High performance through mergers and acquisitions: India's new dynamics

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Contents

Foreword

I am delighted to introduce **High performance through mergers and acquisitions: India's new dynamics.** The report has been published to stimulate debate during Accenture's Second Annual Supply Chain Roundtable in India. We are particularly honored this year to be working with the Confederation of Indian Industry (CII) both as research partners and as co-hosts of the roundtable.

Participants at last year's roundtable will remember the productive discussions we had around the opportunities and challenges posed by globalization to Indian and non-Indian multinationals, based on the insights from our study **India Meets the World**. This year's discussions will be centered around a particularly exciting dimension of today's global business environment: mergers and acquisitions (M&A).

We live and work in a multi-polar world where sources of supply and demand are constantly evolving and shifting around the world. Organizing and growing a global business has never been so attainable, particularly in emerging economies; at the same time, it has never been so complex. The same interconnections between countries, companies and people that bring an abundance of opportunities, also bring with them new and multifaceted risks. In this competitive environment, M&A has grown to become a popular avenue to achieve rapid reach and scale, but this strategy is known across the world for its high failure rate when it comes to execution.

Accenture has championed the need to focus on operational excellence to attain the targeted benefits of M&A. Now, more than ever, we believe that the new dynamics of M&A by Indian companies put a premium on supply chain integration as a key contributor to successful M&A. We are delighted to take this opportunity to further explore the opportunities and challenges that this brings for Indian businesses looking to achieve high performance.

We hope you find the insights in this report interesting and relevant to your specific business context.

Managing Partner, Supply Chain, Accenture India

Executive summary

The increasing economic power of emerging economies has led to a dramatic expansion in multinationals from these markets. Mergers and acquisitions (M&A) have become a popular vehicle for these companies to rapidly access new markets, assets and capabilities. More than 1,100 mergers and acquisitions were conducted by emerging market multinationals in 2006, representing US$128 billion in value[1].

Indian companies have significantly increased their M&A activity over recent years, particularly in terms of cross-border acquisitions. The value of deals conducted by Indian companies grew at a compound annual growth rate of 28.3 percent over 2000-2007 to reach US$30.4 billion in 2007, of which US$22.6 billion represented cross-border transactions.

Indian M&A transactions are primarily driven by the desire for growth. Indian companies are leveraging their low-cost advantage to create efficient global business models; they are seeking entry into fast-growing emerging markets and market-share in profitable developed economies; they are looking to augment their knowledge, reach and capabilities through acquisitions of companies for their brands, technology, talent and product portfolios. Moreover, the competition to achieve these benefits is intense, heightening the need for speed. Companies from Latin America, Eastern Europe, Africa, the Middle East and across Asia are in a race to build their global businesses.

Many Indian companies are conducting multiple M&A deals, building a series of stakes in different businesses and often a variety of industries. This "string-of-pearls" approach allows them to rapidly expand their growth opportunities and extend their geographical footprint.

Indian companies are also bringing a longer-term and more collaborative perspective to M&A. The collaborative approach is based on a conscious effort by acquirers to maintain the value of acquisition targets in developed economies. These target companies are often larger than their acquirers; they frequently possess greater experience and knowledge, and operate higher up the value chain. Rather than acquiring a foreign company and embarking upon a restructuring program, our research uncovers that Indian companies take a more measured approach, often leaving their acquisitions to function relatively untouched, particularly regarding their management teams. Indeed, much of the value of these acquisitions is seen as residing with the management team, and often with the wider workforce. This approach has a stronger emphasis on partnership than traditional M&A deals.

These trends in Indian M&A strategies uncover important implications for operating models. In this context, Accenture and the Confederation of Indian Industry (CII) have partnered on a project to investigate the new dynamics of M&A by Indian companies and their impact on operations. In addition to extensive secondary research, IMRB International was engaged to survey 66 C-level executives from Indian companies that have undergone a merger or an acquisition in the last five years.

The survey findings support and validate the growth-focused M&A strategies of Indian companies, but they also reveal the lack of attention paid to the operational implications of M&A. Specifically, our survey findings suggest that supply chain-related opportunities—which can account for up to 70 percent of costs —are not given the attention they warrant. Only 11 percent of survey respondents identified supply chain management as an area that requires attention during M&A planning and integration.

89 percent of respondents believe that their latest merger has lived up to expectations yet less than half of these satisfied respondents (45 percent) consider that they had undergone a successful supply chain integration. The supply chain is in many cases the most significant source of operational synergies. It is where much of the value that drives M&A deals is lost or captured. Indeed, 73 percent of the M&A operational savings identified by our survey respondents derive directly from the supply chain.

The new dynamics of M&A, particularly the string-of-pearls approach and the increasingly cross-border nature of M&A, are bringing new complexities to the integration process. The cost of neglecting the supply chain is higher than many growth-focused executives may expect. Efficient supply chain integration is not just about short-term cost efficiencies, it has a direct impact on revenues, operating expenses, capital expenditure and working capital. Moreover, supply chain disruptions have a serious and long-lasting impact on profitability through operating income, sales, costs and inventories.

Our research and experience highlight the following operations-focused lessons for sustainable growth:

1. Raise the strategic importance of operational synergies through involvement of relevant leadership and experts throughout the M&A process. This includes bringing operations leadership to the top table, involving operations leadership in globalization strategies and leveraging supply chain skills to raise performance across the organization.

2. Mitigate execution risk through continuous planning and measurement. This includes assigning responsibilities early on, crafting a clear roadmap, tracking appropriate metrics related to operational synergies and prioritizing initiatives.

3. Do not underestimate technology efforts. This includes robust planning for IT infrastructure and networks as well as the involvement of supply chain leadership in planning for IT.

Global growth will continue to be a strategic focus for many Indian companies and M&A is a legitimate strategy to achieve this. However, sustainable growth also requires an emphasis on operational synergies. This requires adequate attention to organizational models that will enable effective and integrated operations across merged entities and geographies.

Looking forward, Indian businesses aspiring to high performance will need to have honed their expertise in M&A, including cross-border acquisitions, with an emphasis on leveraging operational synergies through supply chain excellence. Executives leading the supply chain in these organizations will play a central role in achieving operational excellence, and making them an integral part of the high-performance business of the future.

89 percent of respondents believe that their latest merger has lived up to expectations, yet only 45 percent of these satisfied respondents point to a successful supply chain integration.

Mergers and acquisitions: A new wave for a new century

Today's global economy is characterized by multi-directional flows of products, services, people, ideas and capital. A complex web of interconnections is bringing new opportunities and options to companies and individuals around the world. Most notably, we have seen firms from emerging economies expanding at a speed and scale that is transforming the nature of global business. The 2007 Fortune Global 500 list of the world's largest companies includes 70 companies from emerging economies, up from just 20 a decade ago. In 2005 alone, the top 100 companies from emerging economies increased their foreign sales by 48 percent and foreign employment by 73 percent – this compares with about 10 percent growth in foreign sales and employment recorded by companies in developed markets[2].

