

## SUCCESSFUL INTEGRATION

*By Richard S. Parenteau and J. Fred Weston*

**Acquiring companies must consider integration from the earliest stages of the M&A process to maximize operating improvements and other synergies.**

It has been well established that many mergers and acquisitions fail and destroy value because the combining companies started planning the critical integration phase after the deal closed rather than before. Yet, our research has shown that even when the partner managements think ahead, they may not avoid trouble for two key reasons. Integration plans still have not been started soon enough or they have not been properly connected to other key phases of the m&a process.

To generate the maximum value from a deal in the form of synergies or other operational advantages, it is essential for the acquiring company to focus on integration from the earliest stages of the project and then tightly coordinate essential integrative elements as the m&a process moves through its four typical phases—strategy planning, candidate screening, transaction execution, and the ultimate integration phase itself. By following that approach, the buyer has its eyes open to spot problems that may torpedo the deal or can be corrected with early action or to find pockets of added value that were not initially anticipated. As a final touch, the process includes a review of a successful deal to measure the value created and to gain points for an encore that also enhances shareholder wealth and competitive strength.

### **Phase One: M&A Strategy**

Initially, the strategy and acquisition members of an in-house m&a group compare company objectives, market trends, and customer input with company resources and product programs to

identify ways to build business value. Some goals will be reached via internal programs and others will be via m&a synergy opportunities. In the case of acquisitions, the team will develop an m&a strategy plan for selecting candidates that provide identifiable synergies. The acquirer's operations and integration team later will use these synergies to identify specific key integration activities in four areas: asset acquisition, asset divestiture, organizational restructuring, and capacity changes.

Early creation of a draft operations and integration plan before the acquisition provides two benefits that greatly strengthen candidate selection and support rapid executive approval of the project and the target.

First, the integration draft identifies *integration-enabling characteristics* required of the candidate and allows an anticipatory approach for creating final integration plans. Operation and integration requirements for a good candidate may include:

- Product technology that is compatible with acquirer's manufacturing system;
- Volume production without numerous variations to satisfy specific customers;
- The buyer's sales approach will not jeopardize retention of acquired customers, and
- Compatibility of acquired products with the buyer's sales model and skill set.

Secondly, the draft can identify obstacles to the deal early--either a "*showstopper*" issue that halts the process or a situation in which *effective adjustment processes* can be determined to correct a problem before the crunch of executing the integration plan in Phase Four.

Showstopper issues at the target might include:

- Technology is outdated or cannot be used for efficient manufacturing without major redesign of complex products;

- Products have unique features for each customer that limit volume production without major redesign of the products or adjustment of customer expectations, and
- Customers rely on a long-term relationship with channel sales representatives and are likely to go to competitors if the restructuring changes channel partnership relations.

On the buyer's side, its sales force may not have the skills to sell the acquired products.

Too often these problems are identified after the deal is completed and, typically, these acquisitions failed to deliver the projected value.

Required adjustments that may add to value if identified early include:

- How and where to increase manufacturing capacity;
- Actions needed to add new sales channels to business processes;
- Combining and reorganizing customer support centers;
- Personnel planning to retain desired people for roles in the combined company or to terminate others, and
- Divestiture of portions of either company that are no longer needed or wanted.

This analysis is critical for evaluating acquisition candidates. Identification of showstopper issues leads to early rejection of some candidates. Other candidates will survive the second round of screening only if adjustment requirements are justified by strong long-term potentials of a combination.

An example of successful early planning and excellent execution in all four m&a phases was at a company whose m&a strategy identified an opportunity to expand into a market by replacing its competitor's systems network architecture (SNA), which had a 75% worldwide networking market share, with its alternative transmission control protocol/internet protocol (TCP/IP) for corporate enterprise networks. Careful strategic analysis suggested that by connecting its TCP/IP

network equipment directly to the competitor's mainframe computers using the same mainframe interface hardware already employed by the competitor's SNA network equipment, an orderly market transition from proprietary SNA to open-standard TCP/IP was possible.

The company created an operations and integration plan for acquiring the interface technology and validation tests from the owner, implementing it and validating the new solution internally by compatibility testing and using it at customer sites such as the Federal Reserve System's Federal Funds Clearing Network. The detailed plan prepared in advance allowed a rapid and successful implementation. Within two years of product launch incorporating the new technology, the company's SNA-replacement product line was achieving an annual revenue stream of more than \$1 billion.

By contrast, another company met with failure because weak Phase One planning led it to spend several billion dollars on unsuccessful acquisitions of technology products. The acquired products proved difficult to sell and the projected synergy value from selling the new lines through the acquirer's worldwide sales force was not realized.

