You bought it; don't break it!

The Art of M & A Integration

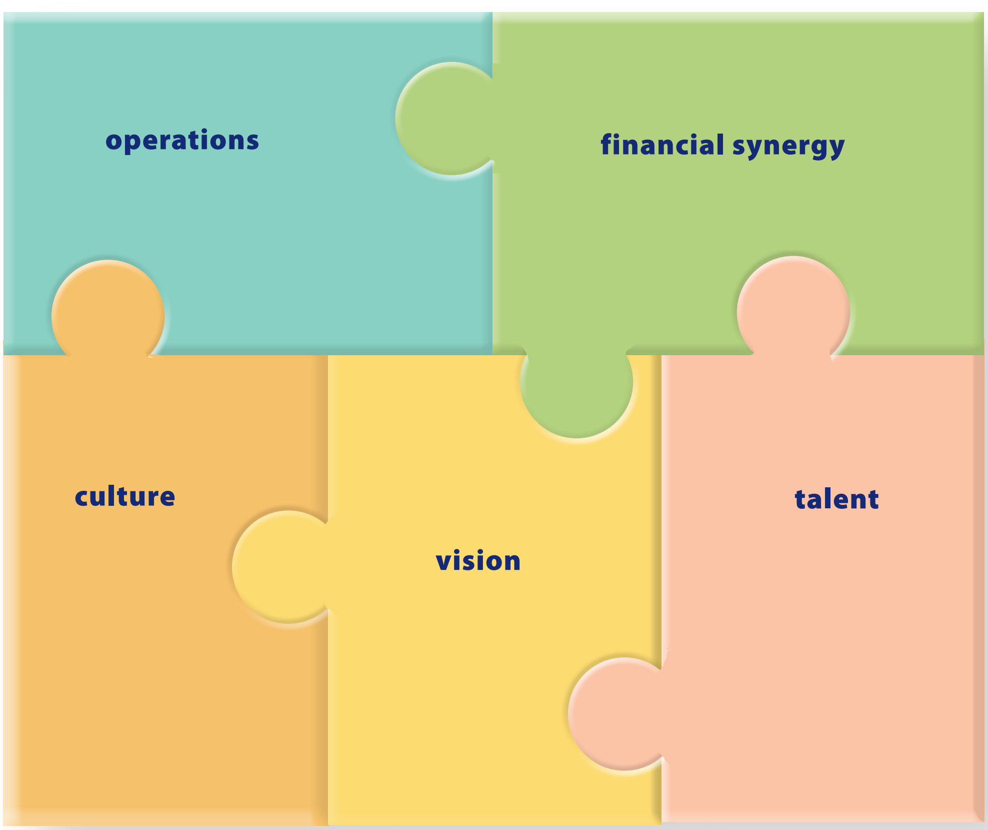
LONG BEFORE THE INK DRIES on the legal agreement to acquire a company or to merge two entities, the integration strategy should be clear, but the timing can be tricky. Attempting to fill in the details too soon can take eyes off the integration. When that happens—often in response to pressure from investors, analysts, and other stakeholders—an incoherent story emerges. Effective integration considers both the internal landscape and the external panorama—with customers central and critical to all decisions.

In the heat of finalizing the deal, integration is often left until the last minute or given short shrift. Rather than roll the dice, consider the following framework, the Five Essential Decisions of Successful Mergers or Acquisitions.

Vision

Review of the parent company's strategy and forces affecting it sets the stage for examination of the target's strategy. The success of the integration process then depends largely on senior leaders taking a holistic look at both companies. This process should circle back to strategic questions that will illuminate cultural differences, clarify which parts of the companies that should be integrated, and which should remain separate. Not all acquisitions require integration, however; sometimes the parent company will decide to run the newly acquired company as a separate entity.