A key factor behind the speed of global expansion by emerging market multinationals (EMMs) has been the adoption of mergers and acquisitions (M&A) as a means to rapidly access new markets, assets and capabilities. More than 1,100 mergers and acquisitions were conducted by EMMs in 2006, representing US$128 billion in value[3].

Indian companies have been active and visible players within this new M&A trend. According to Accenture's analysis of data from Thomson Financial, as many as 543 M&A deals were completed by Indian companies both at home and abroad in 2007, with a total value of US$30.4 billion. This represents a compound annual growth rate (CAGR) of 28.3 percent in deal value over the period 2000-2007. Figure 1 illustrates the increase in both the number and size of deals over this period.

Beyond the headline-grabbing mega-deals like Tata-Corus, there has been a broader trend of Indian companies of all sizes using M&A as a vehicle to achieve their ambitions for growth. If we exclude mega-deals (with a value of US$1 billion or above), the number of deals by Indian companies in the 5 years up to 2008 has increased at 20 percent (CAGR), while the value of these deals has increased by over 15 percent (CAGR). Indian deal sizes are relatively small by global standards and mega-deals make a significant impact on India's M&A trends. In fact, the average size of all M&A transactions by Indian companies in 2007 (including five mega-deals) was about US$56 million, compared to a global figure of over US$100 million[4].

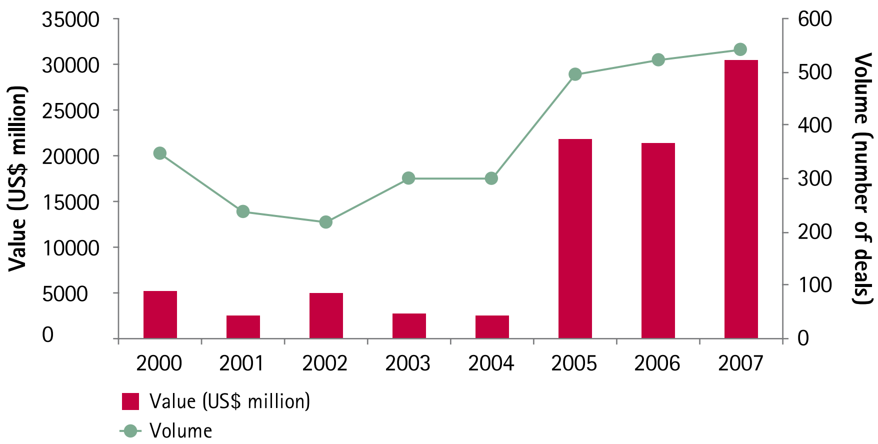
Cross-border acquisitions made up nearly three quarters of the total value of M&A deals by Indian acquirers in 2007, and the majority of those transactions were in developed economies rather than in developing economies (US$20 billion versus US$2.6 billion respectively in 2007).

However, the increasing importance of emerging economies is validated by the relative growth rates; the volume of deals in developing economies grew at 23.8 percent CAGR over 2000-2007, compared to a rate of 19.6 percent for developed economies. Cross-border trends can be seen in Figure 2.

India does not currently have a sovereign wealth fund, (a state-owned investment organization that invests in other countries), although discussions are now underway to evaluate this option seriously. India is the world's eighth largest holder of foreign assets and fourth-largest holder of foreign exchange reserves, yet these reserves are still being invested in low-risk OECD government securities and bank deposits yielding less than five percent. If India does decide to join the world's dozen existing sovereign wealth funds, we can expect the country to have a greater impact on the global trends and dynamics of M&A.

Looking forward, following India's slight dip in M&A activity in the second half of 2007, most experts predict continued strong M&A activity through 2008, with a marginal shift away from mature markets and towards Asia-Pacific markets.

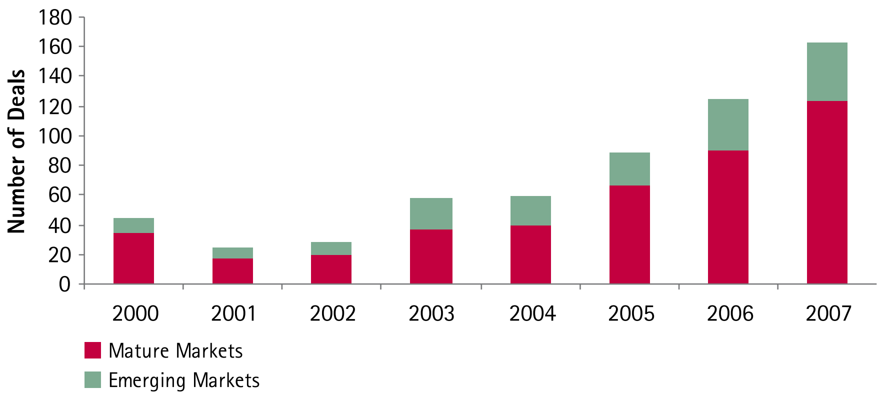
Figure 1: M&A transactions by Indian companies 2000-2007



Source: Accenture analysis of Thomson Financial data

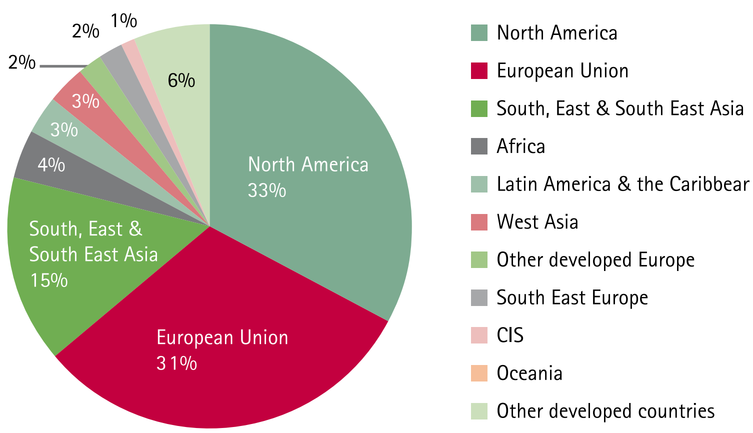
Note: The 2007 figure includes a value of US$12.9 billion for the Tata-Corus deal even though the official value has yet to be released. This figure is sourced from Bloomberg. Please also note that Hindalco's US$5.8 billion purchase of Novelis in February of 2007 is not included in these figures as the acquisition was conducted by a Canadian indirect subsidiary called AV Aluminum Inc.

