

M&A and Divestitures: Integration and Disintegration

A Thought Leadership Roundtable on Digital Strategies

U.S. Chapter Discussion



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Thought Leadership Roundtable on Digital Strategies

*An executive roundtable series of the
Center for Digital Strategies at the Tuck School of Business*

The Thought Leadership Roundtable on Digital Strategies' U.S. Chapter recently convened for a discussion on M&A and divestitures. What are the best practices for M&A and divestitures in the current business environment, especially in the areas of deal-making, due diligence and planning? What are the keys to successful integration (or separation)? The sessions included academics and business leaders from 3M, Cisco Systems, Eastman Chemical, Eaton Corp., Haas School of Business at Berkeley, Hasbro, IBM, Texas Pacific Group, the University of Texas at Austin, and the Tuck School of Business at Dartmouth.

Key Insights Discussed in this Article:

- **Developing consistent and repeatable M&A capabilities can be a potent source of competitive advantage..... 2, 13, 14**
Successful serial acquirers develop strong competencies in areas like pipeline development, deal selection, due diligence, and integration planning and execution.
- **The playing field has leveled dramatically for strategic acquirers relative to financial buyers.... 2, 3**
Tightening credit markets have constrained private equity leverage, causing these investors to look toward strategic acquirers as potential deal partners.
- **Disciplined approaches and processes are key to successful M&A..... 4, 5, 6, 7**
Methodical, rigorous and realistic planning, benchmarking and performance evaluation can greatly enhance results, especially when leveraged over time for continuous improvement.
- **Integration strategy and planning should be driven by business model requirements..... 8, 9**
Plan with market and customer needs in mind, rather than deploying one-size-fits-all integration strategies.
- **Do exhaustive research on every deal, but don't forget to also ask the simple, telling questions.. 6, 7**
Why is the seller selling? Could the money be better invested internally? What are the personal motivations of key managers?
- **Pay attention to key talent and their needs 9, 10**
From identifying the best dealmakers to choosing the right integration leaders to harmonizing sales compensation plans, managing talent is an important M&A success factor.
- **Work to ensure alignment on strategy, expectations and culture to maximize the chances of success in the first 100 days..... 11, 12**
Senior management should set clear expectations early, creating as much internal transparency as possible, but not losing sight of external communications.
- **Pay close attention to HR, IP, and the financial impacts of transitional services agreements when planning divestitures 12, 13**
Don't give away leverage by waiting until the last minute to negotiate TSAs, or by failing to do so with multiple bidders.

Introduction

Driven by globalization, private equity, and the corporate debt markets, deal activity has been strong for several years, and shows few signs of diminishing. Companies that consistently do M&A well can generate considerable competitive advantage, whereas companies that don't can stumble badly.

What market dynamics will drive M&A over the next couple of years? What are best practices in due diligence, planning, deal-making, and most important, integration (or dis-integration)?

M&A Drivers and the Market Landscape

Participants described how they view the current M&A environment, and discussed key drivers of M&A activity for their companies, concluding that the recent tightening of credit markets has created a major opportunity for strategic acquirers, perhaps even one that includes partnering with private equity.

Cisco's Rebecca Jacoby said her company uses M&A to pursue market adjacencies, new technologies, or opportunities "that makes sense to leverage our main business." Her colleague Vince Spina added that Cisco looks at a menu of business objectives including market share, top line growth, entering new markets, cost savings, and obtaining key talent.

Eaton's David Barrie said his company has used M&A to transform its portfolio over the past ten years, making it less dependent on the automotive industry and becoming a player in new electric and fluid power markets while doubling overall sales. "It's been a vehicle for transformation for our company," said Barrie, adding that Eaton now expects four percent of its annual growth to come from acquisitions.

IBM's Moni Miyashita painted a similar picture. She explained that IBM has done billions of dollars in software and services acquisitions while executing billions of dollars in hardware related divestitures during the past ten years, vital to the company's transformation from a hardware company into a software-and-services-driven business. "Nine years ago, hardware was 58% of our company," she noted. "Today, hardware is less than 25%." "M&A is a major part of our growth strategy," Miyashita added, noting that IBM spent \$5 billion just on their acquisition of Cognos in January this year.

