Consulting services

Merger Integration Principles

An executive's guide to accelerating the transition for deals and managing change

pwc

What would you like to grow?

Forward

There is no value in a prolonged integration. It adds cost, slows growth, destroys profit, and reduces or postpones the payback. The basic principles to an accelerated integration are simple:

1. Base the strategy on the economic ***Value Drivers***.
2. Launch small, fast-paced, short-term ***transition teams*** that will accelerate implementation of the Value Drivers.
3. Aggressively ***manage communications*** in order to secure stakeholder support and acceptance.
4. Align ***organisational roles and responsibilities*** to ensure clarity of direction accelerate the decision making process.
5. Select and deploy ***role models*** who support the desired culture.

The holding pattern

After the deal announcement is made the company promptly finds itself in a holding pattern. Positions aren't filled, infrastructure projects are put on hold, financial investments are postponed, etc. The results – competitors get a free throw of the dice, middle management and employee frustration runs high, and the critics come out of the woodworks. While the company sorts through the inevitable lists of things to do, the external market and all the players are in motion.

West-side Baseball – played on the streets of Chicago's west-side. It's like regular baseball in almost all respects. The most important difference is the basic rule of play. After the ball is pitched, and for as long as the ball remains in the air, anybody can kick the bases anywhere they want. Consider the batter's dilemma: to get a hit, he has to keep his eye on the ball. However, as soon as the ball leaves the pitcher's hand he knows the field is in motion.

Many of us will remember the game of British Bulldog when we were at school – a daunting exercise of speed and aggression – but at least you knew what the rules were and what to expect.

Law of unintended consequences

Once a deal closes, management has to manage a multitude of challenges and produce quick wins that support the reasons why the deal was done in the first place. Their actions, in the face of these challenges, can often have secondary effects that undermine the original intent. Managing personalities and politics, and the daily bushfires that invariably ignite, mean that distraction can turn into derailment.

Speed

Speed, focus, and early momentum are vital to recognising early shareholder value.

Band-aid analogy – Remember your first few cuts and scrapes as a kid? Worse than the initial injury was the dreaded Band-Aid removal – that slow, hair-pulling, torturous peel.

It didn't take long to learn that one quick rip works the best. The same holds true for corporate transitions. There is no value in prolonging a transition.

From a financial standpoint, the faster you can complete the transition, the faster you can realise returns on your investment. Shareholders and market analysts may applaud the audacity of the deal but are instinctively sceptical of corporate behaviour, and will only grant a short honeymoon period before casting their first doubts – simply a case of "damned if you do – damned if you don't". If your transition is not progressing along a 100-day critical path, you're behind the power curve.

From a competitive standpoint, speed allows you to exploit post-deal opportunities on your own terms, forcing competitors to react and denying them the luxury of a calculated response.

From a personal standpoint, speed reduces pain. It decreases the amount of time you're forced to deal with the crippling effects of uncertainty. Just as there is a time value of money, there is a time value to employee and investor enthusiasm. The earlier you stimulate that enthusiasm, the sooner you can leverage that support into real momentum.

Obsessive list making

If you're like most companies in a transition, nearly everything becomes a priority. The head of each functional area, business unit, or special project focuses primarily on the needs of their own team. The result becomes a master list of mind-numbing, morale-destroying, ego-deflating, knee-buckling litany of tasks.

With an absence of a clear set of priorities, people are more likely to carry out those actions that are easiest to accomplish and personally rewarding rather than the actions most likely to drive shareholder value and capture early returns.

List-driven transitions are prolonged transitions. They dilute resources, undercapitalise efforts, and sub-optimise results. By giving administrative detail and marginal cost-cutting the same priority as other value creating actions, leaders misallocate resources, frustrate the workforce, and retard progress.

Value Drivers

Value Driver Analysis

It's not about strategy. It's about execution of strategy. It's about prioritising and allocating resources to actions with predictably high payoff and success.

Value Driver analysis is a financially based process which helps teams (rapidly) agree on the 20% of integration initiatives that are likely to drive 80% of the economic value. These initiatives also have the highest probability of success in the shortest possible time frame.

