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Sharpening M&A Performance in a Declining Economy

Discussion Group

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Chair

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Introduction

Economic recovery may be on the horizon, but it will likely be slow and uncertain. For those with money and ambition there may still be the opportunity to buy distressed assets cheap. However, M&A deals are more fraught than ever and quality opportunities few and far between. Those wanting to advance their business through M&A will come under intense internal scrutiny and have to undertake more comprehensive due diligence. Market growth will not hide bad acquisitions and integration planning is now vital to M&A success.

Key Take-aways

Members of the Criticaleye community convened to discuss how to sharpen M&A practice in these challenging circumstances. Their insights included:

Financing a deal is currently difficult, but there is money around Buyers must ensure they have done their homework and be consistent with what they deliver to their investors.

Companies should be opportunistic in a strategic way They should understand their aspirations and identify gaps, but leaders should act decisively when assets come up and the time is right.

It is a buyers' market Leaders should target healthy businesses with over-leveraged owners.

Integration planning is crucial to a smooth transition This can start as early as the due diligence stage, and is most effective when overseen from start to finish by a single team. Cultural fit, though rarely a deal-breaker, should be considered as early as possible. There is often a wealth of information informally and publicly available – through former employees, for instance.

Price is still the overriding consideration But labour contracts and pension issues are two other factors that can hugely affect the deal's success

Locate the talent in the company being acquired Often – eg, in technology businesses – this resides not in the chief executive but in his 'techy' second-in-command.

Write a new playbook Do not repeat the mistakes, or strive for the successes, of past deals, but think through the objectives and post-close operating model for each deal case-by-case.

The customer must be the main beneficiary of an M&A deal Suppliers, too, should be carried along as a damaged relationship can hamper effective integration.

Staff must be eased through the transition A balance must be struck when bringing a new company in line, lest its creativity be stifled. Once through the merger, all staff should feel empowered to succeed, and guided by a clear vision.

Leaders should communicate clearly and also listen A 'Minister without Portfolio' on the integration team may pick up issues that would otherwise be missed.

Consultants and lawyers are vital, but in-house project management expertise can be useful It is essential that the organisation 'owns' the acquisition and the integration process, even if the process is facilitated using outside help.

Pressing issues in M&A today

With the repercussions of the crisis still being felt in the banking sector, finance is clearly a burning issue. Cash-flow problems are definitely restricting and slowing down M&A activity; finance directors are sitting on their cash. One delegate described the difficulty he experienced piecing together a deal involving nine financing banks, each with their own paperwork and special requirements.

Investors are no longer taking anything for granted; they are questioning all aspects of deals. They are also expecting consistency from start to finish in the acquirers' approach. Do not go into a deal promising product development and come out of it with cost synergies: your banks will not be pleased, counselled one member. Nevertheless, money, including bridging finance is still available.

Another member commented that, in the aftermath of government intervention in the banking sector, both the Competition Commission and the Office of Fair Trading are looking to reassert their authority and would be scrutinising deals very closely.

Divestments are another important facet to the topic. Many companies are now looking to streamline their operations, and are carving up their assets to retain as much value as possible. Such is their enthusiasm to get things moving, in these situations, the divesting company may offer to help find finance.

Opportunism and strategy

In easier times, deals were often the result of pure opportunism; now, that opportunism should more than ever be tempered with a strategic approach. If companies have a clear view of their aspirations and can identify the gaps, then they can act decisively when the right asset comes up.

It is a buyers' market out there: some studies show that up to 20 per cent of assets on sale are distressed, and the indications are that this is rising. There are undoubtedly some bargains around. However, it pays to choose carefully. Ideally, thought the group, it is best to target healthy businesses with over-leveraged owners – the situation in which many private equity firms find themselves. Credit insurance can also be difficult to find in some industries.

Integration planning

It has never been more important to integrate new acquisitions with speed and efficiency. This process should start before the deal is made. Microsoft, GSK and others, for example, have a single team that plan the integration, starting early in the due diligence stage and seeing it right through to delivery of acquisition benefits.