The operations and integration plan was not developed in either Phase One or Two and the company did not identify the inherent conflict between the existing well-entrenched sales plan and the new product line. A key problem was that the acquirer's sales plan had a strong incentive bias for selling small quantities of large, expensive products. That approach conflicted with the high-volume characteristics of the new product line, i.e. selling larger quantities of smaller dollar-value products. Early planning would have highlighted the challenge in getting the sales force to handle both marketing approaches and identified a critical issue for action during the integration phase.

## **Phase Two: Candidate Screening**

In the screening phase, the strategy and analysis team uses the strategic plan describing the synergies and the integration-enabling characteristics to identify candidates for acquisition. As leading candidates are identified, special synergies unique to a particular company are identified and matched to the key activities of the combined firm. Particular attention should be paid to gaps between a candidate and the new configuration in the combined firm.

The operations and integration team needs to immediately address situations in which the candidate lacks the ability to support a synergy or the planned approach for integration is not feasible. The team will develop a mitigation scheme with related costs or recommend abandoning the specific candidate as an unacceptable fit. It is essential that the operations people have the power to influence the strategists' acquisition decision when there is a poor operational fit.

While the screening proceeds, the operations team is completing its operating draft plan by covering the following areas:

**Best Practices**--Documentation of best practices for areas critical to combining the two companies is essential. Business processes are vital to efficient operation and the combination of the two companies will affect key processes. By identifying the practices in advance and planning for changes, the operating people can minimize employee confusion.

**Synergy Discovery**--Special synergies represent business value from acquisition of a particular candidate. These are generally not obvious from only a cursory investigation and not known to the candidate's management. They allow the acquirer to be comfortable that the probability for success is high and perhaps pay more than initially planned for the acquisition if necessary.

**Motivation by Incentives**--Incentive bonus plans are formulated for most of the employees affected by the acquisition with a sensitivity toward motivating the employees of the combined company to complete a successful integration. We believe the incentive should start with a present value of approximately \$3,000 per person and increase according to the individual's contribution to the success of the integration. The payout should be tied typically to three milestones that the individual can directly influence, with the last being measured about six months from the beginning of integration. For commissioned employees, the incentive program should complement their commission quota goals and compensation. When combined with effective communication, incentives motivate employees to see the acquisition activity as a personal opportunity and to accept the dislocations of organizational change together with the increased work of the acquisition. It is critical to include the cost of the incentive package in the operational and integration cost analysis section of the m&a project and to secure executive approval of the incentive/bonus plans as part of the project.

**Staged Integration**-- Short-term versus longer-term integration activities represent an important distinction in developing schedules. Between the drafting of the original operations plan and the issues raised during pre-closing due diligence, the Operations team must manage a long list of tasks. By separating them into short-term projects designed for rapid delivery of value and longer-term projects for everything else, a reasonable integration plan for the first 100 days after the deal can be accomplished early enough for successful execution.

**Communications**--Continuous communications are the lifeline of a successful integration. The operations team must plan an ongoing effort using a variety of communication mechanisms to distribute information internally as well as to customers, vendors, partners, and stock market analysts.

**Training**--Employees and outside parties must be trained about the effects of the acquisition, new products, pricing strategy, ordering, support, etc. Substantial amounts of the supporting business collateral will need updating over time. Items likely to require early attention include product brochures and catalogs, marketing material and demonstrations, website and advertising information, pricing and ordering documents, sales “pitches”, support documentation, analyst and investor communications, business and employee contact lists, internal business process documentation, and product certifications.

**Acquisition Announcements**--Preparation of the acquisition announcement is a combined effort between the strategy and operations team, sometimes in consultation with outside specialists. The acquisition announcement, usually from the CEO, must convince audiences that the deal is a major positive step for the company and demonstrate why the company wins. But the presentation also must include a candid assessment of the integration challenges and organizational restructuring that will occur. It is critical to maintain ongoing operations and avoid debilitating distraction from “fear of the unknown.” People need to know the status of their jobs and also that the impact of the acquisition on their workload is being considered in the integration. Finally, the employees must be told that there will be recognition, i.e. the bonuses and incentives, for successful integration.

Another example shows the pitfalls of an inadequate operations plan developed at a company where there was no operations team assisting the strategy people with candidate screening and where integration was done ad hoc after the acquisition closed. During integration the acquired company’s product was discovered to actually duplicate a product that a division of the buyer was within two weeks of delivering and these internally developed products already were integrated into the product pipeline. The acquisition created unnecessary conflict and depressed

morale at both companies. Had an operations and integration unit been involved early, it could have suggested that the acquisition was unnecessary.

We have observed several situations where the risk of the m&a strategy is exacerbated because the strategy unit is primarily market-focused and that lacks current information about product initiatives within its company. A key value provided by including an active operations team is its knowledge of the acquiring company's functional units and the ability to fill knowledge gaps in the strategy team.