Although Value Drivers are unique to each transaction, the three steps for identifying them are fairly standard:

1. ***Identify the Value Drivers.*** The management team should identify
   (i) actions that should be taken to increase and sustain revenue, decrease cost, or capture other value,
   (ii) an estimate of the quantitative impact, the time frame, and the assumptions underlying the estimate, and
   (iii) the probability of success, including interdependencies with other actions, obstacles that may prevent realisation, and resources required for implementation.
2. ***Rank the Value Drivers.*** Convert estimates and assumptions into a simple measure of shareholder value (for example, free cash flow), and rank each Value Driving action based on its financial impact and probability of success.
3. ***Make the decision to concentrate resources.*** Secure senior executive team consensus and commitment on the key post-deal actions and the relative impact they are likely to have on value creation.

Value Driver Matrix *(see Figure 1)*:

- The left side of the matrix lists are all the Value Driving actions by financial impact (e.g. cash flow).
- The bottom of the matrix lists the Probability of Success (POS) for each Value Driving action. The POS is a function of available resources, time-to-complete, key assumptions, and impediments (e.g. regulatory, technical, competitive).
- The matrix plots each action by financial impact and 'POS'.
- The company must base its transition on those actions in the upper right hand quadrant – highest financial impact and highest POS – to have a Value Driven transition.

Value Driver Matrix

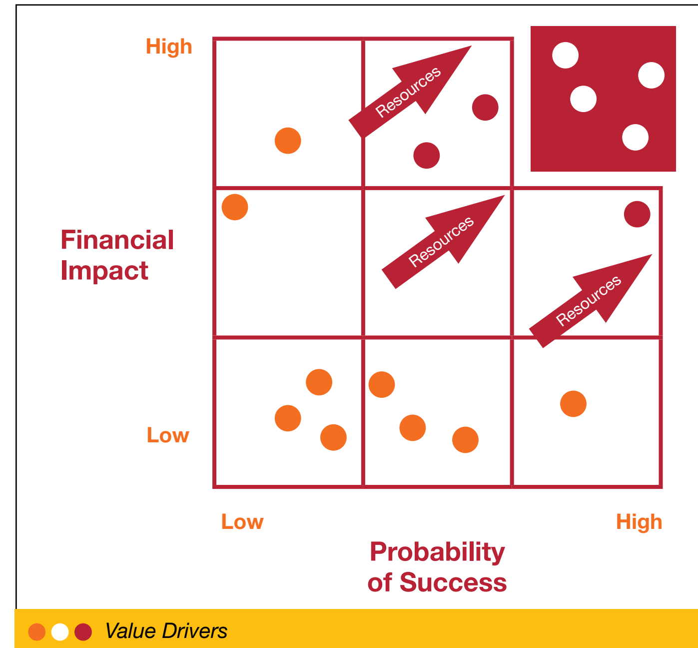

Figure 1—Intiatives are ranked according to financial impact and probability of success. Those with the highest financial impact and highest probability of success receive resource priority.

Transition teams

Five Frogs on a Log – Five frogs are sitting on a log. Four decide to jump off. How many are left? Five. Why? Because deciding and doing are not the same thing.

Deciding is easy, executing is hard. After the deal is done, management typically awakens to the cold reality that strategy and execution are two different animals. The executive team charges headfirst into the transition minefield with no map, no armour, and no clue. Implementation becomes a detail lost in hype and left to overworked, underinvested transition teams and steering committees.

With no clear sense of direction, companies tend to gravitate toward one of two planning extremes. They either form too many transition teams and end up with a "planning circus", or they scrupulously avoid anything representing a participative process and end up creating a small "members only" club. Pursuing the members only path stalls cooperative decision making and reduces support and buy-in.

Planning Circus – There's an old yachtsman's creed: If you can't tie good knots, tie a lot of them. Many companies think that this applies to selecting transition teams. The basic idea is sound, but this method of teamwork tends to add work and prolong the transition. In other words, it becomes a planning circus. The result is always suboptimal. Size slows speed and dilutes accountability.

The primary purpose of a transition team is to implement strategy, not develop or validate strategy. The transition team's charter is to make progress on things that create real economic value, real fast. The process of forming and chartering these teams is aimed at defining concrete deliverables, creating clearly defined roles, and committing the organisation to specific timetables for taking action.

