Post-Merger Integrations: In For A Pound, Out For A Penny

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Introduction

> The Economist once wrote that mergers "are, like second marriages, a triumph of hope over experience. [...] Corporate mergers have even higher failure rates than the liaisons of Hollywood stars."

In fact, studies have shown that 60-90% of mergers and acquisitions fall short of expectations.

One of the key reasons for the high failure rate is a poorly managed post-merger integration (PMI) process. PMI is an integral part to any merger or acquisition – and the single most important determinant in successfully realising strategic synergies and maximising value capture.

This note summarises Ginkgo Management Consulting's view on PMI and provides three key success factors to winning in integrations.

Lars Godzik,

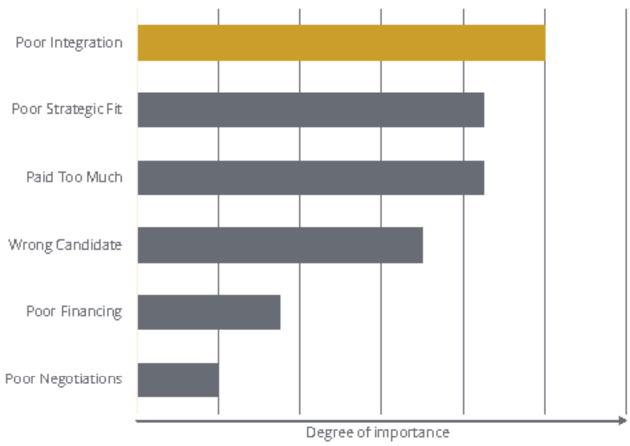
Founding Partner, Ginkgo Management Consulting

1 Experienced Integration Team

Studies show a number of reasons why the majority of mergers and acquisitions are deemed unsuccessful. Many of these originate from mistakes in the pre-close phase of deals, such as poor strategic fit between the merging entities, inadequate due diligence, overpaying for a company, or wrong choice of acquisition target.

However, most CEOs cite as the number one reason for an unsuccessful acquisition the poor performance of the post-acquisition integration process.

Exhibit 1: Reasons for Failure for Mergers & Acquisitions



Source: EIU, BCG, Ginkgo analysis

Integrations are, by their very nature, difficult to navigate and highly complex to manage.

As a result, much has been written about how to run successful integrations, what specific areas to focus on and which pitfalls to avoid.

Ginkgo Management Consulting has learnt from experience that three primary topics, which do not receive regular mention in publications, are at the basis of a successful integration approach.

The primary key to a successful integration is an experienced integration team. No other element has the potential to have such a big positive impact on integration success as a team of experienced, qualified and skilled individuals. Moreover, the appointed specialists have to realise a number of key requirements.

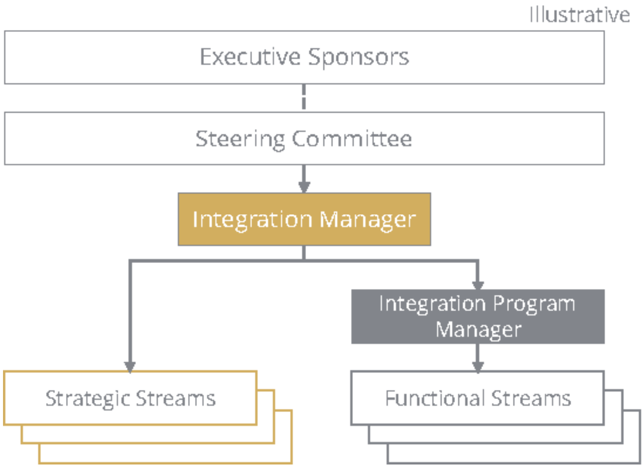
Staffing of Key Positions. A large number of stakeholders, participating parties, and a wide spectrum of expectations make integrations complex to manage.

Therefore, seasoned integration specialists must occupy the main roles within an integration project. Arguably the two most important positions within an integration team are:

- Integration Manager: responsible for handling the overall integration, applies laser focus on the strategic synergies to maximise value capture of the integration

- Integration Programme Manager: reports to the Integration Manager, orchestrates a seamless functional integration from a centralised programme management office

Exhibit 2: Integration Team Typical Structure



Depending on integration complexity and size, other roles may require experienced specialists or can be manned by internal staff assigned to the integration effort full or part time. This holds especially true for the individual strategic and functional stream leads.

