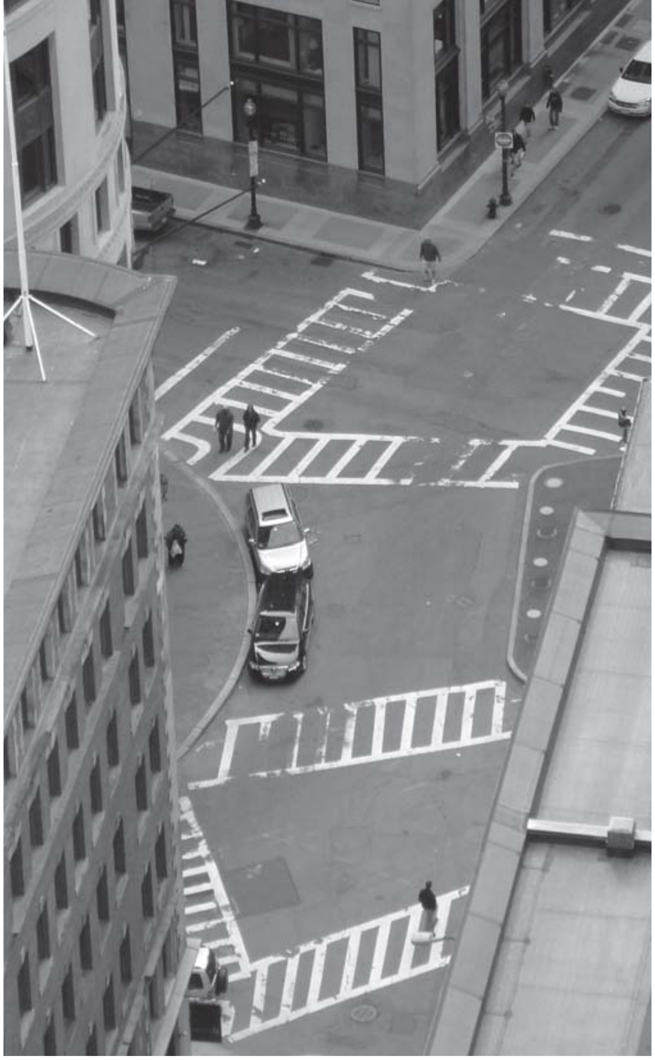

Tailor integration to identify value, keep the right people and focus on critical decisions

The 10 steps to successful M&A integration

By Ted Rouse and Tory Frame

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Mergers and acquisitions—well conceived and properly executed—can deliver greater value than ever right now. And savvy acquirers are taking action, as deal activity accelerates amid signs of recovery.

One reason is the effect that a downturn has on asset values: Other things being equal, it's a good time to buy. Bain analysis of more than 24,000 transactions between 1996 and 2006 shows that acquisitions completed during or just after the 2001–2002 recession generated almost triple the excess returns of acquisitions made during the preceding boom years. ("Excess returns" refers to shareholder returns from four weeks before to four weeks after the deal, compared with peers.) This finding held true regardless of industry or the size of the deal. Given today's relatively low equity values, acquirers with cash to invest are likely to find deals that produce similar returns.

A second reason: Many companies are getting better at M&A. At the beginning of the period from 1995 to 2005, about 50 percent of mergers in the US underperformed their industry index. By the end of the period, only about 30 percent were underperforming. One explanation, based on our experience, is that some companies have learned to pursue deals closer to their core business, which increases the odds of success. They more frequently pay cash rather than stock, which encourages better due diligence and more-realistic prices. The long-term trend of more-frequent acquisitions has also pushed companies to develop repeatable models for successful integration and managers with professional integration-management skills.

Despite these successes, many acquirers—perhaps most—leave huge amounts of value on the table in every deal. Companies continue to stumble in three broad areas of post-merger integration:

- ***Missed targets.*** Companies fail to define clearly and succinctly the deal's primary sources of value and its key risks, so they don't set clear priorities for integration. Some acquirers seem to expect the target company's people to integrate themselves. Others do have an integration program office, but they don't get it up and running until the deal closes. Still others mismanage the transition to line management when the integration is supposedly complete, or fail to embed the synergy targets in the business unit's budget. All these difficulties are likely to lead to missed targets—or an inability to determine whether the targets have been hit or not.