Geelong Football Club – The Geelong Cats adopted a strategy that helped them win two Grand Final Premiership trophies after a 12 year drought. Rather than use the same strategy of other teams, full of flooding and stoppages, the Cats adjusted their plays with a will and a means to attack; play full throttle and dare the opponent to keep up. They kept to this strategy, regardless of opponent, throughout the season. They also worked more closely as a team versus relying on the best players to win. Everyone had clear roles and responsibilities, both individually and as a collective.

The same strategy works for launching transition teams. Decide on the game plan (strategy, Value Drivers, and priorities). Build the right team structure, define roles and give individuals their game plan (charters, responsibilities and actions plans).

Transition team selection process:

1. Group Value Drivers into categories.
2. Assign a transition team for each cluster of Value Drivers.
3. Staff transition teams with a few (three to five) of the best and brightest people. Configuring teams on the basis of functional knowledge, line of business, special initiative or market segment is common. Cross-functional teams may be used in more complex Value Drivers. Representatives from both companies are important, but there is no room for horse-trading.
4. Select a transition team captain; the executive committee should do this.
5. Sponsor each transition team by a member of the executive team.
6. Assign timelines and accountability.

Launching the transition:

1. Conduct a two-day offsite launch of all the transition teams simultaneously to create a sense of urgency, to energise the teams to act, and to:
2. Create a common understanding of the reasons for the transition, the Value Drivers, and the actions that must be taken over the next few months to accelerate progress.
3. Create concrete action plans for each Value Driver with assigned accountability and committed time schedules.

Manage communications

Communication imperatives

Once a deal has been announced, the focus quickly moves from being an economical equation to an emotional one – all of a sudden every manager, employee, customer and supplier is thinking about what it means for them and their job.

Hyping, equivocating, and hip-shooting tend to be dominant tactics for managing communication during a major transaction. The messages are usually content free. They are more about making pronouncements than connecting with people. They fail to connect with the real information needs of employees, customers, suppliers, investors, and other stakeholders.

As the acquirer, you are paying a substantial hidden premium in lost productivity as your employees spend time each day wondering, worrying, and gossiping. In the absence of effective communication during a transition, rumours and partial truths quickly mutate out of control and drive down the prospects of capturing early shareholder value.

When management announces a change and follows it with silence, or worse yet, equivocal statements and pleas for time to sort things out, they allow dozens, sometimes hundreds, of molehills to proliferate.

Communication is a stabiliser. It keeps people focused and energised rather than confused and perplexed. It minimises the crippling effects of uncertainty on performance. It builds support for a new business proposition among all the stakeholders who are expected to buy into and deliver the new proposition.

Four firm rules should be followed: no secrets, no surprises, no hype, and no empty promises.

Effective transition communication is based on three simple principles:

1. Silence is not an option, even if you do not have all the answers.
2. Know and verify what stakeholders are most concerned about.
3. Have an integrated information strategy that addresses stakeholders' concerns and speaks to them through channels they trust.

Stakeholder analysis

The communication of change is not about announcements. It's about gaining support and capturing buy-in.

All stakeholders quickly begin to speculate about the implications of the deal for them. This speculation is immediate and concurrent with the announcement itself. Consequently, only a fraction of the message is absorbed. It is coloured by personal biases, concerns, and misconstructions. Every group of stakeholders has its own mix of concerns. Understanding those concerns is a primary objective of stakeholder analysis.

Stakeholder analysis helps surface the early urgent concerns (EUCs) that create distractions and disrupt operations. EUCs will erupt into crisis if not dealt with immediately.

Stakeholder analysis involves three steps:

1. Identify all stakeholder groups across all locations. Stakeholders include employees, customers, suppliers, contractors, strategic partners, and major investors.
2. Gather data quickly from as many stakeholder segments as time and resources permit. This is done through focus groups, interviews, and surveys as soon after the announcement as possible.
3. Consolidate information gathered and build a database of clear statements of concerns, perceptions, and preferred communication channels by stakeholder group.
4. Plan communications so that everyone has a role to play to deliver the message and manage stakeholder issues. eg. CEO emails are good, but soon lose impact. Site based employees will listen to their immediate supervisor or manager.

Organisation roles and responsibilities

Organisation alignment

Barnyard chickens have a well-defined pecking order. Mix in another flock and you disrupt this order, the rules governing which bird peck's another becomes uncertain.