Immediate Alignment with M&A Team. In an ideal world, integrations start long before the finalisation of the deal agreement. The integration team aligns itself with the M&A team from the outset of the acquisition process to fully understand the strategic intent of the deal to realise it diligently throughout the integration.

However, most companies do not have the luxury of being able to involve an integration team in the early stages of the acquisition process, but wait until the deal is finalised.

In this case, it is important that an experienced integration team is appointed that is able to immediately pinpoint key elements of the business plan, rapidly align itself with the strategic acquisition intent and execute the integration accordingly.

Strong Leadership. Acquisitions create an environment of significant uncertainty. Hence, manage resulting employee emotions and overcome resistance to change, senior management of both companies must be involved in the integration process to send employees a strong message of commitment to the acquisition. The executives in question need to use the integration team as leverage to push for a flawless integration.

Therefore, the integration team and senior management must work closely together to:

- Establish senior management ownership and participation
- Hold senior management accountable for integration success
- Retain senior leadership of acquired company and enable their success
- Deal with difficult decisions, emotions, and actions quickly and decisively

2 Complete, Clear and Flexible Framework

The basis for any successful integration is a clearly defined framework that is religiously applied throughout the post-acquisition management phase.

This forms the platform for the integration team to achieve a consistent, coherent, transparent, and actionable integration execution. Such a framework must be tried and tested and have a number of characteristics.

Comprehensiveness. The framework must lend a comprehensive structure to the integration process, incorporating all integration components. Among other things it has to enable the integration team to:

- Identify all stakeholders in the integration process from both companies, define their roles, outline their responsibilities and activities
- Establish a robust integration Governance
- Identify and manage all interdependencies for the strategic and functional integrations
- Embed processes to manage corporate culture issues and change requests
- Allow for knowledge transfer between the companies' business units

Clarity. The framework must provide transparency to the integration process and maintain constant pressure on team members. They must be continuously aware what their responsibilities and next steps are and what is expected of them. The framework must also permit senior management to have a snapshot view of the status of the integration at any point in time. For this, it must be structured in a way as to:

- Allow for meticulous planning, based on clearly defined parameters and measures of success, with well-defined timelines and milestones
- Incorporate a clear and well-managed communications plan for all parties involved
- Include continuous feedback cycles

Flexibility. Every integration has a different set of requirements, based on acquisition type, size and strategic intent.

The ideal framework provides a single approach that fits all acquisitions, strongly reducing integration concept complexity.
To satisfy this condition, the framework needs the necessary robustness of processes while incorporating a high degree of flexibility.

The most successful frameworks that incorporate this requirement use a modular approach for the different integration phases, which enables the modules to adapt to the specific situation and deal type, and they can be scaled to best fit the individual requirements.

Case Study

"Pan-APAC Cross-Industry Integration"

Ginkgo Management Consultants helped to acquire and integrated a leading APAC digital content provider into a global electronics equipment manufacturer. Being the first time the manufacturer had acquired a digital service provider, strategic fit and business direction had to be defined, as well as expectations set. Creating and implementing a detailed integration plan secured all key senior management's buy-in and support.

As a result, the integration was largely finalised in less than four months and the manufacturer is one of the first in its industry to provide end-to-end digital services in its portfolio.

3 Integration Funding

An element that is often overlooked in integrations, but can be the cause for significant tension and confusion, is their funding. Frequently, companies are not aware of the costs associated with the integration process.

As a result, they often don't sequester the integration budget from the halo effect of the business budget, or fail to establish an integration budget at all. Without the appropriate funding, integrations are doomed to fail. To avoid this, companies must take specific actions.

Integration Cost Transparency. While PMI costs are almost impossible to quantify accurately, companies must attempt to bracket them.

This includes more discernible items (e.g. training; communication costs; redundancy payments) to rather veiled ones (e.g. depreciation of fixed assets that will be discontinued post-integration; costs associated with delays in integration due to contractual obligations, especially with IT infrastructure).