Figure 2a: Cross-border M&A transactions by Indian companies, 2000-2007



Source: Accenture analysis of Thomson Financial data

Figure 2b: Number of cross-border M&A transactions by Indian companies by target location, 2000-2007



Source: Accenture analysis of Thomson Financial data

Dynamics of 21st century M&A

Benefiting from an enabling environment

India's business environment has become increasingly amenable to M&A, particularly cross-border transactions. Over recent years, Indian companies have faced few difficulties in accessing finances to purchase companies much larger than themselves – they have gradually turned to debt, private equity and foreign lenders and are benefiting from the increasingly sophisticated domestic banking sector. It is still early to gauge the medium- to long-term impact of the US credit crunch on the M&A prospects for Indian companies; some companies will be affected by the tightening of credit, but other, cash-rich companies may find that they have a renewed competitive advantage in bidding against firms whose usual sources of finance have become constrained. Moreover, if large numbers of distressed assets become available at affordable prices in economies that have been hit by the crunch, some ambitious Indian companies may even prepare for a potential shopping spree.

Indian companies have also benefited from a series of regulatory policies that have progressively relaxed controls on the flow of capital out of the country – this has been partly due to government efforts to balance the economy's significant and growing capital inflows. Also, India's sizeable foreign exchange reserves of around US$ 272 billion—now the fourth largest in the world, having grown from less than US$1 billion in 1991—give the Reserve Bank of India a greater capacity to convert domestic currency to overseas currency on behalf of corporates, allowing them to fund overseas acquisitions more readily.

Confidence has been an important factor that has been particularly visible in the case of India's M&A boom. Success stories are shared through the media on a daily basis; business titans are continually venerated for their astute acquisition decisions, and the M&A option is given more credence and validated in the minds of CEOs as an effective means for global growth[5].

A string-of-pearls approach to growth

A key characteristic of the new wave of Indian M&A is the tendency to build a series of smaller stakes in different businesses and often industries; a string-of-pearls approach that allows companies to rapidly expand their growth opportunities and extend their geographical footprint.
For many Indian companies, the process of building a portfolio of complementary businesses is intuitive as it fits the traditional conglomerate approach which has been so successful in India and many other emerging markets. In many cases, Indian companies have gained experience and confidence by venturing into similar markets in emerging economies before tackling more sophisticated mature markets.

Figure 3: India's most acquisitive companies, by number of transactions

Bennett Coleman & Co
27 Acquisitions

Timeline: 6 in 2005, 7 in 2006, 14 in 2007

Target Industries: Automotive, Consumer Goods & Services, Electronics & High Technology, Industrial Equipment, IT Services, Media & Entertainment, Outsourcing, Pharmaceuticals & Healthcare, Retail, Telecommunications

Target Countries: India

Average Size of Acquisitions: US$2.34 million

Dr. Reddy's Laboratories
10 Acquisitions

Timeline: 1 in 1998, 5 in 1998, 1 in 2000, 1 in 2002, 1 in 2004, 1 in 2006

Target Industries: Pharmaceuticals & Healthcare

Target Countries: Germany, India, UK, US

Average Size of Acquisitions: US$87.78 million

HCL Technologies
14 Acquisitions

Timeline: 1 in 1998, 4 in 2001, 2 in 2002, 2 in 2003, 2 in 2004, 1 in 2005, 1 in 2008

Target Industries: Capital Markets, Consumer Goods & Services, Insurance, IT Services, Telecommunications

Target Countries: India, Thailand, UK, US

Average Size of Acquisitions: US$43.73 million

Hindalco Industries
11 Acquisitions

Timeline: 3 in 2000, 3 in 2002, 2 in 2003, 1 in 2005, 1 in 2006, 1 in 2007

Target Industries: Chemicals, Metals & Mining

Target Countries: Australia, India

Average Size of Acquisitions: US$117.41 million

Hindustan Unilever
10 Acquisitions

Timeline: 3 in 1999, 4 in 2000, 1 in 2002, 1 in 2003, 1 in 2007

Target Industries: Consumer Goods & Services

Target Countries: India

Average Size of Acquisitions: US$17.28 million

Ranbaxy Laboratories
16 Acquisitions

Timeline: 1 in 1998, 1 in 1999, 1 in 2000, 1 in 2001, 2 in 2002, 1 in 2003, 1 in 2005, 5 in 2006, 3 in 2007

Target Industries: Pharmaceuticals & Healthcare

Target Countries: Belgium, France, Germany, India, Romania, South Africa, Spain, US

Average Size of Acquisitions: US$80.80 million

Tata Consultancy Services
11 Acquisitions

Timeline: 2 in 2002, 3 in 2004, 3 in 2005, 2 in 2006, 1 in 2007

Target Industries: Capital Markets, Consumer Goods & Services, IT Services

Target Countries: Australia, Brazil, Chile, India, Philippines, Switzerland

Average Size of Acquisitions: US$30.66 million

Wipro
14 Acquisitions

Timeline: 1 in 2000, 2 in 2001, 4 in 2002, 3 in 2003, 3 in 2006, 1 in 2007

Target Industries: Consumer Goods & Services, Energy, IT Services, Pharmaceuticals & Healthcare, Telecommunications

Target Countries: Finland, India, Singapore, US

Average Size of Acquisitions: US$47.85 million

Source: Accenture analysis of Thomson Financial data

Notes:
- The list does not include financial services companies
- Average acquisition sizes are based on officially disclosed figures only
- The list does not include transfer of capital/funds between group firms of the same parent company
- The list does not include acquisitions made by un-named shareholder/investor groups

This was the route, for example, taken by Mahindra and Mahindra's automotive business which targeted Malaysia, Indonesia and Thailand before moving onto South Africa; the European and US markets represent the ultimate challenge[6].

Figure 3 looks at Indian companies that have made over ten acquisitions in recent years. Over the last decade, established firms like UB Group (seven acquisitions), Bharat Forge (six acquisitions), Larsen and Toubro (nine acquisitions) and Mahindra & Mahindra (eight acquisitions) have regularly made headlines. But smaller and lesser known companies that have grown quickly through acquisitions include I-flex (seven acquisitions), Amtek Auto (nine acquisitions), Helios & Matheson InfoTech (six acquisitions) and Essel Propack (six acquisitions).

The implications of the string-of-pearls approach relate directly to CEO expectations of their M&A outcomes. If the objective driving an acquisition is very specific, so are the measures of its success. Any single acquisition has a defined purpose and is seen as one part of a broader growth strategy. Success may therefore be viewed in the context of the deal's narrowly defined objectives, such as successful entry into a new market, or acquisition of a brand, technology or production plant to move up the value chain. This mindset and approach makes it more likely for a CEO to view any particular acquisition as successful, as the defined purpose of the deal is relatively easily achieved. This differs from the traditional measures of M&A success through impact on shareholder value, which is particularly difficult to decipher when multiple M&A deals are conducted.