The same principle applies in a merger. CEO's seldom experience more pressure to clarify authority, control, and reporting relationships than after the announcement of a merger. Succumbing to pressure, their decisions favour form over function, titles over accountability, and hierarchy over role clarity. In M&A, the first symptoms appear during the horse-trading and negotiating that accompany the early stages of a transition. The result often leads to barnyard behaviour and an early preoccupation with organisation charts.

Organisation charts say more about authority, status, power and turf than about the flow of information and the way decisions are made. Changing roles and complex interrelationships are not clarified with the publication of a traditional organisation chart. People want to know what is expected of them, what they are accountable for, what decisions they own, and what decisions they share. Boxes and lines don't answer these questions.

Steps to creating an effective organisation chart:

1. Define the impact that each executive position has on driving value in the new organisation.
2. Describe the results for which each executive position is accountable, what decisions each position owns, what decisions each position shares, and the interdependencies between all the executive positions.
3. Do the same thing for the subordinates.
4. Prepare an organisation chart.
5. Publish the accountability and decision authority for each position on the chart, and define how the configuration supports the creation of long-term, sustained economic value.
6. Set clear and link incentives at all levels aligned to desired outcomes from both business strategy (business as usual and organic growth) and integration.

Policies and practices

One of the unstated advantages of a deal is the opportunity it affords a business to renovate outdated structures and align new roles with business priority. A merger provides a temporary shield for altering structure, redeploying people, redesigning roles, and reconfiguring core work processes and systems.

Unfortunately, the opportunity to eliminate practices and processes that constrain and obstruct performance is typically lost in a narrow minded, post-deal rush to reduce cost. Management teams begin carving costs before fixing, or even understanding, the systems and procedures that drive the costs. A phenomenon driven by promises that the significant acquisition premiums paid are justified by synergy-related cost cutting.

Turning camels into racehorses – Remember the story about how a camel was created? A committee set out to design a racehorse and, committees being committees, compromised until it ended up with a camel. Many companies have created camels over the years. When they want to turn those camels back into racehorses, they try cutting off the humps-and they end up not with racehorses but with dead camels.

When an effort is finally made to integrate or reengineer processes and practices, choices are made on the basis of which company's individual practices are deemed best. Other people's best practices work best in other people's companies. Best practices are based on past conditions. A deal creates new conditions. By communicating a strategy of selecting the best practices from both companies, leaders invite open and bitter debate over everything. This retards progress, creates distractions, and lowers morale.

Hull speed – Boat designers always wrestle with something called hull speed. A boat can only go as fast as the hull design allows. Once maximum hull speed is reached, the craft cannot be made to go faster, even with larger engines or more sail. To go faster, the hull must be redesigned. But hull redesign can have a profound impact on safety, stability, handling, and cargo space. All of these factors must be considered simultaneously when designing a boat.

The same principle applies to the design (or redesign) of an organisation's system, procedures, and structure. Organisations enter a merger or acquisition as fully functioning, self-contained systems of processes and practices. Selectively swapping out a practice from one organisation and substituting a practice from the other organisation disrupts these systems in ways that are difficult to anticipate and even more difficult to correct.

No merger of equals

There is no such thing as a merger of equals.

Red footed and blue footed boobies – In the Galapagos Islands, there lives a species of waterfowl called a booby. Some boobies have red feet and some have blue feet. Once upon a time a group of inquisitive naturalists mated red-footed boobies with blue-footed boobies to see what would happen. Would the boobies have one red foot and one blue foot. Better yet, would some purple-footed boobies emerge? Well, to the disappointment of the naturalists, neither occurred. The hatchlings were either red-footed or blue-footed boobies. It was Mother Nature's way of saying there is no such thing as a merger of equals.

Businesses also tend to be either red or blue. Yet many executives believe they can successfully blend the best of two organisations; they attempt to create a purple-footed corporate booby.

Role models

Culture

Corporate culture is the set of entrenched behaviours that characterise how a company gets things done. Culture often becomes the scapegoat of failed deals. However, while cultural differences are undeniably a challenge, culture is rarely the culprit.

