TUCK SCHOOL OF BUSINESS AT DARTMOUTH
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M&A and Divestitures: Integration and Disintegration

A Thought Leadership Roundtable on Digital Strategies

European 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' European Chapter recently convened for a discussion on mergers, acquisitions and divestitures. What are 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 ABB, BMW, BT Group, Erste Bank, Hilti, Holcim, IMD, and the Tuck School of Business at Dartmouth.

Driven by globalization, private equity, and the corporate debt markets, M&A activity has been strong for several years. And despite the recent private equity slowdown, deals of all sizes continue to get done. From huge companies "merging as equals" to smaller companies getting swallowed to provide access to markets, products, talent, technology and other assets, M&A has become a fixture of the global business landscape.

Yet these deals pose many different challenges for corporations, including cultural, process, and system integration. While the fundamental question of merging, acquiring, or divesting—and on what financial terms—is an important and strategic decision for most firms, the devil is often in the details of integration (or separation), the thought and due diligence that was given to it in advance, and the investment in it during execution.

Companies that do M&A well can generate considerable competitive advantage, while those that don't can stumble badly. What are the key strategic and execution issues that companies need to focus on to make the most of their M&A initiatives? What market dynamics will drive M&A over the next couple of years? And what best practices in due diligence, planning, deal-making, and integration (or disintegration) are most important to focus on? The insights presented below represent a cross-section of the considerations that can make the difference between success and failure in this high profile and critical business arena.

Emerging markets are becoming a key focal point for global M&A activity, offering some of the most attractive opportunities, yet the greatest challenges to strategic acquirers.

While traditional M&A deal drivers still predominate (e.g., build scale, acquire market share, talent, and technology), global corporations are increasingly focused on expanding geographic coverage via emerging market deals.

These deals potentially offer greater growth opportunities, and emerging markets are often less picked over and consolidated. Yet buyers must be prepared to invest substantial capital for the long term, and often must 'earn the deal' by bringing clear non-financial value (e.g., operational know-how) to the table to woo demanding sellers. Most significantly, M&A deal dynamics and cultural issues vary broadly across the spectrum of emerging market geographies, notably in key markets like India, China, Russia, and Latin America.

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It's important to recognize and act on M&A 'windows of opportunity,' for example the current pause in private equity activity.

Major opportunities for strategic buyers, like the wholesale 1990s privatization of Eastern European national industries, don't always come at the most convenient time. Be ready to go with plans, processes, and homework done in advance when these windows open. Get local and regional managers fully engaged in the M&A process, because they're closer to the deal pipeline and will hear about the best opportunities before corporate does. With private (non-listed) sellers, its crucial to get the approach right the first time, as you may only get one chance.

The current de-leveraging and slowdown in private equity may create an opening for strategic buyers, but of unclear duration as there's still plenty of PE money sitting on the sidelines. Whether prices and premiums come down or not, there are fewer 'crazy' deals getting done and cash is again a major advantage.

M&A decisions should ideally be driven by business unit needs and strategic fit rather than corporate mandates and non-organic growth targets.

While financial markets may reward non-organic growth via acquisitions, corporations should take a portfolio approach, prioritizing deals which advance business unit goals and maximize the strategic fit.

There is often tension between top-down corporate and local M&A agendas, and prioritizing deals within the global portfolio of business opportunities is a challenge. Business units must aggressively sell their deals, and corporate decisions makers must get top managers to personally 'sign up' for making deals successful. In hindsight, customers will be the ultimate judge of a deal's value (and in the case of listed companies, analysts and shareholders will have a say as well).

Executives should treat forecasts, financial metrics, and valuation models as important tools, yet acknowledge their limitations and focus on the bigger picture behind the numbers.

Financial metrics and modeling techniques are by definition incomplete, frail, and subject to broad interpretation and manipulation. Differences in hurdle rates, WACC or DCF assumptions may be used by corporate to encourage certain types of investments over others. Cost savings and synergies are often easier to forecast than revenue growth and synergies. Integration costs are tough to predict and model. Additionally, there are many potential pitfalls where large amounts of financial value can change hands based on final contract details such as definitions of cash, assets, and debt.

Furthermore, since most deals are not auctions, actual final pricing may come down to emotions and people, and there are usually significant non-financial deal points. Decision-makers should look at the deal numbers with an eye to the overall corporate financial impact (EPS, debt, etc.), and should recognize that getting an accurate financial look-back on deals is often difficult because acquisition results may get buried in the larger entity.

People are at the heart of M&A, and properly evaluating and retaining the key management and staff of an acquisition is crucial.

Although current management may be expected to walk away in some situations (e.g., hostile deals or asset acquisitions), friendly deals which keep existing talent in place typically yield the best outcomes. Corporations should do their homework in due diligence to identify top talent, understand their motivations, and then sell them on the value of staying with the company.