- ***Loss of key people.*** Many companies wait too long to put new organizational structures and leadership in place; in the meantime, talented executives leave for greener pastures. Companies also may fail to address cultural matters—the "soft" issues that often determine how people feel about the new environment. Again, talented people drift away.

- ***Poor performance in the base business.*** In some cases, integration soaks up too much energy and attention or simply drags on too long, distracting managers from the core business. In others, uncoordinated actions or poorly managed systems migrations lead to active interference with the base business—for example, multiple (and contradictory) communications with customers. Competitors take advantage of such confusion.

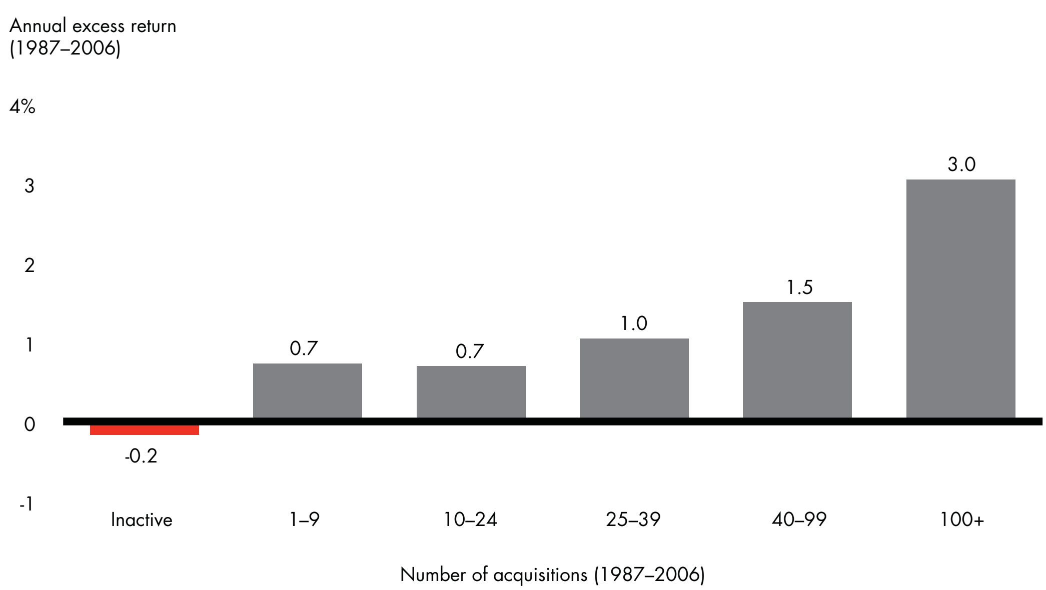
Successful integration—the key to avoiding the risks of a merger or acquisition and to realizing its potential value—is always a challenge. And it is complicated by the simple fact that no two deals should be integrated in the same way, with the same priorities, or under exactly the same timetable. But 10 essential guidelines can make the task far more manageable and lead to the right outcome:

1. Follow the money

Every merger or acquisition needs a well-thought-out deal thesis—an objective explanation of how the deal enhances the company's core strategy. "This deal will give us privileged access to attractive new customers and channels." "This deal will take us to clear leadership positions in our 10 priority markets." A clear deal thesis shows where the money is to be made and where the risks are. It clarifies the five to 10 most important sources of value—and danger—and it points you in the direction of the actions you must take to be successful. It should be the focus of both the due diligence on the deal and the subsequent integration. It is the essential difference between a disciplined and an undisciplined acquirer.

The integration taskforces are then structured around the key sources of value. It is also necessary to translate the deal thesis into tangible nonfinancial results that everyone in the organization can understand and rally around—for example, one salesforce or one order-to-cash process. The teams naturally need to understand the value for which they are accountable, and should be challenged to produce their own bottom-up estimates of value right from the start. That will allow you to update your deal thesis continuously as you work toward close and cutover—the handoff from the integration team to frontline managers.