Measuring success in this more defined way also reinforces the confidence of Indian companies and endorses their serial acquisitions. In fact, the Accenture-CII senior executive survey found 89 percent of respondents stating that their latest merger had "lived up to its expectations." This result sits in interesting contrast to the commonly quoted global M&A success rate of around 33 percent and with the experience of our own previous analyses. For example, in a recent global survey of more than 600 business executives conducted by Accenture and the Economist Intelligence Unit, less than half (45 percent) indicated that their most recent deals achieved expected cost-saving synergies and just over half (51 percent) said their deals achieved expected revenue synergies. The 89 percent M&A satisfaction rate in our survey illustrates that, when seen through the lens of the 21st century Indian dealmaker, objectives, measures of success and confidence play an important role in shaping the M&A experience.

The cost of inaction

As markets liberalize and companies globalize, the competitive dynamics of some industries can be fundamentally affected by players that dominate the global market through sheer scale. This may become an increasingly common occurrence as large state-backed corporations from emerging economies like Russia and China continue their global expansion. In these industries, Indian companies with limited global reach may not have much choice but to compete at that larger scale. In a recent interview, Amit Kalyani, Executive Director of Bharat Forge, one of the world's largest suppliers of automotive components, told Accenture that "there is not a choice whether you go global or not. It's a necessity because your customers, your suppliers, everybody is global. If you are not in the same league or level or have the same advantages, you will be in trouble." This is a factor that is not often measured in traditional M&A valuations: the opportunity cost of not conducting the deal. For example, who can say what would have happened to Tata Steel in the scale-dominated global steel industry if they had not acquired Corus? As global competition increases, even more industries will see scale and consolidation as a necessary route to survival.

Above all, the new wave of Indian M&A is being powered by a desire for growth, usually rapid growth and often global growth. This study will now turn to the importance of this trend and its implications.

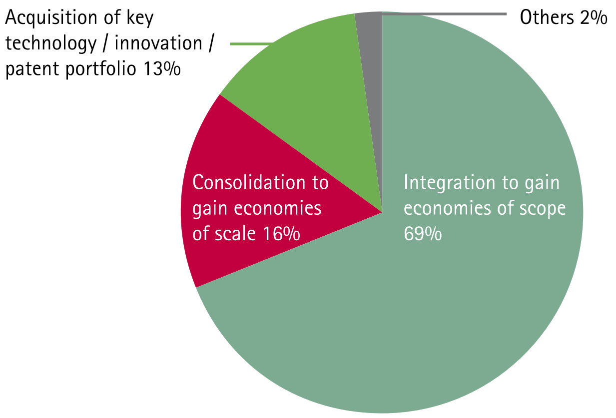
Growth: The ultimate driver

Indian M&A transactions are primarily driven by the desire for growth. Indian companies are leveraging their low-cost advantage to create efficient global business models; they are seeking entry into fast-growing emerging markets and market-share in profitable developed economies; they are looking to augment their knowledge, reach and capabilities through acquisitions of companies for their brands, technology, talent and product portfolios. Moreover, the competition to achieve these benefits is intense, heightening the need for speed. Companies from Latin America, Eastern Europe, Africa, the Middle East and across Asia are in a race to build their global businesses.

69 percent of the Accenture-CII survey participants identified Economies of Scope (such as expanded markets and enhanced product and service portfolios) as the key strategic intent behind their M&A decisions over the past five years. A further 13 percent of respondents identified the acquisition of key technologies and innovation capabilities as their primary objective. In comparison, only 16 percent identified Economies of Scale (such as more integrated supply chains and reduced overheads). There is a clear focus on growth objectives rather than operations and costs (Figure 4).

Accenture's client experience and numerous studies substantiate the fact that much of the M&A activity by Indian companies is grounded in growth and revenue objectives. This is particularly true in the case of cross-border deals. Some 81 percent of Indian business executives in a recent Accenture study said that their key motivation for going global was to find new markets to sustain top-line growth[7].

Figure 4: Survey: What was the strategic intent behind your latest merger or acquisition?



An Indian view of growth and success

Long-term perspective

Cultural and legacy factors have allowed Indian companies to take a long-term view toward growth. Experience within India's domestic markets has given Indian executives an appreciation of risk and complexity that puts a premium on long-term planning and relationships. In terms of timelines for M&A planning and achieving synergies, family-run organizations that are only partially listed or not listed at all, have the luxury of taking a longer-term view as they do not have the quarterly demands of shareholders. Acquisitions are a natural preference for family-run firms that wish to maintain decision-making control, but even listed companies often maintain legacy characteristics and a family connection.

The strategic long-term play is well illustrated by Suzlon Energy's purchase of Hansen, a Belgian gearbox manufacturer. Suzlon's acquisition was made in the full knowledge that Hansen (a supplier of essential components for Suzlon's business) had order books that were full, requiring Suzlon to wait two full years after the acquisition to source their first product from the company. Suzlon's wider priorities, such as not losing Hansen's existing customer base, took precedence over achieving quick wins. This long-term strategy has paid off with Suzlon multiplying the value of its investment five-fold[6].

Collaborative perspective

Our research has uncovered that Indian M&A strategies tend to take a collaborative approach: that is to say, each transaction is viewed as one element of a greater strategy, and the value of each deal is seen from the perspective of both the acquirer and the acquired company. As Tata Tea's vice-chairman RK Krishna Kumar recently stated, "Sometimes acquisitions should have an equivalent impact on the acquiring company."[8] This is a new trait in the M&A landscape that is typical of emerging economy multinationals. It is based on a conscious effort to maintain the value of their acquisition targets which are often larger companies than their own and which frequently possess greater experience and knowledge than themselves and operate higher-up the value chain.

Analysts have only recently begun to seriously measure M&A value creation by looking at both sides of the deal; traditionally, M&A success has been measured by looking only at variations in the acquirer's indicators. A recent analysis[9] found that if looked at from the acquirer's perspective, 58.3 percent of global M&A transactions led to the destruction of shareholder value, with an overall loss of 1.2 percent in value. In contrast, when looked at from the target company's perspective, it was found that there is an overall increase in shareholder value of 18.6 percent. The overall combined impact of M&A deals – when taking both acquirers and acquired companies into account – is an increased return to shareholders of 1.8 percent.

The collaborative approach is a conscious effort to maximize the long-term value of the assets being purchased. There is recognition of the value lying on each side of the deal, and acknowledgement that learning is a two-way process, in many cases from the acquired to the acquirer. This approach has a stronger emphasis on partnership than traditional M&A deals.