To create a consistent understanding of the integration costs, it is advisable to:

- Assign clear accountability for delivery of the integration business case
- Involve all related teams in the identification of integration cost items
- Incorporate all costs associated with the integration in the business case, including one-time, recurring, and long-term costs

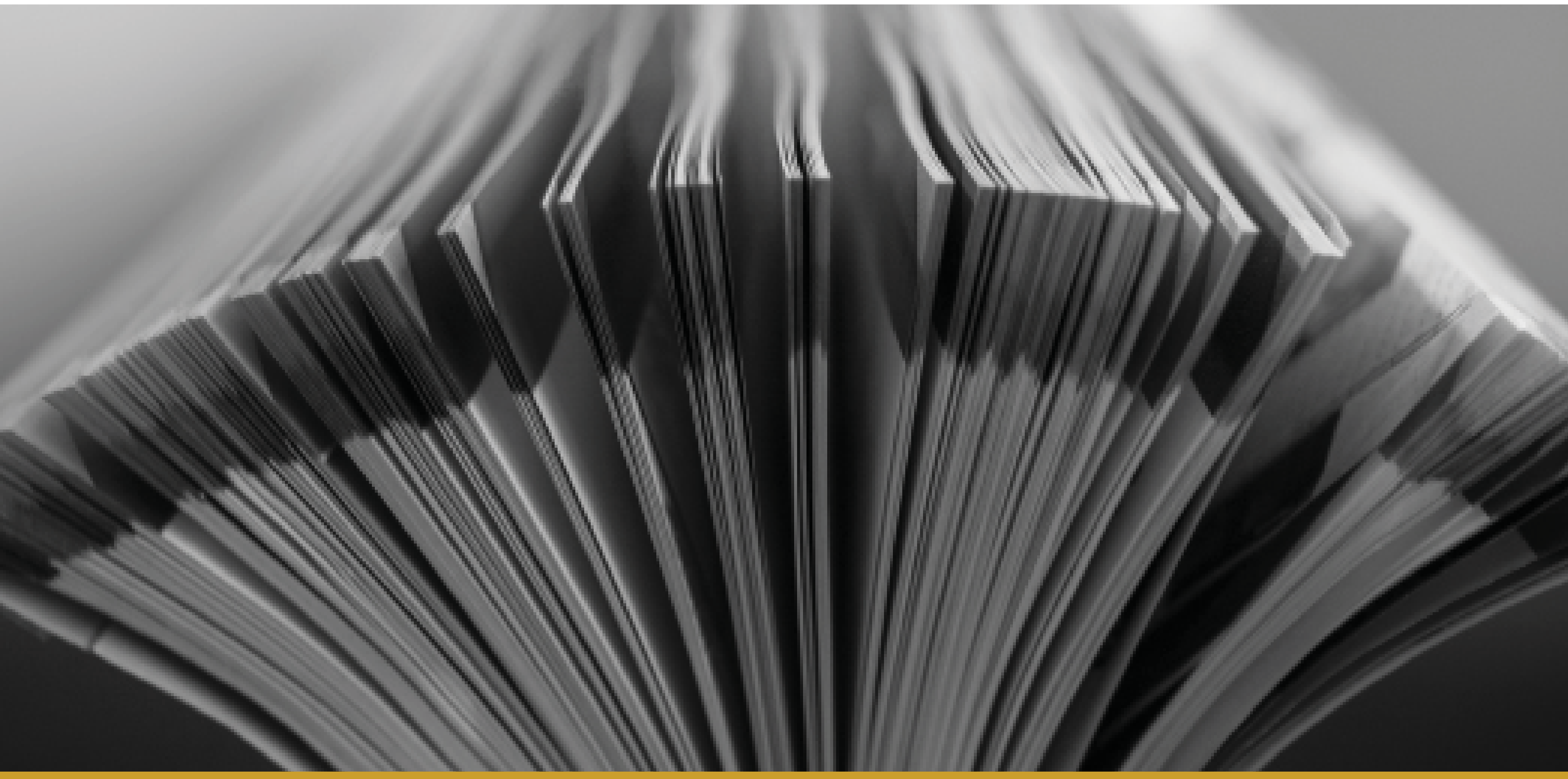
Clear Funding Agreements. Once the overall cost of the integration has been estimated, an integration budget has to be established. For this, it is important to define clear funding agreements about which department will pay for which expenses and how those costs will be recorded in corporate budgets and accounting records. Companies will have to answer questions like:

- How to establish integration budgets, in general?
- Where does the integration budget sit?
- When does integration funding roll into the operational budgets of the various business units?