Frequent acquirers outperform in the long term



Note: Annual excess return is defined as a company's annualized total shareholder return less its cost of equity (calculated using CAPM)

2. Tailor your actions to the nature of the deal

Anyone undertaking a merger or acquisition must be certain whether it is a *scale* deal—an expansion in the same or highly overlapping business—or a *scope* deal—an expansion into a new market, product or channel (some deals, of course, are a mix of the two types). The answer to the scale-or-scope question affects a host of subsequent decisions, including what you choose to integrate and what you will keep separate; what the organizational structure will be; which people you retain; and how you manage the cultural integration process. Scale deals are typically designed to achieve cost savings and will usually generate relatively rapid economic benefits. Scope deals are typically designed to produce additional revenue. They may take longer to realize their objectives, because cross-selling and other paths to revenue growth are often more challenging and time-consuming than cost reduction. There are valid reasons for doing both types of transactions—though success rates in scope deals tend to be lower—but it is critical to design the integration program to the deal, not vice versa.

Consider the recent spate of announcements about computer hardware companies buying services businesses. In 2008, it was Hewlett-Packard buying EDS. More recently, Dell announced the acquisition of Perot Systems, and Xerox made a bold move for ACS that will more than double the size of its workforce. These are clearly scope deals, as these companies search for ways to move up the value chain into more profitable lines of business. And they require a new type of integration effort for these hardware companies. If HP, for example, applied the same principles and processes that it used in integrating Compaq, it would greatly complicate the EDS acquisition.

3. Resolve the power and people issues quickly

The new organization should be designed around the deal thesis and the new vision for the combined company. You'll want to select people from both organizations who are enthusiastic about this vision and can contribute the most to it. Set yourself an ambitious deadline for filling the top levels and stick to it—tough people decisions only get harder with time. Moreover, until you announce the appointments, your best customers and your best employees will be actively poached by your competitors when you are most vulnerable to attack. The sooner you select the new leaders, the quicker you can fill in the levels below them, and the faster you can fight the flight of talent and customers and the faster you can get on with the integration. Delay only leads to endless corridor debate about who is going to stay or go and spending time responding to headhunter calls. You want all this energy focused on getting the greatest possible value out of the deal.

The fallout from delays in crucial personnel decisions is all too familiar. When GE Capital agreed to buy Heller Financial in 2001, paying a nearly 50 percent premium over Heller's share price at the time, GE Capital indicated that it would need to reduce Heller's workforce by roughly 35 percent to make the deal viable. But it didn't move quickly to say who would remain. Key players departed before waiting to find out, and several helped Merrill Lynch create a rival middle-market unit the following year.

4. Start integration when you announce the deal

Ideally, the acquiring company should begin planning the integration process even before the deal is announced. Once it is announced, there are several priorities that must be immediately addressed. Identify everything that must be done prior to close. Make as many of the major decisions as you can, so that you can move quickly once close day arrives. Get the top-level organization and people in place fast, as we noted—but don't do it so fast that you lose objectivity or that you shortcut the necessary processes.

One useful tool is a clean team—a group of individuals operating under confidentiality agreements and other legal protocols who can review competitive data that would otherwise be off limits to the acquirer's employees. Their work can help get things up to speed faster once the deal closes. In late 2006, for example, Travelport—owner of the Galileo global distribution system (GDS) for airline tickets—announced that it intended to acquire Worldspan, a rival GDS. The two companies used a clean team to work through many critical people and technology issues while they awaited final regulatory approval from the European Commission. When regulators gave the green light, the company was able to begin integration immediately rather than spending weeks waiting to gather the necessary data and making critical decisions in a rush.

5. Manage the integration through a "Decision Drumbeat"

Companies can create endless templates and processes to manage an integration. But too much program office bureaucracy and paperwork distract from the critical issues, suck the energy out of the integration and demoralize all concerned. The most effective integrations instead employ a Decision Management Office (DMO); and integration leaders, by contrast, focus the steering group and taskforces on the critical decisions that drive value. They lay out a decision roadmap and manage the organization to a Decision Drumbeat to ensure that each decision is made by the right people at the right time with the best available information.

