which will allow it to:

- identify points which impact on value and therefore affect price and bid negotiations;
- de-risk the deal, eg warranties against outstanding legal claims etc; and
- prepare for the implementation of synergies by understanding what may or may not be achievable, eg. IT systems compatibility.

With intrinsic value often accounting for 90% of pre-deal valuation it made sense to focus due diligence activity on the financial aspects of the business. This review of trading results for the last five years identified trends which might impact on company profitability over the next few years. Today, with more money chasing fewer deals, a greater proportion of the valuation is made up of strategic and synergistic elements – indeed these can account for up to 50% of the value. Investigations undertaken during the pre-deal period should be as all encompassing as possible, aimed at testing the assumptions which dictated the initial value in stage 1. These will include due consideration of the commercial characteristics of the business, eg achievability of synergies, assessing management quality or cultural fit. Many companies, however, continue with the traditional approach.

It is important to check that the original rationale for the deal still stands and to understand the extent to which the valuation may have been changed. A holistic approach to due diligence ensures that effort is focused on the aspects which affect deal negotiation and benefit delivery.
**Stage 3: Post-completion**

Despite best efforts, commercially sensitive information will be withheld from the acquirer pre-deal. Only on completion does the acquirer at last have full insight into the target business and have accurate information on which to base implementation plans.

Traditionally, only 50% of the synergy benefits originally identified will prove to be achievable – the key challenge for the new management now that it has open access to the target, is to identify where full value will actually be derived from the newly combined business. The plan must be designed to find an extra 50% and more.

The only value which really matters is the one which is arrived at three or more years after completion, when the integration programme is complete. Unfortunately in two thirds of cases this final value is lower than the one which dictated the valuation at stage 2, and therefore many acquirers must concede their transaction has been a failure. Research conducted by KPMG Consulting (*Colouring in the Map: mergers and acquisitions in Europe*) confirms this.

The actions of the first 100 days will have greatest impact on the value created by the deal. Handling of this critical period is the key determinant of deal success or failure. In particular, better planning for the post-completion stage during the pre-deal period was identified as a major area for improvement for those respondents who thought their transactions unsuccessful, with ‘acting faster’ in post-deal integration and ‘greater due diligence’ both in equal second place.

In this guide we outline:

- how to derive maximum benefit from the pre-deal period (*Section 2*);
- the 10 golden rules for the 100 day period (*Section 3*); and
- the factors which actually make the difference between success or failure (*Section 4*).
Successful acquirers take the long term view and recognise that the cost of their investment in pre-deal planning is minimal compared with the potential impact of failing to generate the desired level of return from the transaction. Increasingly companies face a delay to the transaction timetable while they await regulatory clearance. A key challenge is to use that time to best effect, while not having yet the certainty the deal will go ahead.

KPMG has developed a guide to pre-deal planning:

1. Be clear about strategic intent

An M&A is a tool to meet strategic objectives, not an end in itself. Even if the integration process runs smoothly, a flawed strategy will inevitably lead to serious problems. Be sure that the strategic rationale is translated into a shared vision (ideally with measurable targets) and communicated to all stakeholders.

Management also need to determine what is valued in the target. There should be clarity about which areas need to be protected and leveraged (whether it is management and employee expertise, access to a customer base, production capability, or products and technology) and to understand the priorities and risks associated with each.
2 Assess the top management team

Identify and involve the team who will be responsible for managing the new business. It will be important to:

- consider the role of the target company top team in the future plans of the business;
- consider whether between the two businesses there exists a management team capable of running the new, enlarged business. Often the management team needs external strengthening;
- determine how key executives need to be secured or incentivised;
- define succession and contingency plans as the departure of top team personnel from the target is common;
- define and communicate a process for selecting the management team; and
- decide any redundancy matters relating to the top team swiftly but be aware that the investigation process by its nature asks many questions and often results in a breakdown of trust, so it is ill-advised to make snap judgements about management during the pre-planning phase.

3 Determine approach to integration

Two key questions must be addressed during the planning period:

- to what extent should we integrate these businesses?
- what style should we use to carry out the integration?

The motivation behind much of the current M&A activity is based on the opportunity to achieve synergies from bringing businesses together. Typically organisations under-estimate the extent of integration they should be undertaking early on. However, failing to integrate the target sufficiently is responsible for much of the disappointment around the extent of benefits derived from a transaction. By the time they realise this is the case, the 100 day period is over or inappropriate messages may have been communicated (eg ‘no redundancies’) to stakeholders.

In terms of style of integration, it is clearly valuable to learn lessons from past experience, however, a successful approach adopted in one case may not work as well when applied to another.

At one extreme is a directive approach, based on a ‘just do it’ mentality entailing minimal involvement from the workforce. This may be appropriate in low tech industries. At the other extreme, a facilitative approach puts emphasis on managers to find solutions. It assumes a highly skilled workforce working to a high level agenda and assures implementation through involvement and ‘buy-in’. This can be appropriate in high growth markets.

The decision on which approach to adopt may vary for different parts of the business (eg divisions, countries, functions) and is based on:

- quality of people;
- availability of resource;
- degree of risk;
- distance from customers;
- complexity of issues; and
- access to best practice.

