EXECUTIVE INSIGHTS

Keys to Unlocking Merger Value — Revenue Synergies

Revenue synergies are at the heart of growth-oriented M&A. As two or more companies are brought together, revenue of the combined business is typically expected to outperform —achieve a sum greater than the legacy parts. Frequently, revenue synergies are the most exciting elements of exploring a deal in the first place and the primary rationale.

So why are companies 10 times more likely to announce cost synergy targets than revenue synergy targets?[1]

The short answer is that defining and realizing revenue synergies is challenging. For this reason, investors and stakeholders often put greater weight on cost synergies, with revenue synergies frequently positioned as "upside" to the value creation potential of the deal. At L.E.K. Consulting, we believe this weighting significantly undervalues revenue synergy potential, and a lack of investment in revenue synergies becomes a self-fulfilling prophecy of suboptimal financial results. In this *Executive Insights*, we review four key imperatives to maximize the value of revenue synergies:

1. **Revenue synergies must be clearly defined**
2. **Revenue synergies must be prominent and clearly tied to sales goals**
3. **Revenue synergy realization must be measured against total top-line and bottom-line performance**
4. **Your customer dictates the "size of the prize"**

Here's a closer look at each imperative in turn.

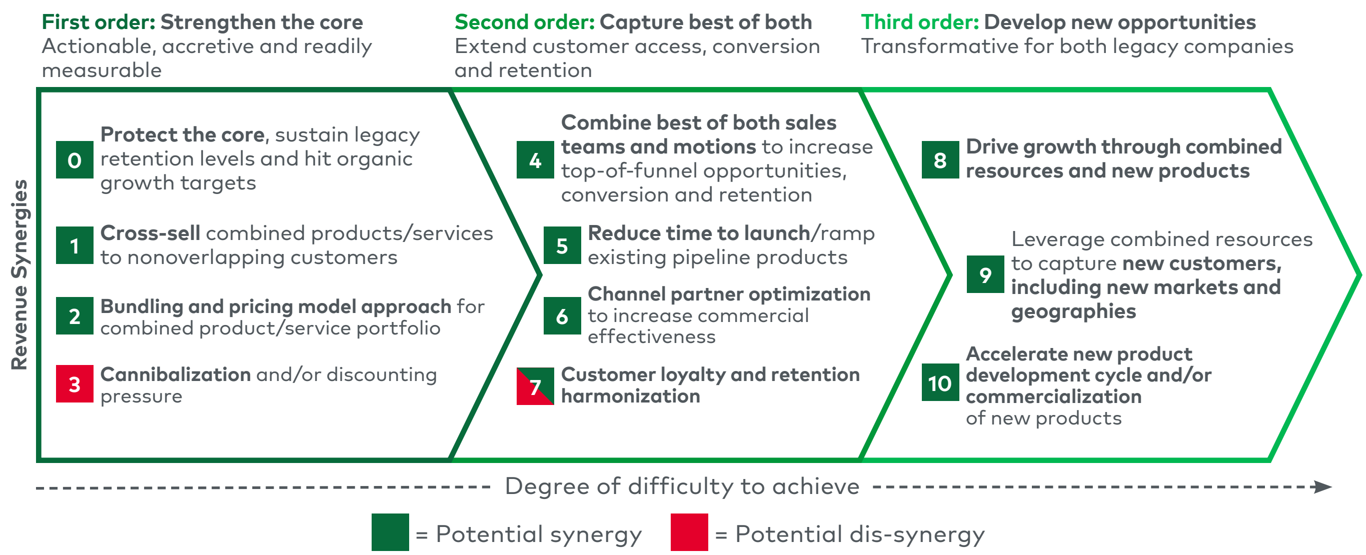
1. Revenue synergies must be clearly defined

We see many firms fail because they do not invest the time upfront to clearly define what revenue synergies are and, just as important, what they are not. For example, revenue synergies can oftentimes overlap, as is the case when considering cross-sale of an acquired product and expanded market access to a new customer segment. Similarly, you must be able to clearly delineate between organic growth that would have manifested in the absence of the transaction and the growth that is incremental and directly the result of the deal. Crisp definitions upfront can prevent double counting and ensure the combined company's financial performance is aligned with synergy expectations. Good hygiene in synergy definition (and prioritization) is fundamental to ensuring that goals are achievable and trackable and leaders can be held accountable to deliver.