To get started, ask the integration taskforce leaders to play back the financial and nonfinancial results they are accountable for, and in what timeframe. That will help identify the key decisions they must make to achieve these results, by when and in what order. Using this method, one global consumer products company recently was able to exceed its synergy targets by 40 percent—faster than originally planned—while retaining 75 percent of the top talent identified. (For a primer on how companies can create an effective decision timeline, see "Making it happen: The Decision Drumbeat in practice," on page 7.)

6. Handpick the leaders of the integration team

An acquisition or merger needs a strong leader for the Decision Management Office. He or she must have the authority to make triage decisions, coordinate taskforces and set the pace. The individual chosen should be strong on strategy and content, as well as process—in other words, one of your rising stars. Ideally, this individual and other taskforce leaders will spend about 90 percent of their time on the integration. Given the importance of maintaining the base business's performance while you're pursuing integration, one solution is to put the No. 2 person in a country or function in charge of the integration taskforce. The chief can take over the No. 2's responsibilities for the duration.

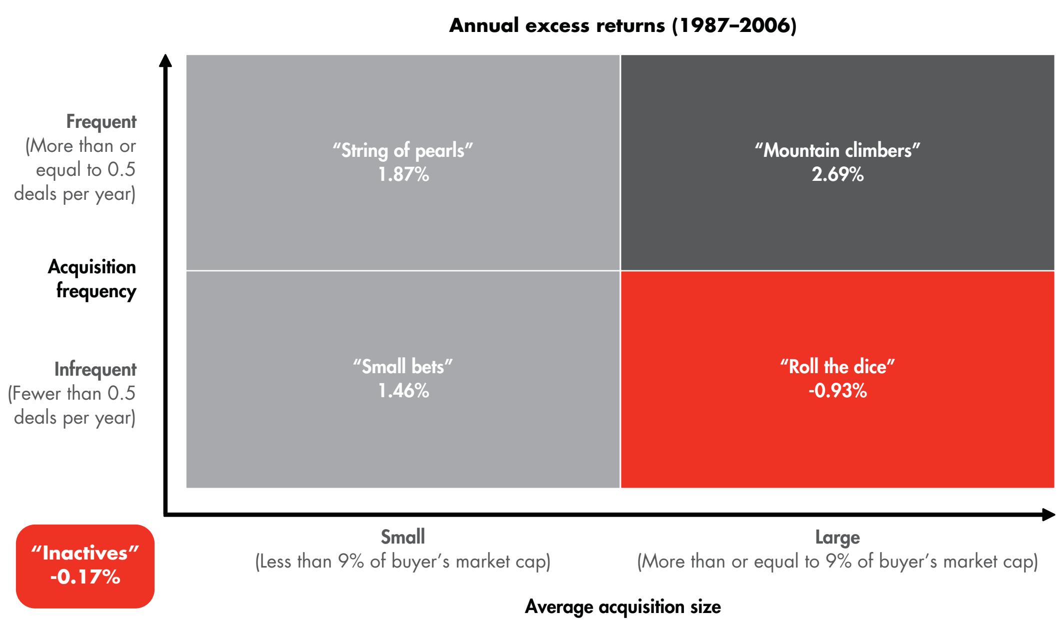
7. Commit to one culture

Every organization has its own culture—the set of norms, values and assumptions that govern how people act and interact every day. It's "the way we do things around here." One of the biggest challenges of nearly every acquisition or merger is determining what to do about culture. Usually the acquirer wants to maintain its own culture. Occasionally, it makes the acquisition in hopes of infusing the target company's culture into its own. Whatever the situation, commit to the culture you want to see emerge from the integration, talk about it and put it into practice. A diagnostic can help reveal the gaps between the two, provided acquirers are appropriately skeptical about people's descriptions of their organization's culture and provided they recognize their own potential biases.

Whatever you decide on, executives from the CEO on down then need to manage the culture actively. Design compensation and benefits systems to reward the behaviors you are trying to encourage. Create an organizational structure and decision-making principles that are consistent with the desired culture. The company's leaders should take every opportunity to role-model the desired behaviors. And they should consider carefully the fit with the new culture in making decisions about which people to keep. Will they support and reflect the new culture—or not?