It's easier to transform corporate culture following a merger or acquisition than at any other time. Investors, customers, suppliers, and employees all expect changes to occur. The marketplace is primed, the workforce is ready, and management is eager to get underway. However, despite overwhelming evidence that cultural differences must be addressed swiftly, many executives believe it is possible to merge cultures gradually.

Preaching vision and values – You cannot merge two cultures by waiving a banner proclaiming common vision and values. Cultural integration is about behaviour change – not rhetoric.

Culture change is based on four factors:

1. ***Defining desired behaviours.*** This should begin with the Value Driver analysis. Statements about strategic and economic benefits must be converted into straight forward behavioural examples of how people will be expected to operate in the post-deal environment.
2. ***Deploying role models.*** Select role models who exemplify the desired behaviours and deploy them in visible positions of authority throughout the company.
3. ***Providing meaningful incentives.*** Shower the role models with recognition. This will position them as people whose behaviour should be emulated. The message will further be reinforced if other employees who engage in the desired behaviours are quickly and visibly promoted, recognised, and rewarded. This sends a signal to the rest of the company.
4. ***Avoiding muddled messages.*** Avoid having a difference between written policies and rewarded behaviour.

The most common mistake that executives make when the deal is struck is horse trading. Executives either attempt to take care of their own people or bend over backward to show impartiality.

Turtles on fence posts – There is an old Chinese proverb that says "If you see a turtle on a fence post, you know someone put it there." In the context of mergers and acquisitions, it refers to people in senior positions who didn't win these posts on their own merit. The result is the wrong people in the wrong jobs.

First-rate people hire first-rate people, second-rate people hire second-rate people, and third-rate people hire morons.

In selecting role models what matters most is what people will do, not what they can do.

Shooters and bashers – Many years ago an elementary school coach invented a game called boxing basketball. He put a pile of boxing gloves in the middle of the court. Each of his nine-year-old players was told to select one glove. The rules were simple – normal basketball with one exception. The kid who had the ball could get bashed as long as he held on to the ball. The coach was trying to teach teamwork and ball movement: the longer you held on to the ball, the more you got bashed.

A player could choose to put the glove on his strong hand or his weak hand. There were advantages and disadvantages. With the glove on his strong hand, he would be pretty good at bashing but have a harder time shooting. If he put the glove on his weak hand, he'd be good at dribbling, passing, and shooting but not very good at bashing. At the beginning, most of the nine-year-olds put the glove on their good hand - bashing was the order of the day. The kids just didn't get it. After a while some players realised that winning the game was about making points, not bruises. So they switched hands. The teams with more shooters regularly beat teams with more bashers. They moved the ball around, avoided most of the bashing, and scored most of the points, while the bashers chased the ball around the court, trying to catch up with somebody to slam. Eventually there were two kinds of teams: Shooters and Bashers. Shooters allied with shooters and bashers allied with bashers. Shooters always won the games. But there were always teams of bashers. It wasn't that the bashers couldn't become shooters. They just preferred bashing to winning.

Contact

How PwC can help

For more information on this topic, please contact:

Ajay Rawal
Partner
(02) 8266 2848
ajay.rawal@au.pwc.com

Chris Greenwood
Director
(02) 8266 0694
chris.j.greenwood@au.pwc.com

Richard Shackcloth
Partner
(03) 8603 3121
richard.shackcloth@au.pwc.com

Shane O'Sullivan
Principal
(03) 8603 5333
shane.osullivan@au.pwc.com

Mike Sum
Director
(03) 8603 5924
mike.sum@au.pwc.com

Andrew Cordner
Director
(03) 8603 3349
andrew.cordner@au.pwc.com

The information contained in this publication is general in nature and does not constitute advice. PwC will not be held responsible to those persons who act solely on the information provided in this document. You should seek your own professional advice from an appropriately qualified person on your company's specific situation before taking any actions on this issue.

This material is intended for PricewaterhouseCoopers professionals and their clients. Quotation, citation, attribution, reproduction or utilisation of any portion of this publication by any party other than PricewaterhouseCoopers is strictly prohibited without express written permission. No part of this paper may be reproduced, stored in a retrieval system or transmitted in any form or by any means – electronic, mechanical, photocopied, recorded or otherwise – without the prior written permission of PricewaterhouseCoopers.

© 2011 PricewaterhouseCoopers. All rights reserved.