Hasbro's Tom Courtney said his company looks to acquire brands that can benefit from the company's global reach, enabling these brands to grow faster than they could on their own. "Cranium is an acquisition we recently did where the brand was very strong in the U.S.," Courtney explained, "but it had very limited exposure in international markets. We can take a brand into the Hasbro system, put the strength of our sales and marketing resources behind it, and make it really hum globally." In areas outside of the company's expertise, he said the company may prefer strategic alliances to acquisitions. However, within the company's area of expertise acquisitions are preferred and actively pursued.

Texas Pacific Group's Blair LaCorte called the last five years "the golden age of private equity," thanks to a historically low cost of debt capital. "You could almost buy companies for free," he explained, thanks to the leverage available from banks with few covenants and low or deferred interest, which gave private equity a big advantage over strategic acquirers. At the same time, new accounting rules also made it tougher for corporations to make non-accretive acquisitions.

However, "the tables have turned" with the recent tightening of credit markets, LaCorte said, and the playing field has become much more level, causing private equity to view corporations as potential partners rather than harder-to-outbid competitors. "We're now looking at more divestitures, like we used to do five years ago," he noted, including deals where the seller 'rolls,' or keeps a piece of equity in the divested business to help finance the transaction. "I think we won't compete head-to-head; it's an interesting time for you guys to think about how you work with private equity," he added, describing a deal TPG did last year with Northwest Airlines to buy Midwest Air. "Northwest could never have bought Midwest" for regulatory reasons, he explained, but was able to accomplish its strategic objectives with a minority investment.

3M's Mark Copman agreed that there's now a bigger opportunity for strategic acquirers. "Twelve months ago, we couldn't even get in the door in some auction processes," he recalled, noting that sellers "wouldn't even talk to us because we needed to have an audit and having to deal with antitrust filings often caused us to be slower than competing bids from private equity firms." Today the roles are reversed as financial buyers are slowed by more restrictive debt markets, he explained. "We have financial advisors representing sellers calling left and right."

Copman said 3M's new CEO has told Wall Street the company will use acquisitions to grow two to three percent a year, "which is a relatively big number on \$25 billion." This mandate has allowed us to do a variety of acquisitions, he added, ranging in size from over \$1 billion to smaller deals. Many of the smaller deals also serve to help train internal management on how to get deals done successfully, primarily done for training purposes. "We've been able to figure out who the people are that can do deals, and we've also taught people how to integrate."

Peter Goodson of the Haas School of Business at Berkeley, who was part of the management of Clayton & Dubilier, Inc., cautioned participants not to think financial buyers will stand on the sidelines, noting that many large investors "have no other place" to invest their money. "The window won't stay closed very long," he said, adding that there's already over a trillion dollars of private equity capital in investor's hands "who have to spend that money to stay in business."

But Copman questioned, if current market conditions persist, whether financial buyers will be able to achieve sufficient returns to satisfy their investors without leverage, while taking on added financing risk. To which Goodson and LaCorte responded that investor expectations correspond to the market, and though payoffs may not be as big or as quick as they were, it's unclear that corporate acquirers can get better returns.

"We think the strategic players we compete against are relatively weak in terms of their ability to deliver pay-to-value," said Goodson. He noted that private equity partners generate large fees regardless of short-term profits, so they're "a little bit more relaxed about the returns in terms of their compensation." And he added that great managers still want to work for private equity

owners, because “not being a public company is a tremendous boon to everybody’s morale and common sense,” and because they’ll get a larger equity stake and do better financially.

Approaches to Deal Selection

Given that many acquisitions are opportunistic, Tuck’s Hans Brechbühl asked participants how they avoid bad outcomes like the Snapple deal, where acquirer Quaker Oats thought they knew the business (because they owned Gatorade), but in fact had misjudged the market and Snapple’s distribution network and ended up with an expensive write-off.

“You have to stay in your sweet spot,” said Hasbro’s Tom Courtney. “For us, that’s the toy and game, tangible consumer products market.”

Even a successful foray within the sweet spot can come with issues that need resolution, Courtney added, recalling Hasbro’s acquisition of hobby gaming company Wizards of the Coast, which owned a retail chain Hasbro didn’t want. “We should have had a plan to divest that piece of the business immediately after the acquisition as it really didn’t fit with anything that we were doing strategically,” he said.