When Cargill Crop Nutrition acquired IMC Global to form the Mosaic Company, a global leader in the fertilizer business, the new CEO, who came from Cargill, knew from the outset that retaining IMC employees and creating one culture would be important to the success of the fledgling company. One-on-one meetings with the top 20 executives and surveys of the top teams from both companies revealed differences between Cargill's consensus-driven decision-making process—which would be the culture of the new company—and IMC's more-streamlined approach, which emphasized speed. Armed with an early understanding of the differences in approach, the CEO was able to select leaders who reinforced the new culture.

The penalties are greatest for one-shot mega-deals or sitting on the sidelines



Note: Undisclosed deals assumed at 3% (based on median of disclosed deals)
Source: Bain U.S. long-term acquirer performance study (2007)

Cargill managers also made time to explain the benefits of their decision-making system to their new colleagues, rather than simply mandating it. Result: The synergies estimated (and owned) by jointly staffed integration teams turned out to be double what due diligence had estimated.

8. Win hearts and minds

Mergers and acquisitions make people on both sides of the transaction nervous. They're uncertain what the deal will mean. They wonder whether—and how—they will fit into the new organization. All of this means that you have to "sell" the deal internally, not just to shareholders and customers.

Consider the challenge faced by InBev, the global beverage company, in acquiring Anheuser-Busch, one of the most iconic American brands. Early in the integration process, the leadership team focused on the most effective way to introduce InBev's long-term global strategy to Anheuser-Busch managers and employees. One powerful tool was InBev's "Dream-People-Culture" mission statement, which was tailored to the US company and introduced into the Anheuser-Busch lexicon with strong messages emphasizing the value of its customers and products, to excite the imagination of the AB organization.

It's vital that your messages be consistent. If you are acquiring a smaller company and the deal is mostly about taking out costs, for instance, don't focus on a "Best of Both Organizations" in your first town-hall speech. In general, it's wise to concentrate on what the deal will mean in the future for your people, not on the synergies it will produce for the organization. "Synergies," after all, usually means reducing payroll, among other things—and people know that.

9. Maintain momentum in the base business of both companies—and monitor their performance closely

It's easy for people in an organization to get caught up in the glamour of integrating two organizations. For the moment, that's where the action is. The future shape of the company, including jobs and careers, appears to be in the hands of the integration taskforces. But if management allows itself and the organization to get distracted, the base business of both companies will suffer. If everybody's trying to manage both the ongoing business and the integration, nobody will do either job well.

The CEO must set the tone here. He or she should allocate the majority of time to the base business and maintain a focus on existing customers. Below the CEO, at least 90 percent of the organization should be focused on the base business, and these people should have clear targets and incentives to keep those businesses humming. By having No. 2s running the integration, their bosses should be able to make sure the base business maintains momentum. Take particular care to make customer needs a priority and to bundle customer and stakeholder communications, especially when systems change and customers may be confused about who to deal with. Meanwhile, establish an aggressive integration timeline with a countdown to cutover—the day when the primary objectives of integration are completed and the two businesses begin operating as one.

To make sure things stay on track, monitor the base business closely throughout the integration process. Emphasize leading indicators like sales pipeline, employee retention and call-center volume.

Olam International, a global leader in the agri-commodity supply chain business with $6 billion in annual revenues, has managed to maintain its base business while incorporating a stream of acquisitions. In 2007, for instance, Olam purchased Queensland Cotton, with trading, warehousing and ginning operations in the US, Australia and Brazil. Olam ensured that a core part of the Queensland Cotton team remained focused on the base business, while putting together a separate team made up of Queensland Cotton and Olam employees to manage the integration. That helped the company navigate difficult conditions due to drought in Australia, while also growing their Brazil and US businesses well above the market. Olam's acquisitions contributed 16 percent to its total sales volumes in fiscal year 2009 and 23 percent to its earnings, which have grown at an overall rate of 45 percent CAGR since 1990.

10. Invest to build a repeatable integration model

Once you have achieved integration, take the time to review the process. Evaluate how well it worked and what you would do differently next time. Get the playbook and the names of your integration experts down on paper, so that next time you will be able to do it better and faster—and you will be able to realize that much more value from a merger or acquisition.