### **Phase Three: Due Diligence and Transaction Execution**

Thorough due diligence followed by rapid transaction execution must be accomplished for potential synergies to be achieved. This is a period of intense activity with legal constraints on who talks to whom and on what schedule. Proper time phasing is essential as integration proceeds.

Generally, members of the operations team supported by outside specialists are best prepared to accomplish the operations diligence work or in some areas to review the findings of other specialists. Properly coordinated diligence work is performed in a specific sequence to identify showstopper issues not previously spotted as early as practical, yet limit interaction between acquirer and target personnel to minimize legal risk in case the transaction is not completed.

The operations team should prioritize key integration activities with relationship issues near the top. Although deeper examination may identify additional items, we consider the following to be among the most important tasks because they contribute significantly to the core synergies of most acquisitions.

**Key Personnel**—Emphasis should be on singling out the target personnel most needed for successful operations and integration and determining how to address all issues that will affect

their excitement for contributing to the combined company and commitment to successful integration. This requires a detailed examination of each person's work record and new role in the combined company. Analysis should include prior commitments, compensation plans, performance, skills, geographic logistics, etc. together with how the individual will integrate with the new organization business practices and culture.

**Commitment**—Determining commitment requires identifying the acquirer's key personnel required for successful integration and what must be done to keep them committed. The buyer's employees invariably take on additional integration tasks after the closing, including the guidance and training of target employees. It is critical that the incumbent personnel understand the value of the combined company and relevant portions of the operations and integration plan so they will consistently reinforce a message of positive teamwork and good culture to their new co-workers.

**Customer Relationships**--Closely examine and clearly understand key customer relationships and mutual commitments required for successful integration. Assure that the integration and newly devised operations plans supports these relationships and honors outstanding mutual commitments.

**Key Alliances**--Key alliances and business partners may be impacted by acquisitions. The operations and integration plan should recognize these relationships at both companies in detail and provide appropriate transitions for the partners to the combined company's business model.

**Market Analysts Relationships**—Frequently, industry analysts stop covering the target's products after an acquisition. Loss of market visibility can be deadly to market-related synergies so the integration plan must pay attention to maintaining or replacing analyst relationships.

Those five areas deal with key integration activities that likely will touch all major functional areas of the company and require a multi-disciplined approach to perform the required diligence. The operations and integration team's key contribution is to assemble the results of the study and guide specialists toward solutions that contribute to the success of the plan.

For example, the human resources representative will be examining compensation and benefit issues with an eye toward fitting the target's employees into the acquirer's existing comp and benefits framework. Other team members can help by directing the HR people to variations for special situations that can keep personnel motivated during the difficult integration phase.

On an overall basis, the operations and integration people can use the diligence phase to augment the basic plan with a complete assessment of associated costs and incentive programs. As a result, the acquiring company's executive management has a complete handle on all the synergy values identified in the deal at the outset. The transaction that top management approves thus can reflect expected increases in business value from the acquisition synergies, net of operations and integration costs and required incentives and bonuses.

A unique logistical problem that could have jeopardized considerable value in a deal was testimony to the good work that can be done through early intervention of an operations team. The target had an engineering group at an inconveniently remote location and it was important to secure the intellectual property represented by those engineers and complete their current project—before they were relocated to the combined firm's main engineering location. The operations team, working with HR, arranged to pay a project completion incentive--in one case equal to an engineer's base pay during project completion, or effectively double time for eight months. The projects were completed on schedule without significant personnel losses.

Otherwise, we believe the relocation would have caused the engineering group to leave before completing their work.

Sometimes the target is allowed to continue operating as an independent subsidiary of the parent, a risky approach in our opinion with the problems at Tyco International Ltd. illustrating the hazards of a business model based on unrelated subsidiaries.

In one case that we know of, the acquirer did not develop an integration plan that properly tied the acquisition synergies to key integration activities. We identified two major problems with this approach that should have been resolved during the diligence phase and would likely have aborted the transaction had they been found early. There was no provision in the acquisition agreement for the new “independent” subsidiary to develop products or technology that specifically contributed to increasing sales of the parent’s products. In addition, market analyst communications to maintain the market presence of the subsidiary’s products were overlooked.

As a result, the buyer did not achieve increased value in the combined business, either through increased product revenue at the parent or sales at the subsidiary. In fact, the subsidiary’s product sales declined. This acquisition was regarded as a failure and the subsidiary was subsequently sold. Later the parent was put “in play” and was sold as well.

#### **Phase Four: Integration**

In the first three phases—roughly taking place before closing—operations and integration was in a supporting (but still critical) role. After closing, the O&I team is primarily responsible for the successful integration of the acquisition. The team that developed the plan should have significant responsibility for the management of the plan, which includes communications, schedule management, issue resolution, plan adjustment, and performance measurement.

