Suring Up Your M&A Transaction with Successful PMI

By Dr. Heiko Frank

Analysis of why more than 60% of M&A transactions fail and examination of options for successful post merger integration phase (PMI)

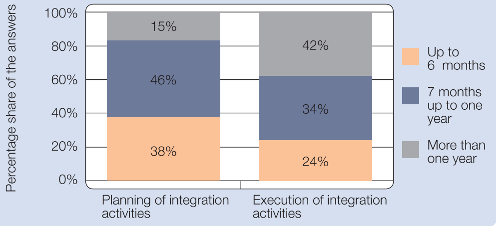
The global market for M&A transactions has boomed over the past two years, despite a slight decline more recently in Q III and Q IV. The highest activity levels can be seen in USA, UK and Japan. Germany is also a strong contender in 9th place, while Israel and Italy are surprisingly stagnant in places 20-30* (survey by Marc research at City University London). When we compare figures, we see that the last 18 months have witnessed the acquisition and sale of a staggering 15,000 companies worldwide. According to the international transaction database Mergermarket, 5,600 M&A transactions were registered across the globe in the first 6 months of 2011 alone. Although this figure is slightly less than that achieved in the same period last year, the value of these mergers has risen (measured as a total of the purchase price paid) by 28% to 1160 billion US dollars.

The sheer volume of individual M&A transactions and their overall value means that we are dealing with a powerful force which clearly has the ability to significantly impact on the health of the global market. It is therefore important to secure the successful outcome of each transaction. However, this success depends not only on pre-closure efforts, such as strategy and thorough due diligence but also to a large degree on the quality of the post merger integration phase.

Experts agree that classic **reasons for failure** include longer periods of integration than planned, a lack of cultural incorporation and overrated or unexamined operative synergies. Since M&A activities increase the complexity of corporate operations and produce a need for greater communication, this can cause costs to initially rise and not fall. It doesn‘t take long for the required process optimization to fall by the wayside.

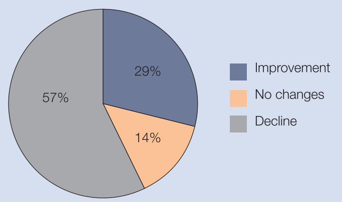
Integration takes longer than planned

Planning time vs. time needed for execution of integration activities



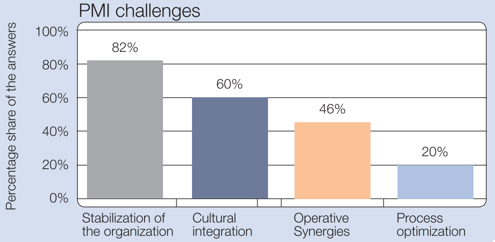
Profitability worsens in over 50% of transactions

Change in profitability after the transaction



"Soft factors" decisive for success of PMI

PMI challenges



Facts prove the difficulty of sustainable M&A success

- "57% of merged companies fail within three years due to an inability to realize potential benefits" (Mercer Management Consulting).
- "85% of all mergers miss the targets set"(A. T. Kearney).
- "83% of all mergers do not improve shareholder value" (KPMG).
- "If we look at the mergers and takeovers in recent years, we see that 60% of companies were not able to successfully integrate their new partners into their own organization" (Oliver Wymann).
- "As a rule, 4 of 5 mergers generally fail. The reasons for this are often not the lack of a suitable partner but more often than not the inability to make sufficient use of the potential options arising from the merger" (Münchner Management Kolloquium).

Sources: PWC, Business Week, AT Kearney

On top of this, if staff members are not adequately addressed at their individual stages of development, the acquired organization (target) can be permanently destabilized in its overall structure and restrict the individual freedom of the staff to operate. One common example during this phase is the frequent loss of key managers.

This regressive trend on the world stage then achieves the opposite of what was originally intended, and we end up not with high-achieving, streamlined businesses but sluggish and cumbersome corporate mammoths. Instead of cutting costs and boosting profits, we seem to bring about the exact antithesis.

To prevent this negative result, it is vital that the PMI phase of each merger is well planned and that all facets of it are conducted in a coordinated manner. This **article illustrates structured procedures and methods** which can considerably increase the success quota of your M&A transactions and brighten the future of your corporation.