If you had evaluated Blockbuster in 2002, while Netflix was in its infancy and the web still nascent technology, you would have given the company high marks as an acquisition target. But if you had asked how well prepared they were to deal with emerging distribution systems, you would have felt less confident about their ability even to sustain their value. With some vision, you might have predicted they were six years from irrelevancy and nine years from bankruptcy. The same test would



apply to companies in the music and publishing industries over the last five to seven years.

Financial Synergy

Some authors refer to "incompatible business models" undermining a deal, but what does that really suggest? It means that when companies make money in vastly different ways, doing extremely different things, and no one recognizes it, joining them is challenging, costly, and probably ill advised. If you don't understand how the other company makes money, it is impossible to assess the pragmatics of their growth plans. Over-confidence in creating projected future value creates its own set of problems—ones that can increase in complexity if no one challenges assumptions.

Once the acquirer understands the financial picture and assesses the credibility of the projections, they can make integration plans more rationally. For example, the new joint operation will need to look different, depending upon whether the new organization will increase only in size or whether it will grow in scope as well.

Various formulas exist for determining the role revenue, cost savings, cash flow, returns on investments and assets should play. Consequently, when the deal moves to the due diligence phase, the finance people will have myriad lenses to look through to examine the financial fit of the organization. Fulfilling the promise of the deal, however, requires more than analysis; it takes a thorough understanding of how financial decisions affect the behaviors of all employees, especially those in sales and operations—the engines that drive everything else.

Operations

For obvious reasons, an existing customer base makes a company attractive from a strategic standpoint, but from an integration viewpoint, acquirers need to look beyond the customer base to understand how the target company interacts with them.

Acquirers will then want to know, "What value does the target provide customers?" As you examine your target company's brand and repute, what do you find? You'll want to see evidence that they respond well to competitors and changes in the industry, and their customers would miss them if they went away. A solid track record for taking appropriate risks, continuous learning, growth, and agility will offer further evidence that they understand what they must continue to do to provide their best customers the best value. More than any other single factor, their ability to adapt will contribute to efforts to integrate operations and maintain sales after the close.

Before deciding to merge or acquire, acquirers need to understand how their deal partner makes critical decisions, formulates strategy, and implements that strategy. At the integration stage, acquirers will want to understand what resources the target offers, the processes that have worked well for them, and the brand they have built. The answers to these questions will do two things. First, you'll understand which among their sacred cows you'll spare, and two, you might discover ways to improve your own ways of doing business.

Cultural differences that derail M & A deals have more to do with beliefs about the ways the companies make money and less to do with customs and interactions.

One of the biggest impediments to integration involves change—the change itself, the fear it brings, and the speed with which it happens. Everyone on both sides of the deal will expect change; the fear will surface when people don't understand what those changes will be or when they will occur. During these critical times, indecision and secrecy will be your enemy. Companies that weather all the stages of the deal and emerge successful do so because they keep their eyes on both their external and internal customers.

Talent

Most acquirers conscientiously work on integration of business systems, but few pay attention to an equally important part of the transaction—the assimilation of people. Acquiring companies tend to keep their senior leaders in place, but decision-makers on both sides should challenge this assumption. Often the target company will offer exceptional talent in key areas.

Integration proceeds from the minute the buyer signs on the dotted line until everyone alive has forgotten that two separate companies ever existed—in other words, forever. Although commonality exists regarding best practices for making the integration of talent go smoothly, no formula or checklist exists to adequately address every situation. However, when making talent decisions, look beyond the obvious success indicators like performance reviews and experience to determine which person will make the best decisions for the newly minted organization.

Culture

Culture involves the pattern of shared assumptions that a company has adopted and adapted over a period of time as they solved their problems and adjusted to the world around them. During a merger, the goal is to join two companies that might have adopted and adapted to the world in very different ways—often when the assumptions of each will be only partially visible. Although all aspects of culture play a role in any major transaction, the cultural differences that derail M & A deals have more to do with beliefs about the ways the companies make money and less to do with customs and interactions.