Do Not Be Penny-Wise, Pound-Foolish. Businesses spend substantial amounts of time and resources on the acquisition process, expecting significant positive returns on their investments. While much corporate focus is given to the deal realisation, it is the degree of success of the integration that is the key to whether the expected returns are fully achieved.

Despite this, senior management tends to pay little attention to integrations and sees them as the first opportunity post-deal to save costs – a natural reaction to just having invested in an acquisition. To maximise the return on investment, senior management needs to:

- Understand integrations' scope: usually, integrations are medium to long-term projects and require ongoing attention
- Invest wisely: integration experts are required especially during the initial stages of integrations where the majority of steps and processes are defined that determine the course of an integration
- Avoid penny pinching: the short-term cost savings achieved from economising on integration efforts are greatly outweighed by the resulting unrealised synergy effects and value capture loss, which can reach tens or even hundreds of millions of dollars over the years

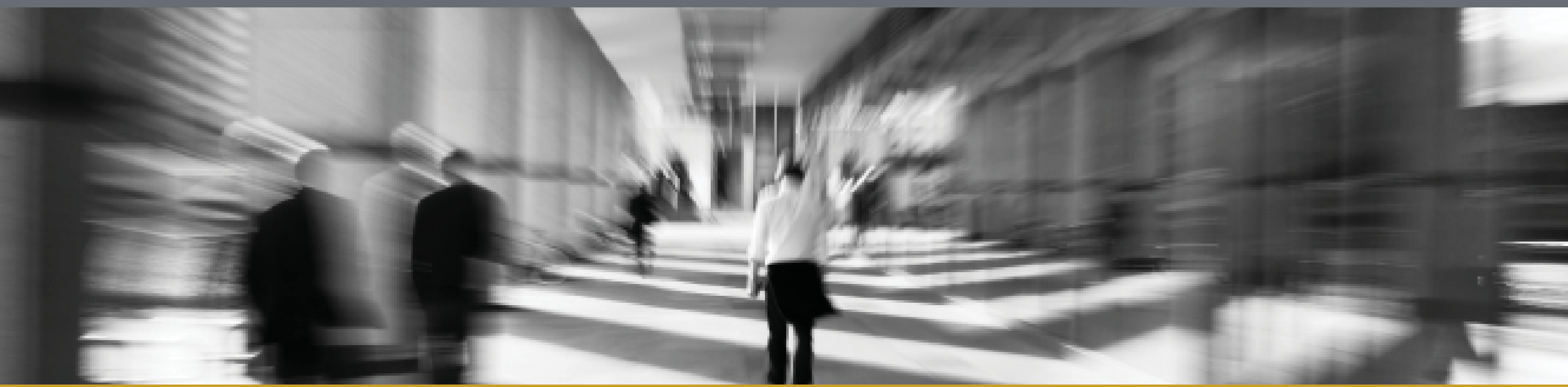


Case Study

"Integration of Cutting-Edge Service Provider"

Ginkgo Management Consultants performed the due diligence, evaluated strategic scenarios and managed the post-acquisition integration of a European ISP and switchless reseller into a global mobile operator. The new business strategy was incorporated in the strategic and functional integration and successfully implemented, in cooperation with 16 cross-functional client teams.

This led the operator to be one of the first in Europe to include WLAN in its service offering and generated a two-year 900+% subscriber base increase and 120+% site increase.



Summary

In Ginkgo Management Consulting's experience, integrations require meticulous planning, clear prioritising and continuous monitoring from a dedicated, experienced integration team, using a well established, consistent framework.

This holds especially true for the early stages of the post-acquisition phase which is crucial in shaping the overall course of integrations.

Thereafter, to guarantee the success of continued integration operations, a full and seamless handover of all integration activities to internal staff has to occur.

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