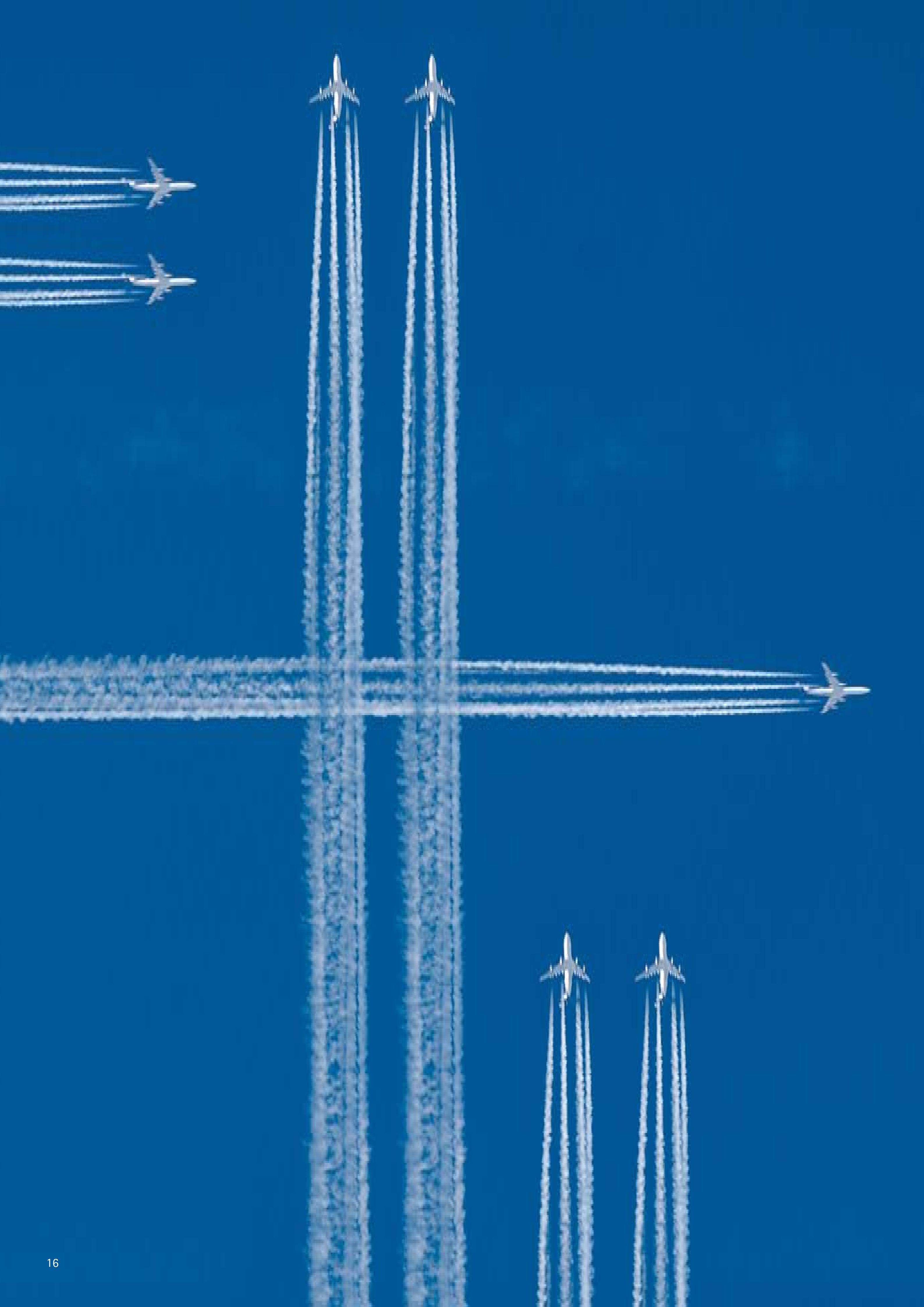
Talent perspective

In many ways, the collaborative approach comes down to a fundamental principle: acquiring and keeping the best people. Whether the target of the acquisition is a brand, an asset, an innovation process or customer insight, the deal is often aimed at attaining the talent that generates these prizes. With talent becoming one of the world's rarest commodities, and conscious of India's talent shortages, an acquisition that loses precious employees risks destroying the value of that deal. In a recent interview with Accenture, R. Gopalakrishnan, Executive Director of Tata Sons, told us "we want the top team in, and we don't lose them ... we are not for the 'slash and burn' kind of acquisition; fire the guys, put in your staff, and take it over." A similar attitude was expressed in our interview with Rajeev Dubey, who drives Mahindra & Mahindra's globalization strategy, where we were told that wherever possible, the company has tried to maintain local teams in top management. In fact, in a global study by Accenture with the Economist Intelligence Unit, over 90 percent of the Indian executives involved in M&A transactions agreed or strongly agreed that the valuable employees from the target company were retained after their merger[10].

Beyond maintaining key leadership figures, this approach can bring benefits by maintaining the wider skilled workforce. For example, the UK trade unions involved in the purchase of Jaguar and Land Rover were delighted when Tata Motors entered the bidding because of their track record of limited interference in foreign workforces. With at least 40,000 jobs in the UK depending on these two brands, this was an important aspect of the successful bid[8]. There was a shared understanding that the objectives underlying the acquisition could be fulfilled without requiring short-term lay-offs.

Interestingly, this approach also contributes towards the benign image that India has built in many countries around the world. We have already seen some instances of protectionist backlash against globalization. Companies and sovereign wealth funds from certain nations have experienced significant negative press, often driven by political motives and election calendars. In this context, India's globalizers have so far remained relatively unscathed, with some companies and individuals even earning global acclaim. To a large extent, foreign perceptions of India are not within the control of Indian companies, but the Tata Motors example illustrates that there can be winning strategies.

The growth opportunities that M&A brings to Indian companies are without dispute. Our next section looks at the need to place a greater emphasis on the operational considerations in an M&A journey.



Operational synergies: Overlooked and underestimated

89 percent of respondents believe that their latest merger has lived up to expectations, yet only 45 percent of these satisfied respondents point to a successful supply chain integration.

A successful global growth strategy cannot be implemented without due attention being paid to operational excellence and sustainability. The confidence displayed by Indian business leaders – as illustrated by the 89 percent success rate in M&A indicated by our survey respondents – can be a great motivator and stimulant for decisive action. But Accenture's experience and research indicates that executives are much more confident about their M&A strategies than they are about executing them. More than two-thirds of respondents in our survey identified poor execution as the key factor behind the failure of M&A deals.

Above all, our survey findings suggest that supply chain-related opportunities – which can account for up to 70 percent of costs – are not given the attention they warrant.