Non-financial considerations like role and authority often trump financial incentives, and companies may want to consider giving top acquired talent a major chunk of the new business to run, though this may require sacrifices for existing managers. Top talent that's gotten rich in a private equity deal may be the toughest to motivate. Mid-level managers are perhaps the most at-risk to poaching by headhunters as a deal closes, and need to be personally convinced that the acquirer understands, respects and values them as individuals, and that staying will make sense for their career.

Recognizing and managing cultural differences is crucial for realizing deal value; seemingly trivial differences can often be much more problematic than large obvious ones.

Cultural differences are the most common cause of failed acquisitions, and recognizing and addressing them early on is key. Be explicit about differences: don't let people 'assume' they understand each other, even if they're from the same geographic region, because minor behavioral disconnects (e.g., etiquette) or divergent conceptual definitions can have major consequences.

Try to forge a common perspective across cultures: both sides should understand the rationale for the deal, and ideally they'll both be giving something up and gaining something. Deals work best when there's no one dominant nationality or language; yet geography and language are not the only considerations. Cultures can also be values-based (paternalistic private family-owned business vs. market-driven listed company). Harmonizing cultures is a long term process that requires sufficient management focus plus proactive approaches like physical collocation or management rotations. Don't forget that change can flow both ways … you may want to explicitly 'infect' the parent culture with elements of the acquired culture.

Integration should be purpose-driven, with a focus on customer needs, on business model and processes, and on why you did the deal in the first place.

Challenge the assumption that everything must be integrated … what does integration mean in a world where many virtual value chains function quite well? What's really required to achieve synergies? To satisfy customers? To achieve the deal goals? Spend time up front talking about the business model and business processes and let that drive the integration planning. If you're primarily acquiring talent or access to a new market segment, for example, systems integration may not be important. On a smaller acquisition where you want to preserve the target's entrepreneurial spirit, consider providing a senior-level gatekeeper to protect the unit from being smothered by corporate 'helpfulness.'

Establish a multi-competence integration team, starting with the key people who did the deal (and make sure they deliver what they promised). Consider separating the integration 'process' and 'content,' with process being run by professional teams and content being run by the local managers closest to the businesses.

The timing of IT's involvement should depend on what's expected: if significant IT synergies are anticipated, get them involved early on. And if realizing the value of the deal involves substantial process re-engineering, IT will likely be in a position to play a major role not just at the systems integration level, but at an organizational and process level.

The first 100 days are critical to the success of any deal. Communication, decisiveness, and clarity of expectations are among the key success factors.

From the start, eliminate uncertainty by making sure everyone understands why you did the deal, what the goals are and how they'll be measured, what will be changing, what the integration will look like—and that none of it is personal. Surface problems right away and address them openly. Communicate milestones and metrics internally and to shareholders to keep momentum. Tee up quick wins to tangibly demonstrate the potential of the combination. And be sure to align the sales forces and their compensation structures as quickly as possible to avoid infighting or customer confusion.

Top management, including the CEO and key lieutenants, should get personally involved (preferably on site), both to make the acquired employees feel important and to closely track integration progress and make sure needed support is available. Top management should also help keep the organization from becoming too internally focused by setting aggressive targets, discouraging over-engineering or excessive 'best practice' promulgation, and keeping the spotlight firmly focused on customers and the marketplace.

Divesting a fully integrated business can be both emotionally and logistically difficult. Getting managerial buy-in is the key.

Asking long-time staffers to leave the company as part of a divestiture can feel like selling your children, and if key managers refuse to get on board it can jeopardize the deal. Tell the truth about why the deal is necessary and be sure you've provided sufficient incentives to enough managers to assure their full support.

Beyond that, there are many details to get right in divestitures, ranging from transitional IT services to IP and knowledge transfer and licensing. Pre-negotiate these as concretely as possible, as some buyers (e.g., private equity) may be harder to wean from operational systems than others.

Knowledge, discipline, planning, and strategy are the keys to succeeding at M&A. Encourage learning from past successes and failures, and don’t forget to sweat the details.

You needn’t do lots of deals to be good at them, but it’s crucial to be disciplined, thoughtful, open, and strategic in your approach. Stay diligent to avoid becoming complacent as you do more deals.

It’s important to have a strategic M&A plan so you’re not making deal decisions on an ad hoc basis. At the same time, the devil is in the details of each deal, from due diligence to final negotiations, to integration planning and execution. The winner is often the party most knowledgeable about the target’s business and key assets, as well as the deal terms (which is why private equity firms spend billions on research and consultants).

Participants in Thought Leadership Roundtable on Digital Strategies London, 4 April 2008

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