Post merger integration traditionally consists of 3 main phases (Plan-Do-Review):

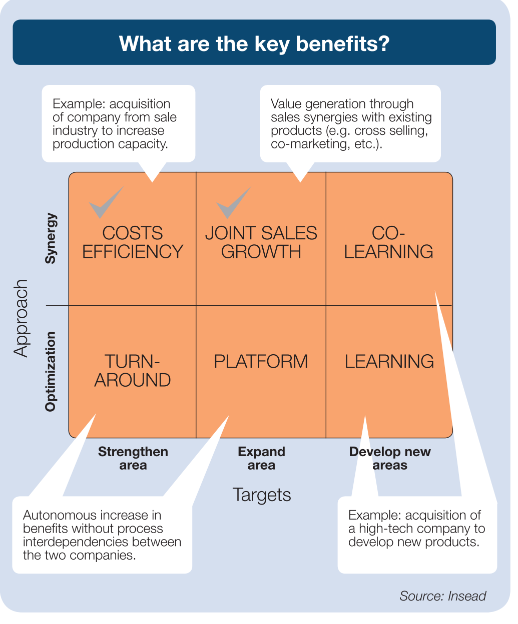
Plan: compile a strategic impact map
Do: roll out the PMI activities
Review: monitor and develop the process

Strategic Impact Map (PLAN)

The **strategic impact map** defines the core reasons behind the integration. It makes sense to specify these before the actual transaction is signed and closed, although they will need to be reconsidered again after closing.

This map is made up of certain components, including any arrangements governing the degree of merger (from retention of status/autonomy to collaboration and partial integration, up to a complete absorption) at a structural, operational and cultural level. In general, the more similar the companies are (market, products, position in the vertical value chain), the greater the extent of integration will be.

Another important component is benefit drivers. Optimization and synergy leverage should be examined in detail in relation to this. The following diagram illustrates the possible key benefits from an acquisition/sale:



The strategy impact map evolves from components such as those described above. Once these are in place, we can decide where the key focus of the integration phase should be, which areas of action are critical for success, how fast integration should take place, how many staff members should be involved and which method of PMI (bottom-up, top-down or hybrid) is most effective.

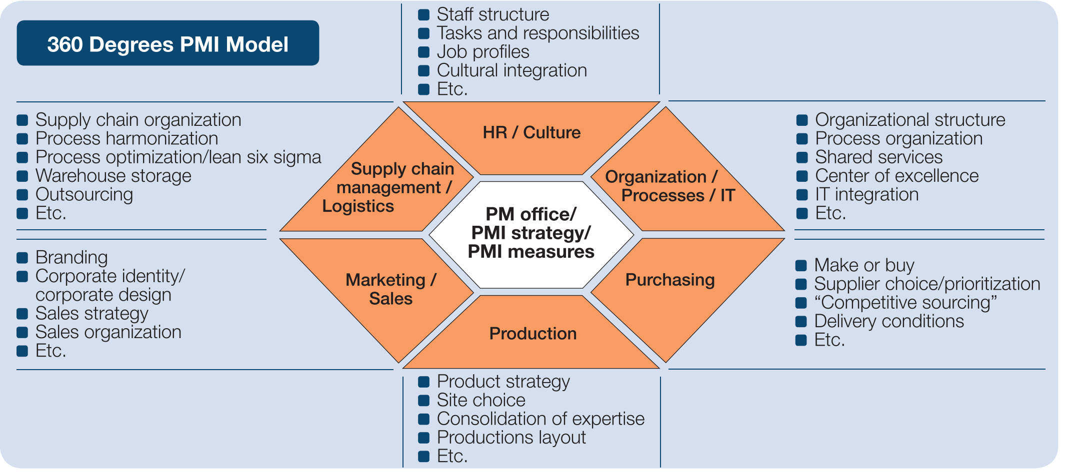
Experience shows that it pays to always involve the management from both the purchasing company and the selling company. Possible risks at this stage include so-called „hidden agendas". This is where it is essential to encourage those involved to lay their cards on the table and work towards a common goal. One-to-one discussions, management workshops and moderated meetings are ideal tools for achieving target and implementation congruity. The "100 day plan and execution" approach has proven itself to be a valid structure for starting the PMI process.

Post Merger Implementation Phase (DO)

This is the stage at which successful execution of the planning phase (strategic impact map) comes to fruition. The key platform from which all activities stem is the integration team and its project management office. This should consist of carefully selected people from various levels of both companies who have a high degree of empathy and authority. External support is often required as the teams often lack sufficient PMI experience and methodological know-how. The team itself should report directly to the management as part of a fixed procedure with specified contents and documentation requirements. It is responsible for overall coordination of the post merger process. The motivation and momentum for change and integration reaches a peak just after closing and the first 90 days following are critical for the success of the merger. The PMI stands and falls with the type of management practiced during this interim period. Multilateral activity is an absolute necessity.

As indicated, integration takes place on various levels:

- **Strategic integration** (e.g. joint alignment to vision, mission & guiding principles and transfer of strategic resources),
- **Structural integration** (this includes consolidation of various organizational structures and the processes behind them. Shared services, centralized activities and jobs to be performed by the various business units all need to be defined)
- **Systemic and functional integration** (this includes questions such as the optimization of IT hardware and software systems, supply chain, sales structures, machine parks, production layouts, brands and marketing etc.)
- **Cultural and human resources integration** (e.g. early integration of stakeholders including advisory boards, measures for adjustment of corporate culture, execution of required change management tasks, organization of help desks, definition and execution of communication between staff and management in a manner suited to the company etc.)



