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Creating a new Board for merging businesses

Few events have more potential to change a company as fundamentally as a merger. Yet, if that is to be a positive and successful change, then the Board must be proactively involved – particularly in the critical step of forming the new Board of Directors.

In this article, Beyond the Deal's **Adam Tyner** *and* **Carlos Keener** *explain that mergers provide a unique opportunity to improve Board processes and dynamics, abandoning bad habits and improving the chances of the merged entity enjoying long-term success.*

Mergers provide a unique opportunity to improve Board processes and dynamics, so make the most of it

A transformative merger often creates a new company with a strategy and mission substantially different from that of either legacy organisation. Even mergers that simply extend market reach or focus on economies of scale often create significant changes in the processes and cultures of the organisations coming together.

A merger also means a new Board of Directors. This new Board will have the unenviable challenge of determining business direction and operational bylaws, while simultaneously providing the day-to-day oversight and support required for the newly-merged organisation. The Board's success will depend on appointing the right people and implementing appropriate standards and processes as quickly as possible.

And, as if this challenge were not sufficient, there is also the issue of time - or rather, the lack of it - and, in publicly-listed firms, the intense scrutiny applied by the market around the time of the merger. This scrutiny now goes well beyond the traditional focus on shareholders: In addition to increasingly organised and active shareholder groups, the UK Companies Act (2006) places additional responsibilities on the Board to regard 'the interests of the company's employees; the need to foster the company's business relationships with suppliers, customers and others; and the impact of the company's operations on the community and the environment' when promoting the success of the business. Meanwhile, Sarbanes-Oxley puts internal accounting and financial controls at the heart of Directors' responsibility with Board members of organisations found guilty of accounting crimes facing large fines or even prison.

If that isn't enough, keep in mind that, in a fragile recovery with volatile capital and commodity markets, simply growing your way out of mediocre merger performance – a useful trick in previous years – is no longer an option. The role of the Board is significantly more complex than before, and its ability to remain detached from the details of integration – and all the stakeholders it impacts – is long gone.

Companies undergoing significant change need strong, aligned and engaged Board leadership, and not just for the new business in the long-term – it is required from Day 1. In a merger, naming a new Board quickly is not enough. That Board must also demonstrate this leadership, get to grips with key areas of integration, and work hard to build market and employee confidence in the new entity.

And, with timescales tight, mistakes can be costly. Given these challenges, two questions take prominence for merging organisations:

1. What are most important priorities when creating a new Board of Directors?
2. What role can the new Board play in supporting and accelerating integration?

BUILDING A BOARD TO SUPPORT THE BUSINESS

First, let's remind ourselves of the traditional role of any Board of Directors. It is there to:

- Govern the organisation by setting the strategic direction, objectives and key policies
- Select, appoint, review and support the performance of the CEO
- Ensure the availability of adequate financial resources
- Approve annual budgets
- Account to stakeholders for the organisation's overall performance and adherence to corporate values

In building a merged Board quickly, three elements will determine how effective it is at fulfilling the duties outlined above:

- **Membership:** Who will serve on the Board? What competencies and experiences are needed, both individually and collectively?

- **Internal Board Processes:** How the Board gets its work done, including meeting cadence and schedules, the use of standing and ad-hoc committees, report and information standards, strategy and budget review and approval processes.

- **Board and Management Interactions:** Effective interaction between the Board and management is essential. What is the quality of conversation and examination at Board meetings? To what degree does the Board actively participate in the setting and vetting of strategy?

Board membership is typically the first element addressed in a merger. While board seats are generally allocated based on equity or ownership, the contentious question of who will fill those seats can still become a fairly political affair. To stem the politics, an expectation should be set early in the merger discussions that assignments will be determined based on what is best for the future company – a consideration of those wider stakeholders mentioned above may help deliver a more balanced, stable structure than one that focuses solely on shareholder representation and return. As the most viable Board candidates are naturally those with the appropriate experiences and abilities to support the new company's mission and strategy and provide necessary oversight, it is particularly important to have a clear strategy defined before the transaction or board selection. If the mission, strategy and oversight needs of the new company closely resemble those of the pre-merger companies, then incumbent Board members are likely to be good candidates for the new Board. If the new company's needs have changed, however, then new members should be considered.