Cisco’s Rebecca Jacoby said that sometimes it makes sense to do deals outside your sweet spot, noting that while Cisco is used to venturing into adjacent technology and geographical areas, it has recently been making acquisitions where the customer base or business model is different, and learning a lot in the process.

“There are huge implications for us all the way through our basic, operational processes,” she said, citing Cisco’s recent acquisitions of Linksys, with its retail channel, WebEx, a software as a service company, and Scientific Atlanta, with its hands-on relationships with service providers—all models where Cisco had little prior experience. “Each of those offers a little bit different challenge,” explained Jacoby. “But if we can learn how to leverage and operate multiple business models in a synergistic fashion, that’s a huge plus.”

Participants also discussed whether there is a minimum size for a deal to make sense. “Something small could be huge if it gets the right resources put behind it,” proposed Hasbro’s Courtney. But the smaller the deal, the stronger the strategic argument you have to make, countered Eaton’s Barrie. “It’s the strategic nature of the deal that’s the motivator.”

Eastman Chemical’s Lee Whisman asked whether the group thought smaller deals with undisclosed terms might play better on Wall Street than bigger deals with pre-announced financial targets. “Do you get more value from the analysts from those slow, methodical, smaller deals that keep the revenue line bumping up?”

“It’s that consistent story that’s important, not the size of the deal,” responded Eaton’s Barrie. “We have a very defined growth strategy through acquisitions, and that’s where some of those smaller transactions fit in, we can tell the story throughout each quarter to the analyst community, whether they’re bringing technology, channel access, or whatever.”

And Barrie added that though Eaton had never bought a company to keep a competitor from getting it, it had sometimes been happy to let a competitor overpay when an auction had passed a certain threshold. “We’ve been earnest in the effort, but I can recall a couple of instances where we thought we won by losing the auction.”

Participants also debated whether it ever made sense to target deals with no integration synergy, or where the target would strategically be better off as a stand-alone entity, similar to the approach EMC took in its VMW are acquisition.

“It makes sense for us to leverage our infrastructure,” said Hasbro’s Courtney, “but there are deals where we’re sensitive and protective of the existing creative culture, not wanting to disrupt ‘the magic’ of its R&D and marketing teams. “We want to provide the disciplined business structure so it can flourish,” he explained. “But on the creative side, ensure that we keep the creative culture intact as best we can.”

3M’s Copman said his company has developed a ‘menu’ of integration options from which managers can pick and choose. In the case of an entrepreneurial imaging company 3M acquired, a light integration strategy worked well, Copman said, whereas an earlier deal that was left largely alone failed when all the good people left. “The hardest thing is not fighting the last war,” he explained. “It didn’t work here, so we’ve got to do it this way now.”

Hasbro’s Courtney added that a crucial step in deal selection is to sit down with the operating acquisition team and ask them whether they would just rather have the money to invest in their own business, to validate that the acquisition is in fact their top priority. “It’s amazing sometimes some of the answers you get from that one simple question.

Benchmarking M&A Performance

Participants discussed their quantitative methodologies for benchmarking M&A, for building target pipelines and for evaluating M&A performance, and agreed that these tools can be invaluable for setting realistic goals and expectations and evaluating the deal capabilities of individual managers.

Eaton’s David Barrie said his company works backward from sales and EBITDA goals to come up with annual goals for numbers of transactions and even first-round bids, dubbed ‘quality at-bats.’ “We also do productivity tracking, looking at how much time and effort went into a transaction,” explained Barrie. “Are we getting better at it? Reducing our cost?” After a deal is closed, he said Eaton tracks performance against the final valuation model, which becomes the first year business plan. And although the company is good at forecasting and executing on the cost side, Barrie added, “where we always fall short is on the sales synergy.”

To combat over-optimism, Barrie said his team sits down with each deal champion and walks them through the historical data. “They always have higher expectations, you have to back them off,” he explained. “You can pull the statistics up and say, ‘Here’s what we’ve done as a company and in this group. Why is this different?’” As a final measure, Barrie added, if the

champion sticks to their best-case forecasts, you can ask “okay, what percent of your incentive compensation do you want tied to that?”