The approach requires careful consideration and evaluation during the pre-deal period to ensure the integration programme is tailored appropriately to the particular circumstances of your deal.
4 Involve the ‘right team’

Given the range of internal management and external adviser involvement, it is vital to appoint an Integration Director responsible for the transaction process as a whole. One of the teams within the programme will be that of the integration planners. It is important for that team to:

- include a mix of M&A experience and operational management capability. The role of the operational team is key. Initially the acquiring team, but later the operational staff of both businesses, can impact on the ability to deliver value. Their knowledge of the business can:
  - impact on the value/price;
  - help you plan for the 100 days; ensuring integration programmes are achievable;
  - ensure buy-in to the integration plan;
- have continuity through the deal completion into the initial post completion phase so that immediate benefits can be realised; and
- be full time to enable them to give the implementation process their undivided attention.

5 Create the integration programme based on where benefits will be derived

As mentioned earlier, traditionally many of the original synergies will not materialise during integration due to:

- failure to test synergy assumptions; and
- failure to recognise the role of the operational team.

It is therefore important to build a plan to identify benefits beyond those originally envisaged. Often these benefits are limited by prudence or city code rules. However, experience shows that 20% of integration activities will deliver 80% of the benefits, so it is key to focus on the projects which will create biggest impact. These planning activities will be refined once the deal is completed and actual information is available to confirm assumptions about the new business.

Once benefit pools have been identified, it is important to build a plan to deliver them and to establish momentum in the first 100 days. At the planning stage, it is necessary to:

- ensure the process is underpinned and consistent with a common business vision / strategy;
- develop first action plans setting out what should be done to take control of the business (legal, financial, eg. through authorisation levels and reporting lines);
- identify workstreams for the key benefit areas and identify work teams to deliver them;
- allocate tasks, timings, responsibilities, milestones and deliverables for the projects that have been identified;
- revisit plans on an on-going basis as information becomes available; and
- plan to handle the overlap and interfaces between workstreams to avoid losing value.

6 Address cultural issues

Assess cultural differences between the acquirer and the target. Too often these differences are underestimated and yet they can undermine the 100 day programme as well as the longer term implementation. Ability to identify cultural issues will depend on the extent of access to the target pre-deal, but should cover:

- leadership style, management profile, organisation structure;
- working practices and terms & conditions; and
- perceptions from the marketplace.
Communications continue to be important after deal completion (see section 3) and the CEO should take accountability for this issue, ensuring appropriate resource is allocated to it.
The first 100 days is a time of anxiety and uncertainty for both acquirer and target but everyone expects change and management has an opportunity to create a first impression, maximise the value of the deal and set the tone for the future.

It is also the period of greatest potential loss of value.

KPMG has 10 golden rules to guide CEO’s and Integration Directors through the 100 day ‘honeymoon’.

1 Directors must get out of the boardroom!

It is critical for executives to be (and be seen to be) actively involved in the integration. Chief Executives must lead from the front, appear approachable to new staff and involve themselves actively in the merged company. The new senior management team must also show support and learn quickly to operate as a team.

2 Set direction for the new business

The executive team should agree the strategy and vision for the new business and communicate it to the entire organisation. During the first part of the 100 days, assumptions will be tested after which the strategy can be re-confirmed or re-directed as necessary. It is important to ‘operationalise’ the strategy and ensure that all implementation plans are consistent with the overall vision.

3 Create momentum

The stakeholders will be looking for early signs of success so you will need ‘quick wins’ during the 100 day period to reassure them that the integration is progressing well. This requires intensive work by the integration team, to avoid loss of impetus.
However, ‘quick wins’ should not be achieved at the expense of longer term benefits. The balance is struck by using a rigorous process to assess improvement opportunities against the vision for the business. While focusing on ‘quick wins’, also understand that many of the more complex benefits take longer to be realised (eg. IT systems or cultural change). Often these are forgotten as the implementation progresses. The key is to ensure those benefits are ultimately achieved and the process is in place to monitor and quantify them.

4 Understand timing and scale of benefits

The first days of the 100 day period should seek to confirm the critical integration areas (remember the 80:20 rule). Assess early on what needs to be done immediately and what can be left until later. While comparing existing processes in the two companies, it is not about merely achieving ‘best of both’. Indeed, companies should not only look for ‘better’ practice, but should take the opportunity to go for ‘best’ practice. It is futile spending 2-3 years changing to one IT system only to find your competitors have moved on.

5 Understand the emotional, political and rational issues

Many key decisions regarding the future of the business are made during the 100 day period. These decisions are influenced by political and emotional factors, as well as commercial and financial implications.

The ‘Iceberg’ (see above) will sink the integration programme unless you identify it early, by understanding the emotional, political and rational issues and use an implementation process designed to overcome them.

6 Maximise involvement

The most effective way to get support for the change is by maximising employee involvement in the consultation process. While strong leadership is vital for successful integration, so is the need to cascade involvement in the process. A top-down approach engineered by a small group of people is bound to result in limited buy-in and impact on the ability to implement change. By involving as many operational staff as possible in the development of ideas, you will harness energy, generate momentum and identify problem areas early.