73 percent of the operational savings from M&A identified by our respondents derive directly from the supply chain. In Accenture's experience, roughly 50 percent of M&A synergies arise from operations, with the remaining proportion contributed by synergies related to the top line. About 70 percent of the operations synergies would be expected to come from the supply chain. Of course, the statistics would vary according to a number of factors; when Taiwan's BenQ acquired Siemens' handset business in 2005, the supply chain accounted for over 70 percent of total operational savings; in HP's high-profile merger with Compaq, more than US$1 billion in savings resulted from the supply chain, representing nearly half of the combined entity's operational synergies[11]. Because a company's supply chain is in many cases the most significant source of operational synergies, this is where much of the value that drives M&A deals is lost or captured. Dealmakers cannot afford to ignore the supply chain.

Despite this, only 11 percent of survey respondents identified supply chain management as an area that requires attention during M&A planning and integration. With companies making limited efforts to harness the benefits of supply chain integration, it comes as no surprise that in most M&A transactions (71 percent), the supply chain of the new entity remains similar to that of the acquiring company. There is little effort to re-engineer or transform supply chains to maximize the operating efficiency of the new entity. In fact, the impact of the M&A deal on key supply chain metrics was not even tracked by most survey respondents. Among those companies that did track the metrics, most witnessed improvements.

These survey findings fit with Accenture's general observation that senior executives leading the supply chain of the organization are brought into the M&A planning cycle much later than they ought to.

New M&A dynamics put a premium on the supply chain

Added operational complexities

Given the new dynamics of Indian M&A described in the early part of this study, one may wonder whether operational re-engineering is always necessary. Indeed, in specific cases where, for example, small transactions are aimed at acquiring a technology in an industry like biotechnology, opportunities for operational efficiencies may be limited. However, in most cases, experience shows that the new dynamics of Indian M&A put a premium on supply chain excellence.

The string-of-pearls approach to growth adopted by many Indian companies demands significant attention to hidden efficiency opportunities. The complexity and room for efficiencies are further enlarged by the increasing prevalence of cross-border transactions. Over 70 percent of Indian participants in a recent survey conducted by Accenture and the Economist Intelligence Unit stated that they found cross-border acquisitions more difficult to execute than domestic ones. Many cross-border deals are aimed at accessing new markets through the acquisition of supply or distribution networks. It is complex enough to integrate two such networks across borders, but multiple mergers in multiple countries give rise to numerous systems and networks involving a variety of suppliers, distributors and partners around the world, all utilizing different processes and technologies and often speaking different languages. The same complexity arises when trying to serve an array of consumer segments across geographies where service levels and customer segmentation approaches must be integrated. Some organizations, like Mahindra and Mahindra, pride themselves on their variety of business models, each attuned to different markets around the world. This increase in sophistication brings escalating challenges that must be addressed by senior executives in the organization leading the supply chain.

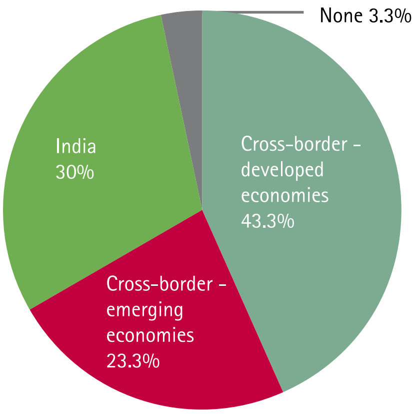
Bharat Forge is a stellar example of a company whose global success has been based on the efficient integration of multiple, global supply chains. The company has brought together the supply chains of several loss-making organizations to create one single coordinated, global, profitable system[6].

67 percent of our survey participants expect to undertake a cross-border acquisition in the next few years, as opposed to only 30 percent expecting a domestic acquisition (Figure 5). Given that many Indian companies are following an approach that involves multiple successive acquisitions, often across borders, the urgency for supply chain integration planning and implementation is amplified.

The impact of overlooking operational implications is evident. Even if we look only at the mergers that have lived up to their expectations in our executive survey, less than half of the respondents (45 percent) consider that they had undergone successful supply chain integration.

The high-level reasons underlying this neglect of operational implications may come down to an over-emphasis on growth objectives, or simply a view that operational considerations are under control – after all, in cross-border mergers, the Indian companies are often the ones bringing the cost advantage to the equation, so the benefits of pursuing further operational efficiencies may be underestimated. Further, in the spirit of the collaborative approach to consolidation, Indian companies may be unwilling to broach topics regarding cost reduction at an early stage in merger negotiations for fear of instilling anxiety within the target company's workforce. However, the opportunities for operational efficiencies do not necessarily involve lay-offs and the benefits accrue to both acquired and acquiring parties. Moreover, operational improvements affect all levers of shareholder value and the cost of overlooking these opportunities is often much more onerous than many companies suspect, affecting many parts of the business and eventually both the bottom line and the top line.

Figure 5: Survey: Expectations of future M&A target destinations



Beyond cost implications

Efficient supply chain integration is not just about short-term cost efficiencies, it has a direct impact on the success of four major types of synergy that are sought in a merger[12]:

- **Revenues –** a superior supply chain protects revenue during times of transition by ensuring that customer orders are not interrupted and by enabling an organization to generate stronger top-line growth in new products, markets and geographies.
- **Operating Expenses –** how effectively a company procures goods and services and how efficiently the supply chain runs has a direct impact on net income and operating margins. In our survey, Indian executives identified sourcing and procurement as the largest area of cost synergies.

Figure 6: Impact of the supply chain on the levers of shareholder value

Shareholder Value		Design	Source	Make	Move	Sell	Service
Operating Profit	Revenue	• Product pricing • Product portfolio rationalization		• Manufacturing lead time	• Response time	• Channel strategy • Product availability • Pricing	• Optimize after sales service
Operating Profit	Cost of Goods Sold	• Product design optimization	• Low cost country sourcing • Make vs buy • Renegotiate contracts – price / volume • Rationalize supplier base • Specification optimization	• Optimum product – plant combination • Contract manufacture	• Renegotiate contracts – price / volume		
Cost of Capital	Working Capital		• Optimize credit terms	• Optimize raw material and WIP inventories	• Optimize finished goods inventory	• Optimize order to cash	• Optimize service parts inventories
Cost of Capital	Fixed Capital			• Plant rationalization • Eliminate equipment redundancies	• Network reconfiguration / optimization		• Optimize service infrastructure

- **Capital Expenditure** – the supply chain often accounts for a significant portion of a company's physical assets (such as manufacturing plants, warehouses and logistics infrastructure). Therefore, synergies in asset utilization and investment optimization can strongly influence a company's cash outflow.
- **Working Capital** – The supply chain's ability to quickly turn raw materials or components into finished goods, get those goods into customer hands and receive payment, plays a major role in a company's cash position.