### ***Communications***

By this time, all disclosure issues will have been addressed and the communications portion of the integration plan must become fully operational. The rationale for the acquisition, its synergies, and the integration plan are well understood only by the executives and the small group of people involved in the m&a. Throughout the rest of both companies bits of information, rumors, and fears regarding organizational change and job security will be circulating rapidly.

Ongoing communications are critical to maintain credibility and focus energy on successful execution of the integration plan as well as to change the plan when needed. The first critical early job of the communications program is to clarify the purpose of the deal, confirm planned organization changes, and show how and when they will occur. If there are workforce reductions, it is important that everyone understand that affected employees will be fairly treated.

Organization changes that will occur later require special handling for affected groups.

Immediately after addressing the organizational issues, executives must communicate the specific assignments in the integration plan and the incentives for success. A successful communications plan will inform and engage employees so that they support the effort and see personal opportunity.

### ***Schedule and Change Management***

Timely task delegation is needed to support the integration schedule. One of the most difficult parts of integration is to manage organizational change, which entails changes in reporting structure, task assignments, and business processes. Program management pays close attention to these tasks and assists with adjustments as the details are worked out across functional units.

Change creates confusion and turf issues, common problems that require quick resolution by the integration team through clarification of plans or fine tuning of the organizational shifts.

Managing the schedule must include celebrating integration milestones as they are achieved to maintain momentum and prop employee morale.

One deal that we cited earlier as a success—the acquisition of a key mainframe hardware interface by the TCP/IP networking systems producer allowing the firm to convert the proprietary SNA market—produced an unexpected dividend well after the deal closed. The buyer, to reiterate, was successful in using the acquired technology together with its TCP/IP-based products to penetrate the proprietary SNA market. But the competing company’s SNA networking division remained committed to its proprietary approach and didn’t concede that a fundamental change was underway in the networking market. As a result, the company’s SNA division suffered declining revenue and reduced market share.

The acquiring company that helped engineer the market change then approached its wounded competitor with an acquisition/alliance proposal. The successful player proceeded to acquire the ailing SNA division for \$2 billion dollars and become its competitor’s *networking partner*. The less fortunate competitor agreed to the arrangement because there was greater value gained from increasing its global network integration and mainframe systems business than the value lost by selling the SNA division.

Although integrating the newest SNA division posed a difficult integration challenge because of prior competition, the acquirer was able to use the integration plan that proved successful the first time for a second run. It was able to show the acquired employees that the SNA product would still command a significant legitimate market, even amid the market shift, and to show that the combined technology of the two operations produced an exciting new opportunity. The combined company actually dominated three key markets and enjoyed the expanded product development, customer support, and manufacturing synergies to support the newest addition

better than before the acquisition. The alliance for product sales and systems integration was also successful, resulting in billions of dollars in increased revenues for both companies.

### **Review, Evaluation, and Renewal**

After the acquisition is completed, the buyer's management should review and evaluate the deal to determine task accountability and learn how to improve the m&a process for the next successful acquisition. Key areas for analysis include:

- Preparation and utilization of the key operations and integration activity list for candidate screening and selection. Was this work done and how was it used?
- Comparison of the list of the operation and integration activities proposed in the strategy phase and the actual steps taken in the integration phase. This analysis suggests how successful early planning was in predicting the integration work that actually was performed after the deal. It also will help in determining if strategy analysis improvements are needed.
- Comparison of projected costs associated with the final operations and integration plan used to support the transaction justification with actual costs in the final integration. Were major costs overlooked or overestimated and why?
- The operations and integration contribution to the executive diligence summary including the go/no-go issues that were uncovered and their resolution, as well as management recommendations regarding transaction execution. How did the operations/integration group influence executive management's transaction decision? How can this be improved?
- Post integration meetings with major groups participating in the integration to identify major successes and problems. How or why did the successes result and how can they be replicated? How or why did the problems occur and how can this be avoided next time?

- As milestones are achieved, integration managers should direct HR to distribute incentive payments according to the approach approved by executive management. Were these incentives useful? How can they be improved?
- A final results summary for top management that include significant lessons learned and recommendations for the future. Management should review the results and determine appropriate rewards.

### **Summary**

This paper documents the need to interweave the integration process with the preacquisition work. This critical process has not been well documented in writing. Acquirers often give lip service to the idea, but they do not actually carry out these necessary interactive procedures in practice. Our failure examples demonstrate this in shocking fashion. Our success stories document the substantial benefits of linking preacquisition analysis to subsequent integration processes.

(bio)

Richard S. Parenteau is Managing Partner of QuickCycle Consulting, Sunnyvale, Calif, and J. Fred Weston is Professor of Money and Financial Markets at the Anderson School, UCLA.