3M’s Copman said his company closely tracks revenue and operating income performance monthly and quarterly for five years after a deal closes, to help identify managers with future deal-making potential. “If their track record isn’t good, we ask them, ‘Why should we have you do another deal?’”

But he also noted that superlative performance, especially on operating income, may in part be a sign of sandbagging, which isn’t always bad. “You want managers to have the freedom to make the changes necessary for the business to be successful.”

IBM’s Moni Miyashita described a rigorous focus on tracking and accountability of the strategic business objectives (financial and non-financial). “We have face-to-face reviews each quarter with the integration executives and the general managers who sponsored the deals,” she explained. These results are reported to the CEO and CFO for two years on all acquisitions. Senior executive focus and execution of value driven integration plans has allowed the company to achieve close to 100% of deal revenue targets and exceed deal profit targets on the overall portfolio of deals in tracking over recent years.

Haas’ Goodson indicated he feels that accountability and disciplined follow through on benchmarking corporate deals is the exception rather than the rule. “We [at Clayton & Dubilier] look at 800 businesses a year and one of the biggest opportunities for us is where people have screwed this up,” he said. “One of the things that makes private equity successful is that the scorecard’s very clear, and it’s driven at you daily as a manager. It’s hard to do that in a large company.”

Organizing for Deal-Making and Due Diligence

Participants compared their companies’ team structures for deal-making and due diligence, concluding that effective deal-making involves leveraging centralized in-house deal resources and outside experts, and most importantly, asking the right questions.

IBM’s Miyashita said line management owns each deal, and makes all the decisions, supported by corporate teams who do outbound business development, deal negotiation, analysis and planning. “It’s an end-to-end M&A process, very aligned with the line management.”

Cisco’s Jacoby said her company’s head of business development not only does deal analysis but owns market analysis for the whole company, sits on the operating committee, and has a dedicated set of program resources for due diligence.

And Eaton’s Barrie described a partnership between corporate’s centralized transaction resources and the business development groups embedded in each operation responsible for pipeline and relationship building. He noted that corporate development has its own finance team dedicated to quality-of-earnings analysis, which he felt had provided a big advantage versus farming that out to an accounting firm.

But Barrie noted that training operations people in acquisitions and tempering their enthusiasm has been an issue. “We had one transaction we looked at where five people from corporate showed up along with 40 people from operations who wanted to get involved,” he recalled.

Haas’ Goodson painted the opposite picture, of a bare-bones deal team in Clayton & Dubilier, consisting of one financial and one operating partner, supported by specialized consultants performing SWAT team-like due diligence. “We want to look at the key drivers in that business, the key customers, competitors, and suppliers,” he said.

Talking to these stakeholders is crucial, Goodson said, and quickly helps uncover the reality of the business, deal memoranda notwithstanding. His firm then brings in a dedicated forensic accounting resource “who we pay maybe \$5 million a year just to work on our deals.”

TPG’s LaCorte said his firm, with 300 employees and 30 partners, spends \$1.2 billion a year on outside service providers like McKinsey and Bain, who set up shop in the TPG offices as part of the due diligence process. But when it comes time to make a decision, he said, a small team of investment and operating partners gets in a room and dukes it out. “It’s almost like you’re setting up the Gladiators,” he said. “There’s an argument about how much you will actually pay for this, in front of the three people who at the end of the day make the decision.”

Hasbro’s Denise Clark noted the importance of having a process for making final deal decisions, recalling that her former employer Mattel at one point lost a million dollars a day due to its failed \$3.5 billion acquisition of The Learning Company, championed by Mattel’s CEO. “That fell into this camp of a CEO wanting to buy a company, really pitching it... but no due diligence was done to my knowledge. We just went out there and made the purchase.”

3M’s Mark Copman suggested that asking the right questions of the business executives championing the deal is critical. Once a deal gets to 3M’s executive-level central deal committee, he said, “we ask the same questions every time: strategic fit, financial fit, how you’re going to integrate it, what are the key risks, and why are they selling?”

Copman said 3M learned from experience to ask this last question, and has tried to institutionalize it by telling war stories internally. “They’re selling for a reason, and there are good reasons to sell, like they can’t access international markets or they don’t have access to capital, but there can be really bad reasons too like their competitors are eating their lunch or the product is over the hill,” he explained.