Other common questions when structuring a Board include: What is the appropriate size? What is the right role for Non-executive Directors (NEDs)? Should the CEO also chair the Board? Different situations will call for different answers but the Board must be sufficiently large to have the capabilities necessary to provide appropriate oversight, yet sufficiently small to reach a working consensus and function as a single team. More important though is the question of depth - the Board, collectively, must have the necessary experience and capabilities to provide support and oversight.

If new expertise is necessary, additional members may be justified, which leads us to the issue of NEDs. The fresh perspectives, experiences and contacts these individuals bring can be especially helpful in mergers in which new strategies, markets or business models are especially prominent. If you are embarking on something entirely new in your merged business, make sure someone on the Board has been there before.

The question of splitting the CEO and Board chair roles is also a situational one. Combining the roles can create greater alignment between the vision of the Board and the execution of the management team, but comes with the loss of an independent point-of-view that a non-executive chair can provide. Generally, the benefits of independent Chair outweigh any advantages derived from combining the roles. Possible exceptions, however, can include when the CEO owns a significant portion of the company or if the CEO is chairing the board of a subsidiary entity over which he/she does not exercise significant operational control.

As with membership, the Board's internal bylaws and processes should be guided by what is best for the company in the long-term. The Board's governance framework must be addressed at the outset of the integration. This framework should establish the roles, authority areas and decision rights of Board committees and individual Directors.

Some of the questions the governance framework should address include:

- What is the process for forming and disbanding ad-hoc committees?
- When, and how often, will the Board meet?
- How will it gather and analyse information?
- What will the Board's role be relative to the management team?

The last of these is the most important, and will set the tone and culture of the new organisation for integration and the long-term business. While there is no right answer, this centres on the fundamental balance of responsibility between the two groups: Decision-making *vs.* decision-approval *vs.* decision-advisory. In a dynamic, fast-moving business environment where things can change from day-to-day, waiting for quarterly Board meetings strangles agility; it can also provide the longer-term perspective that prevents false starts

COMMUNITY COMMENT

Siva Shankar
Corporate Finance Director
SEGRO plc

Keeping the Board close to the post merger integration

These are some steps that I am in favour of to keep the Board informed and very close to the progress of the integration:

Draw out the acquisition integration lessons from the last 5 years from both legacy organisations – These should be 'deep dived' into within a non-threatening environment to ensure that past mistakes on acquisition integrations are fresh in the minds of the new Board thus reducing the risk of 'reinventing the integration mistake'.

Pre-mortem – The directors should brainstorm what series of events need to happen for the merger to become a total disaster. This is based on a technique articulated by Klein and will involve directors pulling key integration assumptions apart and gaining appreciation for how few things need to go wrong, and in what sequence, to reach 'disaster'. This gritty reality check will ensure that an aggressive risk management framework is put in place for the duration of the integration.

Identify attack points from the perspective of an aggressor – Post completion of the merger, prepare a bid attack / defence document for the combined entity. Due to the nature of the document, it will be more brutally honest than the traditional SWOT exercise that comes through from strategic planning, and it is easier for the preparers of the document to bring the more sensitive attack points to the table that may normally be glossed over or avoided as politically sensitive. The attack / defence themes should be debated candidly by the Board as this helps ensure that directors are transparently up to speed on the vulnerabilities of the merging business. This also reduces the risk of insular thinking or positive 'group-think' setting in. To ensure that complacency does not set in later, the bid defence document should be updated every six months until the merger has delivered on most of its critical objectives.

Clear dashboard tracking of KPIs – This should be a one page dashboard with clear traffic light signalling capturing KPIs that highlight true health of delivery on the merger. The carefully selected KPIs should measure all the vital signs of integration success or failure, and be quickly digestible. Apart from being influenced by the original integration assumptions, the KPIs will also be powerfully influenced by sobering insights generated from the "pre-mortem" and "attack points from the perspective of an aggressor" exercises. At the very least, this KPI dashboard should be prepared on a monthly basis, but more regular weekly updates will help ensure that directors are quickly warned of anything going off track requiring their closer involvement.

Regular program of contact with 'the frontline' – Directors should have regular contact with top 10 customers / suppliers / frontline sites as these entities often see things from a very different, and brutally candid, perspective. This should bring further 'real time' information into board meetings.