High cost of neglect

The efficiency opportunities in the supply chain are significant and often rapidly achieved. By the same token, getting supply chain integration wrong can have far-reaching consequences. According to a previous Accenture study with the Economist Intelligence Unit, 67 percent of respondents reported that M&A activity contributed to product-launch disruptions, 53 percent noted that their M&A efforts diminished product or service quality and 62 percent experienced a loss of supply chain talent following a merger or acquisition. The operational effects of their most recent mergers included 52 percent experiencing problems with order-fill rates, 46 percent encountering stock-outs and 44 percent undergoing inventory build-ups.

Supply chain disruptions can have serious and long-lasting implications on customer satisfaction, operating costs and profitability.

The rapid impact and operational efficiencies of getting supply chain integration right combined with the long-lasting consequences of getting it wrong, create a compelling argument for paying more attention to this aspect of the merger process during both planning and integration.

Lessons for sustainable growth

The global economy continues to offer growth opportunities to companies from emerging economies. Indian companies are rightfully chasing their share of this expanding pie. However, there is an imperative to ensure that this growth is sustainable. Sustainable growth requires nimbleness and agility in order to adapt operations to meet new market opportunities as they arise around the world. In this competitive environment, operational excellence, particularly in the supply chain, is becoming of paramount importance. Our research highlights the fact that supply chain excellence is not about short-term cost savings, it is about strategies, processes, people and technologies that have a short-, medium- and long-term impact on both the top line and the bottom line.

As Indian companies grow globally, supply chain issues become increasingly complex and critical to high performance. In this context, the following examples highlight the essence of the lessons we have learned through our research and experience:

1. Raise the strategic importance of operational synergies through involvement of relevant leadership and experts throughout the M&A process

Bring operations leadership to the M&A top table

C-level support for operations-focused initiatives is a necessary but insufficient factor for successful integration. The top management of both merging entities must identify and empower the supply chain leadership and establish a supply chain functional integration team with a clear charter and scope. Our survey found that 92 percent of respondents involved in successful supply chain integration efforts had supply chain leadership involved early on in the process (either before the merger announcement or during the early stages of pre-close planning). At Accenture, we find it important to bring together supply chain leadership along with leaders from across both organizations to take part in an "Intelligent Clean Room" process[13] to maximize the value captured by the merger.

Involve operations leadership in globalization strategies

The supply chain leadership's relevance to overall integration and the wider growth strategy is increasing. As Indian companies extend their operations to more countries, whether organically or inorganically, the supply chain leadership can make a critical contribution in terms of defining the organization's global operating model. The development of flexible operating models has become a strategic priority for global companies; within these models, the ability to create systems that regularly update transportation, distribution, storage and demand management plans are central to satisfying evolving customer and supplier patterns efficiently.

Leverage supply chain skills to raise performance across the organization

Beyond the leadership team, wider supply chain expertise and skills are a key success factor in M&A. The most commonly cited reason for successful supply chain integration in our survey was that the right supply chain skills were involved in the planning and integration process. By the same token, the most commonly cited reason for unsuccessful supply chain integration was the absence of these skills, along with the fact that there was no dedicated team focused on the supply chain. In fact, when asked about the level of supply chain skills in the core merger integration team, many responses came back as "none" or "little."

In Accenture's experience, a Supply Chain Functional Integration Team responsible for developing and implementing the integration plan and reporting into the integration leadership team is a critical way to capture maximum synergy benefits. Moreover, the attainment of synergies across the organization requires effective planning by the integration team to address the cross-functional interdependencies between the supply chain and other parts of the business (Figure 7).

2. Mitigate execution risk through continuous planning and measurement

Assign planning and tracking responsibilities early

Our respondents identified supply chain planning as the area requiring most attention during the supply chain integration process. Beyond the early "clean room" planning stages[12], a dedicated program management office (PMO) is an important vehicle to coordinate planning and implementation across teams, ensuring that critical interdependencies are managed. The PMO acts as a decision-making forum and custodian of the new business model and is responsible for consistent, regular tracking of performance during execution.

Figure 7: Important cross-functional dependencies with the Supply Chain

Function	Interdependencies With Supply Chain	
Marketing	• Marketing and advertising spend • Customer segmentation service levels	• Channel strategy • Product portfolio
Sales	• Promotions plan • Sales projections / demand plans	• Sales campaigns • Retail positioning plans
Finance	• Budgets and planned expenditures • Plant closure costs	• Supply chain cost data / baseline • Supply contract payment terms
IT	• Supply chain applications / platforms • Supply chain data requirements	• Overall IT strategy • Interface / integration requirements
Product Development	• Planned new product introductions • Product roadmaps	• Packaging / labeling requirements • Changes to supply base
Engineering	• Bill-of-materials changes in products • Component requirements	• Engineering plans • Changes to supply base
HR	• Headcount redeployment decisions • Training requirements	• HR policies and procedures • Culture
Legal	• Supply contract terms and conditions • Legal constraints	• Regulatory requirements

Craft a clear roadmap for supply chain integration

The approach to supply chain integration would be driven by the strategic objectives behind the merger as well as specific industry dynamics. Accenture uses three broad approaches, each of which has different implications regarding the levers and targets of the integration process (Figure 8). Each approach is distinct and not sequential, and the level of effort is clearly correlated with the benefits derived. Setting the appropriate approach at the outset is critical as the impact runs into the long-term.

Figure 8a: Three broad approaches to supply chain merger integration

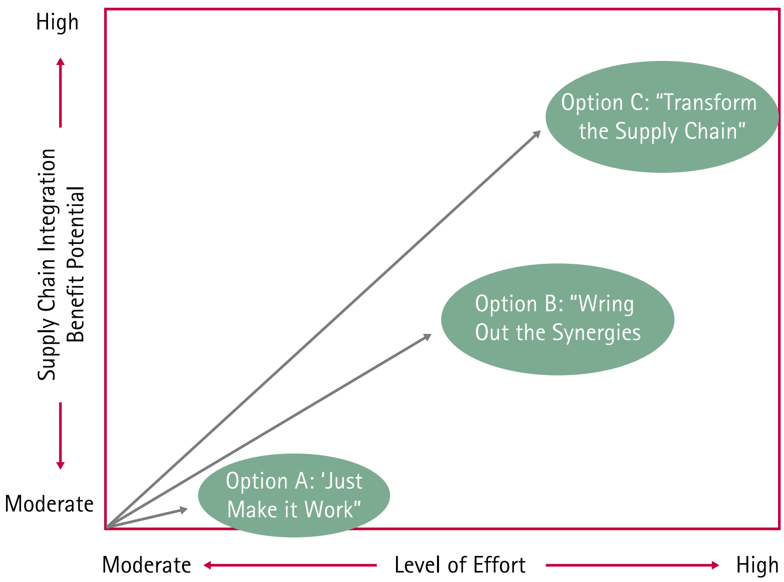


Figure 8b: Implications of different approaches to supply chain merger integration