Haas’ Goodson proposed that researching management is a key to effective due diligence. “Without fail, we hire professionals to do a character check and a deep background,” he said. “And if it’s international, we triple the money we put into that.”

TPG’s LaCorte added that he personally checks references and interviews every single executive. And he recommended focusing more on personal motivations than on the executives’ resumes, to get a more authentic feel for fit with the role. “Where did he go to college? Who were his friends? Why did he make the decision every time he changed his job? I don’t ask anything about their jobs, nothing,” he said. “I want to know how introspective they were, so I

can tell whether they're at a point where they can go do what we want them to do which is be maniacally focused."

"The guy who's built up his own company from a start-up may not be the guy to run it inside IBM," stated Miyashita. "He may be more of a visionary and evangelist, and if you find that out in due diligence that allows you to figure out the best retention and transition plan."

Planning for Integration

Participants agreed that planning for integration should begin early in the deal process, for example alongside due diligence, and that determining the desired depth of integration early on, and harmonizing compensation structures, are two key success factors.

3M's Copman said that after the business makes a decision about what level of integration they want, his team focuses attention on whatever's important to the business from both a front and back office perspective.

"If it's a sales-driven business that we're buying, we spend a lot of time on sales," he explained. "If it's manufacturing, we spend a lot of time on manufacturing and supply chain because it may be factory costs that we're looking to save. We drill down so that by the time we've got a definitive agreement, we've got a complete integration plan and can hit the ground running."

IT generally gets involved in planning early, participants agreed, because it touches so many aspects of any given deal. But often IT's input is more operational than strategic, said Eaton's Blausey. "There really isn't a lot of discussion within IT about does this deal make sense," he said. "There may be obstacles to overcome, both from a process and a technology perspective, but it's up to us to figure them out."

He cited one recent exception, a carve-out from a European direct competitor. "We delayed closing for several months because we couldn't figure out how to do the IT systems, how to actually carve them out and run them on day one without the conflicts of interest," he recalled. "That was probably as close as IT has come to killing a deal."

Cisco's Rebecca Jacoby, while acknowledging IT's operational role in M&A, outlined an additional, strategic role stemming from IT's centrality to enterprise-wide processes. "IT can step up to this process enabler role," she said. "We're one more step in the conversation of if we buy this and we believe it's going to fit in this way, does this make sense to you?"

And when a proposed acquisition has an unfamiliar business model, she added, the operations side of IT can become all the more strategic. "Your IT system's ability to handle whatever transition you need to do can be a stumbling block," she said. "IT ends up being a proxy for the operations organization because IT is in a position to see what's going to go south sooner than anybody else. I tell my people every day, that's our job: to connect the dots."

Hasbro's Denise Clark agreed, noting that depending on IT's role in the company the CIO may be called upon to help make the more strategic, business process decisions. "I personally enjoy being on the more strategic side and helping the business make decisions," she said.

Another key integration planning issue concerns the phasing and depth of integration, suggested Eastman Chemical's Lee Whisman, who recalled an acquisition his company integrated slowly over several years. "We should have known what we were going to do up front, and put that into our model," he said. "We would have had a much more focused transition, and the cultural issues would have been easier. We basically chugged them through three layers of change management."

Cisco's Jacoby suggesting the piecemeal approach can be avoided if the integration is driven up-front by what the business model requires, rather than one-size fits-all plans. "The deciding drivers are really about business model, route to market, and what your customer base is," she said. "For example, we have acquisitions with 100% customer overlap that we didn't integrate, and the customers don't like that. It's very painful to go through integration one step at a time."

Planning the integration of compensation structures, especially in sales, is another key issue, noted IBM's Chuck Tadlock. "That's part of our original analysis," he said, "to identify those crucial disparities, because if you break that piece, the whole revenue stream is broken."

His colleague Moni Miyashita said that integrating sales compensation in particular is often a two-phase process, first ensuring retention by preserving existing or comparable comp plans for a defined period of time, then migrating employees to IBM's plans when appropriate. This requires a lot of careful planning, education, and thoughtful execution.

The Integration Team

Getting the integration team off on the right foot, with the right people and resources in place and all moving parts synchronized effectively, is crucial to M&A success, participants agreed. And selecting the right integration lead executive may be the key piece of the puzzle.