Are you currently running the existing business well enough to sustain the strain of integrating another? A company should start an acquisition from a position of strength, because an acquisition will put a substantial strain on the acquirer's resources. Further, if a company faces difficulties on the home front, an acquisition is unlikely to solve them.

To determine how well you're doing in the integration process, evaluate how well you're doing on the Five Essential Elements for Successful Mergers and Acquisitions:

Integration Assessment

Score this deal from 1 to 4 for each of the statements below.

Rank each on a scale of 1 to 4
1=Totally Disagree 2=Disagree 3=Agree
4= Totally Agree

Vision

1 We have established a timeline for critical changes.

2 We have decided how to integrate our brands.

3 We have committed to a clear mission.

4 We have a strategy to communicate integration objectives.

5 We have a post-merger integration plan based on the investment thesis.

Financial Synergy

1 We have accurately valued the combined tangible and intangible assets.

2 We have established key interim measures of success.

3 We have met the financial criteria set by our investors.

4 We have stress-tested our view of their financial situation.

5 We have made key decisions about the integration of financial systems.

Operations

1 We are able to track customer happiness in real time.

2 Relationships with key suppliers have been secured.

3 We have comprehensive, enterprise-wide IT system capability to replace multiple legacy systems.

4 We have a plan to integrate sales and marketing to fuel growth.

5 We have calibrated speed, giving consideration to possible disruptions.

Talent

1 We have selected the best person for each key role.

2 Each key player has agreed to a compensation / benefit package.

3 Functional leaders are in place.

4 We have clear lines of accountability for each function.

5 We have developed a succession plan for key positions.

Culture

1 We communicated the type of organizational culture needed to fuel success.

2 We have described the specific behaviors people will need to exhibit to succeed in the new culture.

3 Leaders make our values more credible through their behavior.

4 We have a code of conduct for the new organization.

5 Reporting structures are in place.

90–100 Escape Velocity
Congratulations! You have a clear mission, a vision for the future, and a rational plan.

80–89 Thrilling Ride
You have a number of things in place, but you may be tempted to let the thrill of the ride override your good judgment. You are far better off challenging yourself now than wishing you had done so later.

70–79 Unclear Direction
You need to devise a plan and implement it immediately. Otherwise, your well-laid plans during the due diligence will quickly turn to disaster. The energy and focus that you will need to keep this on course is minimal compared to the losses that will accumulate if things go badly.

Below 70 Implosion
Only direct and immediate action will avert the disaster. Whether you're about to do a deal or have just closed on one, you are in imminent and certain danger of taking this deal to the wrong side of zero.

Conclusion

Don't assume that bringing together companies is an entirely rational process. Consider emotion too—yours, your employees', and your customers'. Who in Chicago will soon forget Macy's demanding the name change of Marshall Field's in 2006, compromising a brand name that has stood for excellence in Chicago since 1881? Too often the acquiring company insists on improving things, replacing things, and renaming things that didn't need to change in the first place. If you find a company worth buying in the first place, it's probably worth trusting, funding, and encouraging it to thrive by being strategic about integration.

Client Results

- Merger of two finance companies produced dramatic growth in revenue and profit
- Acquisition and integration proceeded while maintaining sales growth
- Acquisition fueled upgrade in top talent, resulting in no loss of revenue post deal
- Selection of an outstanding new CEO for a NYSE organization impacted market capitalization while positioning the global enterprise for enhanced levels of growth and profitability
- Merger of two global, publically-traded companies returned 50% growth in two years, post deal
- Another merger of global companies achieved 100% growth in share price after two years
- Acquisition led to revenue growth and enhanced reputation of the firm, the board, and Chief Executive Officer
- Firm successfully acquired poorly performing licensee of its trademark and restored brand integrity
- Acquisition succeeded in adding R&D capability and market share while reducing SG&A

Dr. Linda Henman, the author of *Challenge the Ordinary*, works with leaders who want to think strategically, grow dramatically, promote intelligently, and compete successfully after a merger or acquisition.

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