Integration Approach	Supply Chain Merger Value Lever: Product Development/ Rationalization	Procurement & Sourcing	Manufacturing Network	Distribution Network & Transportation	Order To Cash	After Sales Service
Option A: "Just Make it Work"	• No actions	• Secure supply	• Secure production	• Secure distribution	• Ensure availability	• Secure service
Option B: "Achieve Synergies"	• Identify product overlaps and eliminate pricing discrepancies	• Secure supply • Harmonize pricing • Leverage volume	• Optimize production capability	• Optimize distribution network	• Optimize customer interaction model, response, availability	• Optimize service management infrastructure
Option C: "Transform the Supply Chain"	• Rationalize/ rethink product portfolio	• Secure supply • Harmonize pricing • Leverage volume • Optimize specifications • Low cost country sourcing	• Re-engineer production capability • Make vs buy	• Re-engineer route to market and channel strategies • Optimize distribution network	• Re-engineer customer interaction model, customer experience, response, availability	• Re-engineer service management approach • Optimize customer experience

Identify and track appropriate metrics

Our survey of Indian executives found that most supply chain metrics are not even tracked during the integration process. Tracking metrics is an important way to help gauge success and to keep the team focused on priorities. Importantly, these supply chain integration metrics may be different from internal supply chain scorecard measurements used in a non-merger situation. For example, at Accenture, we put an emphasis on tracking elements that will contribute towards meeting targets between the date of regulatory approval and the date when integrated operations begin, as well as important measures such as the number of contracts re-priced and re-negotiated for cost savings (Figure 9).

Prioritize initiatives

Our experience shows that effective supply chain planning can generate an early realization of both cost and revenue synergies. This is particularly true for initiatives like normalizing contract terms and prices. However, more complex initiatives such as the consolidation of purchasing, distribution and manufacturing operations would take more time. Initiatives should be defined and prioritized based on value, implementation speed and difficulty. In this way, clear targets can be set for outcomes within specific timeframes. Early achievements provide visible progress and are important in raising confidence within the workforce and among external analysts and observers. At the same time, our research shows that some of the more complex and time-consuming initiatives, such as direct commodity standardization, can bring significant value. Early prioritization and planning allow for much easier management of trade-offs and timelines.

Figure 9: Illustrative example of a supply chain merger integration scorecard

Illustrative Merger Integration Scorecard

Area	Metric
Operational Effectiveness	• Business-as-usual effectiveness during merger integration
Day 1 Readiness	• % Day 1 requirements successfully met on-time and to-date
Progress in Transition	• Integration milestones achieved on-time and to-date
Product Availability	• % On-time in full order fulfilment versus pre-merger baseline
Synergies Savings	• Supply chain synergies captured versus synergy target
Sourcing and Contracting	• Number of contracts re-priced and re-negotiated for synergy savings • Negotiated savings as a % of expenditure managed • % of external expenditure subject to contract • Spending compliance to contract versus pre-merger baseline
Manufacturing	• Manufacturing costs per unit versus pre-merger baseline and target
Distribution and Logistics	• Transportation cost per unit versus pre-merger baseline and target
Working Capital	• Inventory turnover versus pre-merger baseline and target • Debtor days versus pre-merger baseline and target • Creditor days versus pre-merger baseline and target

Note: Most companies consider Day 1 to be when the merging companies complete their change of control

3. Do not underestimate technology efforts

Make IT a key to success

The integration of Information Technology (IT) is a crucial part of any M&A process. With companies increasingly operating across continents, progressively more complex and sophisticated IT infrastructures and networks are required. IT is integral to the supply chains of most companies today, from entering simple transactions like goods receipts to advanced production-planning tools. In our survey, only eight percent of respondents involved in successful supply chain integration efforts stated that the level of IT integration effort was not substantial. A robust and well-maintained IT set-up can generate enormous efficiencies, but inadequate systems can lead to massive disruptions whose wider consequences are often difficult to keep localized.

Involve supply chain leadership in IT planning

Ineffective rationalization of supply chain systems, standards and processes can eliminate a large proportion of a deal's potential benefit. Supply chain leadership can take active steps to minimize these risks, including[14]:

- Coordinating global reporting and data harmonization. For example, by identifying issues and solutions pertaining to data integration and the development of "executive dashboards."
- Identifying requirements associated with changing or enhancing supply chain applications. For example, by aligning enterprise-wide information associated with supply chain planning.
- Helping to migrate systems to a single or new Enterprise Resource Planning (ERP) platform.
- Ensuring that accumulated data is transformed into "supply chain intelligence." For example, by pushing for high-level supply chain representation on due diligence and merger integration teams to ensure that supply chain insights are applied to key technology issues.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Conclusion

As long as India continues to see a strong domestic economy and trends that enable increased globalization, we can expect exciting growth opportunities for Indian companies. Mergers and acquisitions will continue to provide an avenue to access the markets and tools required for sustainable growth. Effective merger planning and execution will demand greater attention as deals are increasingly cross-border in nature, involving unfamiliar markets, varying regulatory regimes and a mixture of cultures and languages. This will also put a premium on building capabilities in areas like corporate governance, cross-cultural management and leadership styles.

Indian companies are already influencing global M&A trends through their longer-term, collaborative approach that aims to build global champions, step by step. A critical aspect of this approach is the appreciation of the value of the target company, particularly the value residing in its talent. The ability of Indian companies to create an environment that keeps their acquired talent on board will be a critical test of the success of their M&A strategies.

Our research highlights the importance of operational excellence —particularly in the supply chain—as a key factor for M&A success. All too often, supply chain improvements are seen as a post-merger activity related purely to cost-cutting. The reality is that superior supply chain strategies have a much wider impact on the success of M&A, bringing benefits to revenues, operating expenses, capital expenditure and working capital. Moreover, inadequate attention to the supply chain affects profitability, customer satisfaction and top-line growth. In many cases, the supply chain is where much of the value that drives M&A deals is captured or lost.

In this context, there is a need to raise the strategic importance of operations—particularly of the supply chain—through the involvement of relevant leadership and experts throughout the M&A process. It is also important to build the structures and processes to mitigate risk by continually planning and tracking progress during execution. Finally, it is important to recognize that the growing complexity in global M&A integration requires a flexible set of operating structures, built upon robust technology infrastructure.

Looking forward, the mastery of complex supply chains will be a critical factor determining high performance. Organic and inorganic growth will continue to extend supply chains, and integration will become a part of everyday business. As supply chains expand across borders and become more technologically advanced, they will become increasingly exposed to risks such as environmental and terrorist damage, cyber-threats and evolving geopolitical risk. Managing such risks will add new demands to the supply chain skill-set.

Indian high-performance businesses of the future will have well-honed expertise in cross-border acquisitions and integration, as well as a robust, flexible operating model with supply chain excellence at its heart.

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