"Our integration teams are static and every major function has integration people," said Cisco's Vince Spina, "so that team is always together." The integration team should also get input early on from executives of the acquired company, suggested Eaton's David Barrie, to identify issues with the integration roadmap.

"We acquired a company in Germany a few years ago," recalled Barrie. "[We] went there and gave our presentation on how we thought the business would fit... we thought we knew the company well. The Germans spoke up and said, 'You really don't understand our business model. Here's why we're successful.' And based on that, our people decided to change the integration plan."

Selecting the right lead integration executive is a key success factor, proposed IBM's Miyashita, and in IBM's case that person is just as critical as the lead deal negotiator during due diligence. 3M's Mark Copman said his company learned the hard way after years of mixed results that

centralizing integration, with a dedicated pool of integration managers, is a better approach than “pulling the best athlete from the business.”

“We’d take a Six Sigma black belt, give them a bunch of templates and expect them to learn on the job,” he recalled. “The first 100 days are really critical; if they didn’t have the previous integration experience, the variability in success was much greater. In addition, reentering these people after the integration was completed was really hard. We saw that it was really important to have continuity in the integration function, to have these people know they had the job for two or three years. Centralizing integration leaders has made a big difference.”

Barrie added that underestimating the resources needed for integration is a general pitfall, whether from poor planning or due diligence or simply finding subtleties in the business that you couldn’t have anticipated before taking control of it. And sometimes, he noted, you may have budgeted the resources, but for whatever reason you don’t spend them or you scale them back.

Resource constraints can be a fatal trap, said Goodson, especially when multiple deals are in play at the same time. “This is a problem of priority/capacity, and if you screw one up it’s worth ten good ones,” he asserted. Leadership should know its limitations, Goodson warned, “rather than go into battle with your B team.”

Resource issues also come to the fore in cases where integration is delayed, noted Cisco’s Rebecca Jacoby. “With Scientific-Atlanta, we didn’t do a hard integration up front, and two years later we’re doing a more complete integration,” she explained. “But how do you then actually pay for some of the transitional activities you have to do, that have change management associated with them?”

A chronic integration resource bottleneck, said 3M’s Copman, is finance, where a lot of the nitty-gritty work on integrating systems and reporting gets done, typically without any additional headcount. “It becomes an ancillary job for the finance manager of that division or subsidiary.”

Hasbro’s Courtney concurred, saying the resource challenge goes beyond finance to all back office or staff functions involved in integration. “The expectation is that no matter what you put on the table it’ll be completely absorbed with no additional head count,” he said, adding that it’s difficult to bring in consultants to help out because they lack the intimate knowledge of the business.

“It points up a broader issue in executing integration,” said Jacoby. “When you’re doing an integration plan, you’ve got to make all these different parts move together. The change management guy or whoever has to know how to engage with each of those groups to get the whole package put together.”

And that’s especially true when you’re doing deals globally, noted IBM’s Tadlock. “Balancing those skills around the world where you need them, when you need them, is a real challenge,” he said. “It’s easy to say you’ve got the right people at the corporate level because you can get that,” he said. “It’s when you start expanding it out that it gets harder.”

Getting Alignment: The First 100 Days

Participants emphasized the importance of creating alignment of expectations, strategy and cultures, to maximize chances of success starting on day one of an acquisition. Senior management must create and communicate a clear, consistent ‘story’ to maximize the chance of a successful integration, they agreed.

Copman said 3M had taken a look back at where prior M&A deals had failed, and found five recurring reasons why: 1) When the deal was seemed to be priced too cheap (there was almost always a good reason why); 2) when the business model was too far afield; 3) when management did not emotionally “own “ the asset they were buying; 4) when the company overpaid for a deal, and then built an unrealistic multiple into the financial targets, causing the business to overreach in its business plan; and 5) when there was inadequate follow-through on the strategy.

“You have to follow through on the strategy,” he said, citing the example of an ‘anchor’ acquisition intended to be followed by more acquisitions in the same market.

University of Texas’ David Jemison described a merger of two banks where the organizations only found out they weren’t well-aligned after the fact. “After a few months they realized that the word ‘loan’ meant different things in each bank,” he recalled. “In one bank, it was a verb, in the other, a noun. One active, one passive. And the deal was already done, so they had to learn about each other much later than they’d hoped.”