Medium term 'skin in the game' for the directors – The directors should be given significant skin in the game (or 'pain equity') to an extent that their holdings constitute a large part of their net worth.

Short-term incentive scheme – Once key milestones have been agreed for 12/24/36 month time lines, the short-term incentive scheme should be based on specific delivery of targets directly linked to the KPI point discussed above.

and reduces risk. An open (but informal) discussion around 'who does what' is often extremely helpful in getting Boards and their management teams off to the right start.

Mergers provide a unique opportunity to improve Board processes and dynamics, so make the most of it. A merger and the creation of a new board of directors offer the opportunity to abandon bad habits and set new standards. While the new company's strategy, mission and oversight needs will inform the needs, some standards will be common to all companies and boards. One essential standard is that the Board must speak with a single, consistent voice. Another is that it must take an active, critical role in vetting strategic plans and provide an independent, alternative and critical perspective.

USING THE BOARD TO SUPPORT INTEGRATION

In the past, Boards have often been perceived as 'silent partners' in integration, typically approving the original deal and then having little visibility of (or interest in?) progress... until things start to go wrong and the market must be informed. It is increasingly important that Boards play a more active role in integration as their involvement can greatly enhance its success as well as their own ability to perform their role effectively. Board involvement in mergers and integration should include:

- **Overseeing regulatory approval:** Conducted pre-close and therefore separately, both Boards individually can help guide the regulatory approval process, ensuring that potential obstacles to approval are identified in advance, and potential remedies are explored as strategic options.

- Countering deal momentum: George Washington is said to have told Thomas Jefferson that the framers of the US Constitution created the Senate to 'cool' House legislation, just as a saucer was used to cool hot tea. Good Boards are no different. As executives and deal sponsors become increasingly wrapped-up in synergy models and deal minutiae, the Board can sometimes be the only place where the awkward questions around long-term merger viability can be openly raised and properly addressed.

- **Setting long-term strategy:** Experienced acquirers understand that deal success typically comes from long-term alignment of strategy and capability, not short-term financial synergies. Boards can have an extremely-useful role in ensuring that long-term strategic direction and targets are comprehensively discussed and determined well before deal close whenever possible, or as the top priority from Day 1. Boards are also helpful in ensuring that strategic direction and targets are balanced, considering longer-term, non-financial goals in addition to 'the numbers'. When done well, strategy determines business model, which in turn drives integration, which in turn delivers merger benefits; it also provides the key platform for building trust and confidence with the market, customers and employees - all of which is key to a successful Day 1. Businesses who wait for the merger to 'settle in' before confirming their new strategy typically never get around to completing it, with serious – and immediate – consequences for integration.

The ability of the Board to remain detached from the details of integration is long gone

COMMUNITY COMMENT

Jeremy Small
Group Company Secretary
AXA UK plc

Common pitfalls in selecting/ merging boards post-close

The most common pitfall regarding board composition tends to be one of two types: total dominance by the acquiring company's executive team or 'man-to-man marking' (ie, one from each side). Neither works particularly well as the first tends to erode remaining morale amongst the target executives and staff and the second often leads to deadlock and a lack of action either because it is very difficult to enforce decisions or because no-one wants to commit to making them.

Engaging Boards better in integration

Better and active engagement can be engendered by reinforcing the fact that the deal is not to be regarded as completed until integration (suitably and clearly defined) has been concluded. The most important point here is to decide what integration means in terms of its conclusion – something that is far more difficult than it sounds. It can also be helpful to link short- and medium-term incentives with agreed outcomes for integration as this helps maintain focus and sustain effort over the period required.

Barriers to Boards 'staying close' to the deal post-close

All too often, Boards view legal completion as the end of a deal. One way to combat this is to give NEDs (or shareholder representatives in their absence) responsibility for oversight of the integration. This is helpful as it clearly delineates responsibility - the executive team, usually in the form of an Integration Steering Committee, is responsible for running the integration process and they report to a NED-led oversight committee. The latter can, and should, operate at a more strategic level, monitoring progress against integration targets and providing advice and direction when needed - as well as reassurance to the whole Board. In addition, it can be very effective in holding the executive team to account. This permits the executive to remain focused at an appropriate level of detail to ensure the integration process has the best chance of success.