360 Degrees PMI Model

Tefen has developed a 360 degrees PMI model specifically to ensure that these integration levels are realized efficiently and that the transformation process is smooth and successful:

This model requires that the integration team and all those who are participating in it need to work in a structured manner and understand the concept of integration. Speed is an essential success factor and experience has shown that this approach accelerates implementation of the PMI process.

Although multilateral (parallel) activities are encouraged, the integration team should not aim to handle all related topics at the same time but should instead examine the results and specifications of the strategic impact phase, enabling it to set the right priorities and pursue the core targets and expected benefits.

Another critical success factor is the level of communication between the management and the integration team. Details of this should be set right from the very start and everyone concerned should understand that clear communication above and beyond that of normal operations is required. As communication is as an integral part of the corporate marketing and branding strategy, conscious efforts should be made to celebrate all successes but also to deal with any problems arising. Specific examples of good communication as practiced by Tefen include e-newsletters from the integration team, information meetings, hotlines and FAQs. Selected use of social media (e.g. Xing or Facebook), company intranet, internal mailings from the management or staff journals have all been found to contribute to a positive working environment. The same type of approach should be taken for all external communication e.g. public relations, sales staff or trade fair staff training. Support from the marketing, corporate communications and human resources units plus the advisory boards is welcome here.

The focus of integration activities varies between the transactions, according to the type and degree of integration employed to ensure successful change. Some examples include compiling tandem teams, coaching, workshops, training, optimization meetings with exchange of experience or information events and township meetings with the management at a blue collar level.

For example, automotive suppliers will have a completely different list of PMI priorities (F&E synergies, production capacity, full integration) to those of an international IT company (new services in new markets, such as outsourcing, cross-selling, partial integration). There is no **one-fits-all** solution. However, the building blocks of the 360 degrees PMI model are ideal for structured use in **any type of transaction**.

Monitor & Develop Phase (REVIEW)

Once the core of a transaction has been completed, the size of the integration team will gradually reduce. The focus of activities will shift towards helping individuals to help themselves and the various units involved in integration will begin to report back that they have completed the process and are ready to return to everyday operations. A step-by-step handing back of responsibilities, in line with the specified roles and corresponding documentation, has proven to be the best approach.

The process is monitored by the project management office who examine all the usual figures, including time and resources spent, adherence to deadlines and degree of activity fulfillment. Integration controlling figures, ranging from staff satisfaction (directly after closing, during integration and post integration), employee fluctuation, market success (image gain or loss) to integration of the product portfolio and new product introductions, are also important. In day-to-day operations, attention should be paid to language habits and the speed and depth at which new processes are taken on board.

The parameters to be measured should be defined at the beginning of the planning phase, to enable continual and structured recording of the relevant data throughout the process. The data can then be presented on quantitative and qualitative integration dashboards and made available to participants via electronic means. The ultimate objective is to significantly improve turnover and boost the corporate value.

In general, post merger integration periods take from around 6 (best case) to 24 (normal case) months. It is therefore essential that everyone affected understands that they are in for the long haul. Cultural change is also a slow, ongoing process. This makes continual monitoring and assessment so important. There should be a constant willingness to do better, focus on those methods which are successful and generally optimize procedures. We advise that you review the integration progress after a certain period (roughly 6-12 months). Finally, to ensure a fresh approach is taken to each transaction, we recommend forming a case-based integration team each time.

Summary

We have seen that the legal completion of an M&A transaction does not automatically lead to the successful outcome of the project and that thorough integration of the acquired company is an essential part of the process, not merely an „add-on“ luxury. Although the approach we have examined does not cover all facets of post merger integration, it does provide a solid base from which to initiate your PMI efforts.

Let us summarize the main points which need to be taken to heart:

1. Structured approach with „plan-do-review“
2. Four integration levels (strategic, structural, systemic and cultural)
3. Application of 360 degrees model for successful PMI implementation
4. Top quality integration team with high level of management attention
5. Speed is of the essence
6. Respectful response to cultural factors
7. Nothing beats good communication
8. Differentiated use of change management methods
9. Ensure that operative business continues parallel to integration (companies tend to get lost in focusing on themselves)
10. Concentration of improving revenue and value by prioritizing areas of action and work contents
11. Use momentum to renew the corporation as a whole
12. Continued hard work to realize integration and change (contents above personal preferences) – the motto being: client first – company second – self third

We encourage all organizations to take a new look at how they handle merger and acquisition transactions post-closure. Committed efforts over a finite period can reap significant and sustainable benefits for your entire corporation.

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