Tuck’s Hans Brechbühl suggested that a key to alignment might be senior management’s role, and cited a McKinsey study of 167 deals in the late 1990s which identified the consequences of management taking its eye off the integration ball.

The McKinsey study, Brechbühl said, identified five roles that were critical for senior management to perform for the new combined entity: 1) Creating a new and effective top management team; 2) developing a credible, inspiring corporate story to propel the communication effort forward; 3) shaping a strong performance culture (but not an inwardly focused ‘integration culture’ or a ‘survival of the fittest’ culture); 4) championing the interests of key external stakeholders; and 5) balancing speed with time to reflect and absorb integration-specific learnings.

IBM’s Tadlock reinforced the importance of the new top management team “functioning as a single team but without the acquired company’s employees feeling like their management has been ‘taken out.’” But Cisco’s Jacoby warned that “if you’re using the management team from the acquired company you have to be sure they’re not passive-aggressive. Both management teams have to be consistent in their communication,” she explained, “because we’ve found that when that is even slightly off it causes complete gridlock in the integration process.”

In private equity deals, said Goodson, the role of senior management and the new owners in effectively creating alignment is critical. “We’ve got to create the new corporate story immediately, because we’re no longer interested in GAAP earnings. We’re a cash flow company and here’s how we manage ourselves and here’s our scorecard. These are our specific goals and what you’re going to have to do to accomplish them and we either sink or swim.”

Goodson said management must clearly lay out both strategy and specifics, for example expectations about reducing expenses and statistics on debt service per employee, to try to establish a performance culture from day one. “You’ve got to convince them that what you’re doing together makes a lot of sense,” he said, “and that means showing what we mean by our own actions, through symbolism. We’re here with you and we’re not having any donuts.”

TPG’s Blair LaCorte reinforced Goodson’s comments. “If you can set the tone early that this is what we’re going to do, they just accept it,” he said. “If we don’t do a 100-day plan we’ll get so far away from the business that they will not let us back in.”

IBM’s Moni Miyashita described her company’s successful 2004 acquisition of Daksh, an Indian business process outsourcing firm, which has been a huge growth story thanks to an integration executive and a general manager who were able to align the subsidiary’s strategy and execution within the IBM framework, while still maintaining and exploiting the acquired company’s strengths.

“The integration executive, who came from IBM, knew the market, the business model, and the territory. He had run companies in India,” Miyashita recalled. “The general manager sponsoring the acquisition got the mindshare of the senior executives in Asia, India and the corporation, and had a clear strategy about their business and what IBM business process outsourcing would do over there. You have to have complete alignment when you do something that risk taking.”

The Dynamics of Divestitures

Participants discussed key aspects of managing divestitures, including HR issues, intellectual property and brand issues, and the financial and operational impacts of providing transitional services. Transitional services agreements (TSAs) should be negotiated early, and with multiple bidders, to avoid putting too much financial value at risk after a deal price is agreed upon.

A major concern in an environment where deals take longer, making it tougher to keep them confidential, 3M’s Mark Copman explained, is losing key employees to other internal businesses when the word of a divestiture gets out. “People know who the high potential people are, and these people typically want to stay with the company.”

“You’ve got to make sure that the right people go with the business,” he added. “You have to specify who the key people are, and then properly incent them to help you sell the business. We spend a lot of time on divestitures trying to figure out the HR upfront.”

Barrie said Eaton will walk away from a divestiture if the acquiring company can’t provide equivalent benefit levels for at least a year or two. “We have a very strong philosophy on this, we want the acquiring business to be in line with our other businesses,” he explained.

As for intellectual property, including brand licenses, participants agreed that prioritizing IP in divestiture negotiations is crucial. “Patents are the keys to the kingdom,” insisted Tadlock. “Whether it’s an acquisition or divestiture, we have IP people scrub every piece of the deal.”

For IT, the biggest divestiture issue may be the provision of transitional services, and the timely negotiation of TSAs that don't put the company at risk for losing financial value relative to the sales price.