Overall, it is about changing the typical view of a deal so that it is seen in a strategic, rather than a tactical, context. This will automatically alter the time period during which it is actively monitored.

Have a goal, and a high-level plan to get there; and if you don't feel like shouting them from the rooftop, go and get a new one

COMMUNITY COMMENT

Gwen Ventris, Former COO, Europe and Executive Director, AEA Technology plc

Common pitfalls in selecting/ merging Boards post close

Communicating Board appointments (and their perception by both businesses) is the first significant opportunity to signal intent through real action. Acknowledging this, the three most common pitfalls in post close Board composition are:

- Making appointments as a 'reward' for pulling off the deal, without due reference to future strategic agenda, skills and capability requirements. This rarely works for reasons of individual motivation and business coherence – and those overlooked can often feel de-motivated and could perceive it as a negative indicator of things to come.

- Appointments dominated by the acquiring company's current executives and board. This rarely works as it may undermine the morale of the acquired company's executives, leading to disillusionment, resistance to change and, ultimately, key employee turnover.

- Appointing on a 50/50 basis to reflect the functional and numerical power base in each business. This approach can be equally negative leading to organisation inertia, individual and/or functional/departmental power struggles and decision-making paralysis.

Engaging Boards better in supporting Integration

Many executives find the acquisition and deal making process an exciting, adrenalin fuelled activity; an excitement which tends to tail off when the deal is closed and the company turns to matters of integration. For such integration to be successful and effective, it must be factored into the acquisition process at the outset and informed by the long-term strategy of the business. Engaging the Board early is critical and three ways such involvement can be improved are:

- Including integration in the process of acquiring a business. The emphasis on closure therefore shifts from legalities to the return (the outcomes) with the improved business performance expected from integration becoming one of the key milestones in the process. The Board should be active in defining what these objectives are and how they will be measured.

- Engaging in the selection of those to lead and oversee the integration plan. This team could involve executives and non-executives, accepting responsibilities to achieve agreed outcomes. Non-executive directors should take a more active role in strategic oversight and advising and guiding executive contribution.

- Engaging in determining the financial rewards associated with integration, linking executive remuneration to each key milestone and actively overseeing progress to maintain focus and business momentum. Reward for success should be cumulative with actual payments taking place at least two years into the plan to ensure that key players remain with the business, focused and sustain the energies of the organisation on what can be extremely challenging work. Critical to this is achieving clarity of objectives and what constitutes 'the end game' at the outset of the process.

Barriers to Boards 'staying close' to a deal immediately post close, and how this can be addressed

While the skills involved in acquiring a business are significantly different from many of those needed to integrate a business successfully, it is essential that these two key elements are woven tightly together from the start. The scale and nature of certain deals can be complex, time consuming and extremely demanding for key executives who can very often be suffering from deal fatigue by the time they reach closure stage. These early stages of 'acquiring' can be dominated by finance and legal matters which naturally demand the attention of the Board, whereas integration can be perceived as a more operational matter and therefore 'business as usual' to the Board. The barriers to Boards staying close to an acquisition post close can be improved by:

- Redefining the beginning and end of an acquisition transaction to include integration as a significant factor in the deal negotiation and legal closure as a milestone in a longer-term plan. The Board should be actively engaged through specified responsibilities and have oversight of the whole process.

- Defining and delineating the roles and responsibilities of executives and non-executives in the process, setting up sub committees such as an Integration Steering Group led by executives, which could report to an oversight committee of non-executive directors. This provides the NEDs with exposure to the integration plans and challenges on a regular basis and provides checks and balances with regard to executive team performance.

There are also a number of significant flow-through benefits to engaging the Board in these ways; essentially shifting the deal emphasis and their involvement in the acquisition process from transactional to one that has a more strategic perspective of the overall business, giving them a better informed view of organisation capability, competitive positioning and future strategic direction.

- **Building market confidence:** While ensuring a clear rationale for the merger and development of a long-term strategy are key, Boards are also best-placed to take these messages to the market, and should be spending much of their time both pre- and post-merger doing so. Studies have shown that the traditional dip in stock market performance seen on deal announcement can be minimised or even reversed, based largely on the strength and credibility of the *long-term* story given to the investment community. Have a goal, and a high-level plan to get there; and if you don't feel personally confident shouting either of them from the rooftop, go back and get a new one.