The more complex the integration, the more resources are required to manage it in terms of management time, skill and working capital. The integration team should comprise staff who have credibility and influence within the organisation. Managers from both companies should be included in ‘joint-teams’ to encourage buy-in and ensure the rigour and applicability of the redesign process. The ‘joint-team’ members must be on the project full-time to ensure focus and momentum.

7 Continue to focus on communication

We have already highlighted the need to prepare a communication plan prior to the deal. On-going communication is just as
critical to the success of the 100 day and subsequent implementations. Aim to share with employees:

- the shared vision for the new company;
- the nature and progress of the integration project and the anticipated benefits;
- how staff are likely to be involved, and when they can expect to know more; and
- outcomes and rough timescales for future decisions.

Key activities and quick-wins should be communicated as they arise to highlight progress and staff will be encouraged when they hear of growth opportunities being pursued as a result of the deal. Early and honest announcement of all key decisions (especially the more difficult ones) help reduce uncertainty and is more likely to reduce respect. It is important to avoid ‘death by 1,000 cuts’ where an uncoordinated approach can lead to a succession of redundancy announcements.

Project a clear, confident and consistent image for the new company early on, via customer facing staff, through marketing material, with customer account management and through controlled media management.

8 Provide clarity around roles and decision lines
A fast transition can channel energy and minimise the period of stress which damages employee productivity. Until announcements are made about the new organisation structure and appointments everyone feels uncertain, even those whose jobs are secure. (Often acquirers focus on the 5% who are leaving the business and forget the 95% of employees who feel uncertain and bruised by the process.) In order to retain key staff, you should work quickly to decide on the new structure, confirm roles and identify any skill gaps. By the end of 100 days, every employee should have clarity about the process which will decide their future.

CEOs will also gain respect by being seen to be fair when allocating positions. There should be transparency around the process, clarity about the new roles, and prompt communication of decisions.

It is essential that a clear decision making process be established, founded on solid information and analysis. This also helps funnel all key decisions through clear lines of authority and avoid unnecessary bottlenecks at the most senior level. In our experience, at least 30 decisions need to be made each day.

9 Consider all legal issues
There are usually legislative constraints on the speed with which you can progress. Identify these early and build them into your plan. If left unaccounted, especially where substantial post-acquisition restructuring and redundancies are concerned, they may severely hamper your timetable for collective and individual delivery of benefits. For example, if TUPE (Transfer of Undertakings and Protection of Employment) applies, you will need to allow time for consultation.

10 Manage the handover for implementation
It is critical to the success of the implementation that at the end of the day the business itself (rather than the project team) owns the plan. The following measures can be used to judge the success of the 100-day period:

- the implementation is ‘owned’ by operational management;
- measurable plans for the subsequent implementation are in place;
- line managers are taking on increasing responsibility for delivery;
- staff know their roles and continue to focus on customers;
- the new corporate image is clear to stakeholders; and
- quick wins have been ‘banked’ and the scale of future potential benefits has been assessed and are being implemented.

A programme manager should remain in post through implementation and be accountable for on-going delivery of the implementation plan. This includes maintaining momentum, monitoring performance against milestones, and measuring benefits as they are realised.
KPMG has identified the first 100 days post-transaction as the critical period to achieve value creation. But preparation is also key, when management can ensure early involvement of the operational teams capable of delivering benefits, scope the integration programme itself, set up the benefits tracking process, and begin to address the people, cultural and communication issues. Based on its wide-ranging transaction experience, KPMG has identified the three key ingredients which make the difference between success and failure:

**Holistic approach**
In Section 1, we outlined the different stages at which value is assessed and highlighted where value is lost. But the overriding message is the need for a holistic, end-to-end view of the transaction rather than a series of ‘stages’ or ‘intervention points’. The only way to ensure value enhancement is for the acquirer to perceive the transaction as a single process, create a structured programme to encompass all aspects of the deal, and to focus on the desired end result throughout.

**Programme tailoring**
No two deals are the same. Circumstances will inevitably be different, eg
- quality of people
- type of integration
- rationale of transaction
- benefits pools
and as a result there is no ‘one size fits all’, ‘off the shelf’ approach which can be used.

The programme tailoring must be carried out by people who have the experience to solve problems and create imaginative solutions.
Cultural, emotional and political issues

Most organisations approach business change with a heavy emphasis on the rational aspects – the business case, plans, resources, financial measures, and the processes and systems that need adjustment. These factors are, of course, critical; however, the internal political and emotional aspects are magnified due to the high levels of uncertainty and fluctuation associated with a transaction. And this is further complicated by the need to address differences in corporate cultures, whether they be geographic, corporate or functional in nature. The integration programme must be designed to tackle these issues head on. Integration projects are not easy and require hard work on the part of a large number of people.

These softer issues should be addressed overtly and be an integral part of the programme design and implementation.

“We are confident this guide will significantly increase your chance of making a success of your M&A project.”

(‘The moral is not that merging is always wrong, but that it is risky.’
(The Economist 9 Jan 99)