3M's Jerry Ericksen described his experience with his company's pharmaceutical divestiture, which was sold in pieces to three different companies, including an investment bank that had no systems whatsoever. "This one divestiture really was three, and they were all very complicated and very difficult," he recalled. "When you get into providing the services and charging for it, it's a whole new dimension for IT, and it's very difficult. Especially when all of it has to be negotiated, because it gets very convoluted."

Eastman Chemical's Sturgill advised participants to structure their TSAs aggressively to try to get divestitures standing on their own quickly. "We put escalating charges into the TSA," he said. "If you overrun by a month, this is the monthly charge, times two, times three... it seems to work."

"There's a lot of value that's on the table after the smoke clears from the close," added his colleague Lee Whisman. "It's not usually anywhere near the sales price number, but there's still a lot of value to be moved back and forth, and if you're aggressive but fair, you can do something for your company."

3M's Copman suggested trying to negotiate as much of the TSA as early as possible with multiple parties, to avoid getting locked in with no leverage. "The TSA can have huge value. You try to negotiate with multiple parties for as long as you can, not only the purchase agreement, but the TSA in parallel, ... because once you get down to one party, you may have a price, but you can give it all back in the TSA depending on the terms."

3M's Erickson raised a related point about overhead reallocation, noting that once a divestiture is complete, some overhead that was covered by that business must now be absorbed elsewhere.

Closing Thoughts: M&A and Competitive Advantage

Can M&A, when done in a disciplined and consistent way, become a source of competitive advantage? Participants largely agreed that it could, for a variety of different reasons.

"We definitely feel it gives us an advantage," said Eaton's David Barrie. "We've transformed our company, changed our profile based on M&A. And we're usually pretty good at delivering on synergy plans and other performance measures, because we've got the right teams in place, backed up by the right processes."

"Our acquisition strategy is really a key part of our overall strategy, and we have to be able to do it well, with good information, and rapidly," explained Cisco's Rebecca Jacoby. "It gives us a competitive advantage because our obvious direct competitors can't compare with what we've done through acquisitions, in terms of trying to create an end-to-end architecture."

Jacoby added that approaching M&A through the lens of business models is an inspiring framework for IT to think about the strategic contribution it can make to M&A deal success. “This idea of how the customers want to interact with you, when I think about it, it’s just incredible the role IT can play.”

TPG’s Blair LaCorte picked up on this customer-centric view, recounting his firm’s buyout of Burger King and some of the lessons learned which amounted to getting back to basics on the customer. “You have to break it up between back-end and front-end, and look at optimizing both due diligence and integration on the back-end, but then also that customer impact,” he said. “You’ve got to understand who your customer is.”

Goodson, noting how impressed he was with the honest and rigorous performance benchmarking and centralized integration processes among the companies in the room, said he thought these disciplines would provide significant competitive advantage. “You’ve really made this an asset, something that companies can build on and add value to just by its intellectual context,” he said. “These skills and capabilities should translate into shareholder value over time.”

But 3M’s Mark Copman cautioned restraint, noting that while M&A for its own sake can create share price momentum, it’s not necessarily sustainable and doesn’t necessarily create value. “The thing I worry about is that it becomes a drug,” he said. “We constantly remind our team to think of M&A as an adjunct to organic growth not a replacement.”

Tuck’s Eric Johnson picked up on the importance of setting realistic goals to M&A success, noting that he was struck by the discussion about not burdening newly acquired companies with unattainable financial expectations. “Otherwise we can end up in a failure/discouragement mode by paying too much for something and then having goals driven by unrealistic expectations.”

Hasbro’s Tom Courtney and Eastman Chemical’s Keith Sturgill commented on the importance of getting a new deal off on the right foot, specifically planning, getting management alignment, and measuring performance. “What happens early on in the process is so critical to the ultimate success of the transaction,” noted Courtney, stressing the importance of having a ‘first 100 day’ game plan. “Having that good plan out of the gate and some very specific key performance indicators to target in those first 100 days is crucial,” agreed Sturgill.

Overall, participants painted a picture of competitive advantage generated by doing a number of things consistently, well, and as part of a systemic, coordinated corporate approach to M&A. From organizational approaches like centralizing integration resources to disciplined processes like benchmarking and communicating key goals, to a focus on the unique aspects of each deal including customers and business models, successful M&A can be more than the sum of a variety of challenging parts.

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