Bain has done extensive research on what drives success in acquisitions, including two Learning Curve studies completed in 2004 and again in 2007. The data is compelling. Frequent acquirers consistently outperform infrequent acquirers as well as companies that do no deals at all. If you had invested $1 in each group, the returns from the frequent-acquirer group would be 25 percent greater than the infrequent group over a 20-year period. Over the last 15 years, a number of companies, including Cisco Systems, Danaher, Cardinal Health, Olam International and ITW, have shown that you can substantially beat the odds if you get the integration process right and make it a core competency.

Making it happen: The Decision Drumbeat in practice

A Decision Drumbeat is the way to focus your senior management and integration taskforces quickly on the critical decisions necessary for a merger integration to succeed. Here's how one global consumer products company applied this approach to sucessfully integrate a major competitor in record time:

Focus on the fundamentals. The first rule is to clearly articulate the financial and non-financial results you expect, and by when. Parcel out these results to each of the integration taskforces, and have them work out the decisions necessary to get there. Pare these decisions down to the bare essentials—just what's necessary to deliver one integrated company on schedule. It's important to distinguish between integration and optimization decisions. The latter should be put off until the integration is complete.

For the consumer products company, it was imperative to quickly equip the salesforce with an integrated portfolio of brands for the busy trading period, despite the fact that some of the brands were aimed at the same consumers and were positioned in similar ways. The answer in this case was to quickly decide how to target the brands at different outlets, and to leave decisions about fundamental brand repositioning for later, after cutover to a single combined company.

Coordinate decisions. Any integration involves a large number of decisions in a short time frame, and many of those decisions are highly interdependent. So the timing of decisions needs to be closely coordinated, and everyone needs to understand the impact their actions have on others. For instance, most marketing teams would prefer to wait until the end of the integration process to recommend the final product portfolio. Recognizing this tendency, the consumer products company quickly made a decision on the brand portfolio. That set up a series of cascading decisions: Within four weeks, the company had created new SKU lists, order forms and sales scripts, and had trained the salesforce so that they were able to sell each brand when they hit the streets representing the combined company. The Decision Management Office plays an important coordinating role: first, by helping the taskforces work out which decisions must be made to deliver their results; second, by ensuring that the decisions are made and executed in the right order to support the decision deadlines of other taskforces. No one else has the integrated view of the timing and the value at stake.

Assign decision rights and roles. The Decision Management Office should then map out who is responsible for each decision and communicate that to all involved. One of the most effective ways to clarify decision roles, in our experience, is a system we call RAPID—a loose acronym for Recommend (which usually involves 80 percent of the work); offer Input; Agree or sign off on (limited to rare circumstances, for example, when fiduciary responsibilities are involved); Decide, with one person assigned the "D"; and Perform, or execute the decision. The resulting decision roadmap shows who is accountable for each major decision and when that decision needs to be taken.

At the consumer products company, the steering group focused on the 20 percent of decisions that were most critical to integration success, leaving the remainder of the decisions to the integration taskforces. That meant the integration was able to move at maximum speed and, by empowering the taskforce leaders, many gained priceless management experience that led to eventual promotions.

Stick to the timetable. Actively ensure that everyone is on track to make their decisions. The Decision Management Office ensures that each taskforce has what it needs from other taskforces or from the steering group to make their decisions on time through the weekly drumbeat of meetings with each of the taskforces. When necessary, bring in experts to speed up team delivery; and bring teams together for major decision points and cutover plans, which require detailed and coordinated planning. Focus your working sessions on critical trade-offs and the additional work required to resolve them.

Here, again, the consumer products company kept to the deadline by providing extra help to the taskforces when they risked missing decision deadlines—to ensure union negotiators had what they needed to secure agreement from manufacturing employees, for instance, or to work around obstacles in the distribution system when containers from the two companies did not fit on the same trucks. As one senior executive later said: "We focused on decisions, not on process for process's sake. From day one we had a focused plan that everyone understood and believed in, and that really energized the team."

As we emerge from the global recession, companies should prepare to take advantage of attractive asset values and to capture the benefits garnered by frequent acquirers. But they must act with judgment and finesse. Winners in this game will bring a tailored approach to integration, adjusting their approach to the deal thesis with one eye constantly fixed on the critical sources of value and risk. The most experienced acquirers not only understand these 10 steps to a successful integration, they also understand how to adjust their application to the deal and the circumstances.

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