In our experience, while exact sources of synergy vary for each deal, acquirers typically pursue revenue synergies in three tranches (see Figure 1).

1. First-order revenue synergies are focused on **strengthening the core** and are highly actionable, accretive and readily measurable
2. Second-order revenue synergies are focused on **capturing the best of both** commercial organizations and on extending customer access, conversion and retention
3. Third-order revenue synergies are predicated on **developing new opportunities** and are transformative for both legacy companies — these are typically the hardest to achieve and where the line begins to blur between deal-enabled synergies and strategic initiatives for the now-combined company

Figure 1
Revenue synergy overview



Source: L.E.K. research and analysis

2. Revenue synergies must be prominent and clearly tied to sales goals

Providing focus on and visibility into specific areas of revenue synergy, or "initiatives," is a crucial part of achieving success; we've found that embedding revenue synergies into the sales planning process directly helps build and sustain the attention required to get results. For example, developing clear monthly targets for individual cross-sold products enables the head of the newly combined commercial organization to directly monitor synergy realization and actively address any shortcomings through adaptations to sales training, communications or incentives. This is a large part of making sure the value is captured and doesn't get waylaid or fall prey to other priorities as they arise — and they will arise. The reality is that integration is never executed in stasis.

Depending on the nature of the revenue synergies, more deliberate performance incentives may be warranted to align leadership and further catalyze sales teams. Setting goals and aligning on the right incentive packages should be an early part of integration planning with balanced perspectives from the commercial team, which is best placed to comment on customer need and top-line potential, and finance, which can ensure that outcomes support overarching financial objectives.

Last, it is good to remember that revenue synergies are a great driver of excitement during integration, which can otherwise be challenging or daunting for employees and customers.

Achieving top-line growth is something that everyone can support. Celebrating key wins that highlight the benefits of coming together can be a great way to boost morale and focus your team on the "good" of integration. Featuring the first cross-sale to a major account as part of the next all-employee communication or integration update can serve as a rallying cry that helps employees persevere through some of the less exciting changes that can accompany integration.

3. Revenue synergy realization must be measured against total top-line and bottom-line performance

Revenue synergies must tie to the overall financial performance of the company, full stop. Tracking individual revenue synergy initiatives like cross-selling at a product level is still important; as discussed, it allows you to validate that key operational hurdles in product or service delivery have been overcome, and that the sales force has sufficient cross-training and education to be effective in the market. However, revenue tracking cannot become an academic or accounting exercise completed in isolation.

To illustrate one example of where we've seen this go awry: In pursuit of cross-selling synergies, technical sales leads are added, and sales rep and customer focus is pushed to new products. As a result, cross-selling occurs, but cost of sale rises and/or rep focus on the core business falters, leading to unintended financial malaise and overall underperformance.

At L.E.K., we espouse a holistic method of defining, measuring and validating revenue synergy realization that ensures our clients outperform with respect to specific synergy objectives as well as from an overall profit and loss perspective.

4. Your customer dictates the "size of the prize"

One of the most frequent questions we receive from our clients is, "What are typical revenue synergies that we could expect from our integration?" At L.E.K., we believe that the key to meeting (or exceeding) revenue synergy targets is understanding your customer.