The delegates listed some of their top criteria for smooth integration:

- A good customer base with little duplication or other issues
- A receptive leadership with a positive view of the acquiring company
- A good geographical fit, and well-located talent
- Compatible systems
- Culture

This last point provoked some strong debate. Firstly, it is difficult to define 'culture': is it to do with sectoral and market expertise, or, less tangibly, 'the way we do things'? Secondly, one delegate pointed out that culture is never a deal-breaker. If the financial factors are favourable, the deal will go ahead regardless. Deals are planned and executed by the CEO and CFO; the HR director, who may be the best judge of culture, is often the last to know. Nevertheless, 'softer' factors are increasingly important to a deal's success.

Talent is one of these factors, and future relationships should be explored as early as possible. This can be through informal, anecdotal channels, and should include social occasions such as golf or dinner. Often, observed the delegates, the real talent in a company is sometimes not at the executive level, but lower down. Locating and retaining talent is vital.

Turning their attention to reasons for turning deals down, the delegates cited price, and the cult of the CEO – the talismanic figure who defines the company. Labour contracts and pension arrangements can have a huge impact, and both must be taken into account as early as possible during integration planning.

Finally, integration planning should include a clear appreciation of the risks involved, and enough 'Plan Bs' to counter these risks. By communicating clearly throughout the process, leaders can help to maintain business performance.

Moving with the times: customer focus

Write a new playbook for every deal, advised one delegate: don't repeat the mistakes (or even strive for the successes) of the past. For example, the driving force in banking deals a few years ago was integrating systems. Nowadays, the focus should be on the brand and particularly on the customer's needs.

This may mean putting what some see as the straightforward 'wins' of an M&A deal, such as back-office integration, at a lower priority. Other examples of bringing customer focus included rapidly merging sales teams and working with the customer, not against them – for instance, by incentivising them to switch brands, and phasing out old lines slowly.

Leaders must not forget to take suppliers with them, too, added one delegate. And those who are being let go should be treated fairly.

Helping staff transition

The acquisition period can create uncertainties and insecurity for staff in both the acquiring and acquired companies. Several delegates thought that assessments and, particularly, making people re-apply for their positions can poison the atmosphere, but there are strategies for smoothing the transition:

- Parachuting in an outsider to supervise the new division can help ease tensions. Alternatively, an outside expert employed temporarily through the deal period can dispense impartial advice.
- One participant said he employed the 70/30 rule: no more than 70 per cent of staff should come from either company, to guard against feelings of being swamped and to create a shared culture.
- 'Paying people off' (subject to targets) can be a positive move: it allows them to leave with their head held high, recognises their achievement and can boost morale.
- It was emphasised that those who remain after the merger should be provided with the environment and the structures to succeed.

It is also a wise move for a leader to employ a trusted finance expert in the new company. Taking control of the numbers is vital, and they can become the CEO's eyes and ears in the new division.

This led the group on to the subject of replacing the management. Some felt a 'wait-and-see' approach was best: a management team must be given time to settle in, and, besides, pre-deal it is difficult to get a real feel for their talents. One leader said that his company took 90 days to announce all its appointments in one takeover. Others felt that pressing onwards with designing the new organisation was a better policy.

Whichever strategy is chosen, the group agreed that a leadership team must communicate clearly and, above all, listen. A CEO who engages with his or her staff is likely to create engagement in return: for example, www.arcelormittal.tv is an exemplary use of new technology to facilitate two-way communication. And a sweeper, or 'Minister without Portfolio', in the integration team can pick up issues that might otherwise be missed.

Project-managing integration: an in-house capability?

The group agreed that many companies lacked the project-management skills to take control of integrating an M&A acquisition. However, one delegate deplored the reliance on '24/7 consultants'.

Good project-management skills are transferable to other areas of corporate life, but in-house employees often are reluctant to take time out of their normal roles to manage acquisitions. If they are to be asked to do it, they must be convinced it is beneficial to their career. Consultants and lawyers are often vital to facilitating the M&A process, but there must be a single point of accountability within the organisation: the organisation must 'own' the acquisition and integration strategy.