- **Establishing the right leadership:** Starting with the CEO, Boards are well placed to review the construction of the executive leadership team, both as a team and as individuals, ensuring their ability to deliver the merged strategy. Whereas merged Board membership is often constrained by the needs of share representation and political considerations, executive teams can, and should, be based solely on business need and capability. Boards can help ensure that merger politics is minimised (the old, 'one from our side, one from theirs' is understandable, but usually short-lived) and that the executive team shares a single vision motivating to each member, thus building the strong leadership so vital to any merger.

- **Ensuring compliance:** Be it a financial, environmental, operational or safety issue, the buck increasingly stops with the Board. Unfortunately, integration can sometimes result in compliance detail slipping through the cracks. We've seen US organisations discover many months post-close that their newly-merged partner trades in commercially-restricted countries (having never been told they could no longer do so); operating permits and insurances lapse; and – most commonly – unanticipated post-close imperatives to achieve Sarbanes-Oxley compliance (sometimes driven by inappropriate operating model designs) derail integrations entirely. While much, if not all, of this can and should be identified during due diligence, the impacts are often not translated into integration modelling or planning, or passed through to integration teams across the deal divide. Boards should pay special attention to these areas not only as an exercise in strategic risk management, but more proactively to ensure that their impact is understood and fed into integration plans and synergy targets early.

- **Monitoring integration progress and achievement:** Like it or not, Boards have an unavoidable role as managers of market expectations – we've seen too many cases in which Boards have allowed inflated deal promises to be made to the market, only to have to renege on these six or twelve months post-deal. Being able to do so relies on early and complete information, and an open team dynamic in which problems are easily raised and collectively considered. Boards do not have to be surprised at news of delays in synergies, nor should they be. While Integration Steering Committees come in many shapes and sizes, we suggest ensuring that there are at least two Board members on the Committee during merger integration. These individuals can keep the wider Board fully informed in advance of any upcoming challenges or roadblocks; while also injecting that longer-term perspective to help shape integration priorities and approaches.

THINGS TO CONSIDER WHEN MERGING BOARDS DURING M&A

- Use your strategic direction and goals to inform Board membership, responsibilities and governance processes.
- Rigorously understand the individual alignment and motivations of all Board members. Are they genuinely supporting the merger? Address concerns.
- Consider/revisit your use of Non-executive Directors, especially in cases where the new entity will embark on new ventures in unfamiliar territory. Do you have the right mix of experience around the table?
- Understand, and proactively address, new team dynamics. Like any new team, they will need time and effort to become strong and effective.
- Actively use the Board to 'cool the executive tea', both pre-close and post, continually challenging executives and integration teams to take a longer-term, balanced view.
- Give the Board specific integration roles related to market and investor communications, regulatory compliance oversight, risk management, and executive leadership selection.
- Keep the Board fully-informed of integration and delivery of future benefits/synergies. Help them manage market expectations.

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BRINGING IT ALL TOGETHER

Creating a new Board is a critical step in a merger, not only for the future business but for the success of integration. Simply combining or merging two Boards is rarely the right option. Instead it must be created with the merged company and its strategy, mission and governance needs in mind. By addressing membership, internal processes and interactions with management early, then giving it a strong, visible and active role in integration, you will be creating a Board that is better equipped to provide the support and oversight the new company needs, and maintain the positive market perception crucial to the success of the new entity.

Adam Tyner
Principal, Beyond the Deal

Adam Tyner is a M&A Integration professional and Beyond the Deal's lead practitioner in North America. Prior to joining Beyond the Deal, Adam was with Accenture's Organisation Strategy, and Corporate Strategy and M&A practices. His background also includes leading business unit through significant change as a general manager.

Carlos Keener
Founder, Beyond the Deal

Carlos Keener is a specialist in M&A Integration, and the founder of Beyond the Deal, a business that provides integration strategy, planning and execution support to clients worldwide. In addition to leading integration programmes, Carlos advises businesses on corporate and acquisition strategy; enterprise operating model design; integration strategy & planning; and turnaround of poorly performing acquisitions.

Based in the UK, Carlos' work has taken him across Europe, the US, Africa, Latin America, the Middle East, and the Far East.

Contact the authors through www.criticaleye.net