To understand the potential range and magnitude of anticipated revenue synergies, the following questions serve as a good foundation — for your company and the target company:

- **Customer need.** How similar (or unique) is the need or use case you are meeting for your customer? Are your offerings complementary and sufficiently independent, or is there overlap that needs to be considered in terms of potential cannibalization?
- **Customer access.** How does each entity extend market access for the combined entity with respect to existing accounts and/or where is there potential overlap?
- **Buying center.** How similar are your target customer profile and decision-maker? Are you accessing the same or different areas of funding/budget?
- **Channel access.** How dynamic and varied are the methods by which each legacy entity reaches customers and converts sales? Are there practices that can be leveraged to expand access on a go-forward basis (e.g., ecommerce, third-party sellers)?
- **Selling motion and cycle.** How similar is your go-to-market approach and manner of engaging your customers, both in terms of timeline as well as nature of interactions with the customer (introductory calls versus live demos; transparency of pricing menus versus closed-ended quotes; time from initial engagement through closing a sale)?
- **Sales productivity.** How effective are current processes and enabling tools (e.g., pricing and discounting protocols and governance; segment-specific RFP response templates)? Are there practices driving high performance that could be replicated to quickly improve customer access, conversion and/or retention?
- **Speed to market.** How effective is your innovation and launch cycle, and could it be accelerated to bring forward value for your customers (and by extension, the combined company)?

Converting the answers to these questions into revenue synergy expectations is not a simple equation. For example, having overlapping buying centers can greatly simplify the ability to cross-sell the combined product portfolio; however, if the sales cycle for each offering varies, then it can challenge the velocity and success of a cross-selling effort.

Based on a review of transactions between 2012 and 2022, revenue synergies vary widely by industry and type of deal, with some of the most successful deals able to achieve double-digit incremental growth relative to the target asset's annual revenue at time of purchase. The tremendous variation in results certainly reflects variation in opportunity, but we believe it also speaks to how a disciplined approach to defining and driving to revenue synergies can make or break a deal.

At L.E.K., we employ a highly rigorous and analytical approach to ensure that revenue synergy estimates are grounded. We work with teams to embed synergies early on in the planning process so our clients can achieve the maximum potential value of the deal, as quickly as possible.

Conclusion

Confidence in committing to and delivering revenue synergies is rare. It takes careful planning and dedication. However, at L.E.K. we believe there is outsized reward for those who embrace the challenge. Successful acquirers recognize that revenue synergy wins drive both financial benefit and cultural momentum for the newly combined organization. Each is a key ingredient in the "secret sauce" that sets apart truly outstanding integrations from those that fail to live up to their potential.

For more information, please contact strategy@lekinsights.com.

Endnotes

[1]Based on public transactions with announced deal synergies between 2012 and 2022.

About the Authors

John Rutan
John Rutan is a Managing Director and Partner at L.E.K. Consulting's Boston office and a member of the Organization and Performance practice. John has extensive experience in mergers and acquisitions — including post-merger integration — organization strategy (e.g., model design and optimization) and commercial excellence/salesforce effectiveness. John has supported clients across the travel and transport, software, business services, industrial manufacturing, pharmaceutical and energy sectors.

Dan Horsley
Dan Horsley is a Managing Director and Partner in L.E.K.'s Houston office. Dan helps lead the firm's Organization and Performance practice in the US. He works with clients on the development and execution of their business strategy, including driving commercial excellence/sales force effectiveness, organizational strategy (e.g., model design and optimization) and post-merger integration support.

Simon Horan
Simon Horan is a Managing Director in L.E.K.'s Chicago office and a part of the leadership team for L.E.K.'s Organization and Performance practice. Simon has worked across a variety of strategy, organization and performance improvement engagements throughout Asia-Pacific and America. His passion is assisting clients in driving major change, from defining the change to delivering the results.

About L.E.K. Consulting
We're L.E.K. Consulting, a global strategy consultancy working with business leaders to seize competitive advantage and amplify growth. Our insights are catalysts that reshape the trajectory of our clients' businesses, uncovering opportunities and empowering them to master their moments of truth. Since 1983, our worldwide practice — spanning the Americas, Asia-Pacific and Europe — has guided leaders across all industries from global corporations to emerging entrepreneurial businesses and private equity investors. Looking for more? Visit **www.lek.com**.