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Mergers & Acquisitions: Preparing Your Company to Win

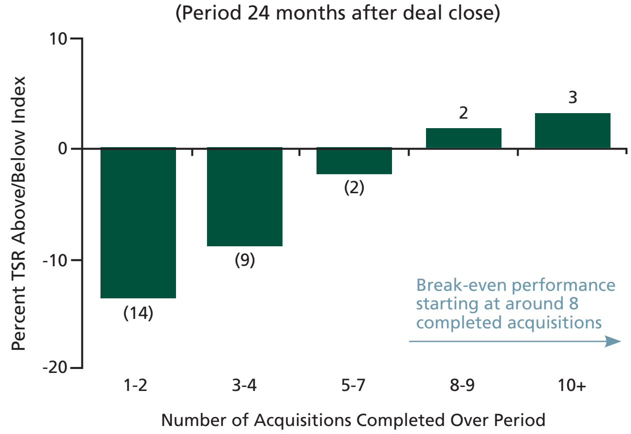
In today's sluggish economic environment, many companies view mergers and acquisitions as a key part of their growth strategies. Buying your way to success is an enticing prospect, but M&A carries unique challenges, and many companies are not immediately prepared to meet those challenges well. Various studies, including one recently published by L.E.K. Consulting,[1] has demonstrated that a majority of mergers destroy shareholder value; creating a whole that is greater than the sum of its parts is easier on paper than in practice.

M&A's disappointing record can partly be explained by the fact that many companies that have generated the cash needed for acquisitions owe their profitability to skills that have little to do with M&A success. It is unusual for a company's core competencies to overlap with the competencies required for inorganic growth. Mergers and acquisitions are rare events, so the opportunities to develop the relevant skills and experience are few. What's more, the time between deals can be years or decades, during which interval valuable experience goes out the door with inevitable employee turnover. Perhaps most importantly, firms do not typically look at M&A as an intended core competency, so they rarely assess how well (or how poorly) they can execute the necessary work.

Earlier this year, L.E.K. analyzed more than 2,500 M&A deals between 1993 and 2010 – a period that included two boom-and-bust economic cycles. Our analysis uncovered an interesting trend: M&A performance is generally better among frequent acquirers. According to our research, experience and repetition matter; typically it takes a company around eight deals before the full range of M&A capabilities become a core competency, and shareholders can expect value creation from an inorganic growth strategy (see Figure 1). That statistic suggests that M&A involves learnable skills; the explanation for the difference between the loss-making first few deals and the value-creating later deals is simply experience.

Figure 1

The M&A Learning Curve
Average Total Shareholder Return Above Index
(Period 24 months after deal close)



Source: CAPIQ data; L.E.K. analysis
Methodology Notes: All deals greater than $50M in transaction value, 100% control transactions, and completed during the 1993-2010 period by public acquirers; U.S. primary location of the acquirer and target; Acquirers' Total Shareholder Returns were compared against S&P 500 sector and composite indices to normalize for market-related performance (S&P 500 composite index was used in the earlier sample years prior to sector indices were created); excludes REITs.

[1]See: Michael Connerty and Bob Lavoie, "Mergers & Acquisitions: What Winners Do to Beat the Odds." L.E.K. Consulting *Executive Insights*, Volume XV, Issue 16.

Mergers & Acquisitions: Preparing Your Company to Win was written by **Michael Connerty**, a managing director in L.E.K. Consulting's Chicago office. For more information, contact transactionservices@lek.com.

So the key questions for any executive considering an M&A strategy should be: Is there a substitute for experience? What are the skills that frequent acquirers develop that gives them an M&A advantage, and how can my company obtain them?

This paper is an attempt to help answer those questions. At L.E.K., we have noticed five steps that any company – from giant conglomerates to firms on the hunt for their first deal – can undertake to prepare their organizations to create shareholder value. They are:

- Translate the acquisition strategy.
- Clearly define the internal M&A process.
- Deploy the right team.
- Develop digital "playbooks."
- Institutionalize the learnings.

In this paper, we explore each of these steps in detail.

Translate the Acquisition Strategy

Most executives understand that the first step along the M&A path is to develop deal criteria. From there, the temptation to jump in and start immediately scouting deals can be very strong. Winning acquirers are more patient. They commit to actively preparing their organizations to embark on an acquisition program. This intermediate step, while easy to overlook, contributes substantially to a company's ability to realize predicted value after a deal closes.

During this critical step, a company must ensure its senior leaders have a deep understanding of the problems or opportunities the company is aiming to address through M&A. A robust M&A strategy defines not only the specific deal criteria, but the broader context and objectives as well. The leaders in charge of looking for the right deals will be steeped in this holistic strategy, and so will the managers who are likely to be involved down the line - such as business unit, divisional and functional managers. With this understanding in place, senior leaders will be able to quickly identify and screen "poisoned apple" deals that may seem attractive but result in high opportunity costs in the form of wasted time or even value destruction if the deal is seen to completion.

Translation of the M&A strategy also entails a thorough understanding of a company's performance in areas where managers hope to achieve synergies with an acquired firm. Successful M&A executives know their company's strengths in specific detail, its areas for improvement, and how an acquisition can help strengthen the former or fill in the latter. For example, consider a company that is searching for targets that can help expand its product portfolio to gain greater share of wallet with customers. That company needs to understand what customers think of its performance, and what additional needs those customers have that the company isn't fulfilling. With that understanding, the company can examine very closely how a target company's products will solve their customers' needs. Only with this insight can the cash-flow benefits from the combined company be correctly predicted.

The same holistic understanding also underpins deals designed to achieve economies of scale in back-office or operational areas – another frequent goal for mergers. A successful M&A executive will identify his or her cost drivers and baseline performance in distribution, service-delivery operations, and key back-office processes. Only with that understanding in hand can the successful M&A executive drive out cost and capital inefficiencies with the addition of a target company.

Often, understanding comes from more than black-and-white numbers. Identifying the intangibles that drive performance allows the successful M&A executive to assess more quickly and more accurately a target company's performance and practices and its compatibility. This in turn generates more rigorous synergy estimates and suggests what it will take to realize them, as well as the risks that have to be managed. In many cases, there is not enough time to assess an acquiring company's baseline performance during a short due diligence of a target company, so having these internal assessments completed well in advance is key.

Translating the Acquisition Strategy: Tales from the Road – "*Recently we worked closely with a leading pharmaceutical manufacturer. Our client was getting ready to execute its M&A strategy, which included becoming a platform for biological drug production and distribution. We helped our client objectively assess its capabilities, including production capacities, utilizations and supporting processes. Alignment to the M&A strategy became clear and gaps and bottlenecks were identified and addressed. As the project moved to due diligence, our client was well prepared to assess how it could absorb production from the target company. With a data-driven fact-base in hand on its own capabilities, our client exceeded the synergy estimates and completed the production consolidation in less time than expected.*" *—Michael Connerty*

Clearly Define the Internal M&A Process

The next phase in preparing an organization for M&A success entails clearly delineating roles, responsibilities, and decision-making steps during the deal process. As with attempting to assess a company's baseline performance, assigning roles and responsibilities once a due diligence has already been initiated will likely result in confusion, inefficiency, and, worse, missed diligence opportunities.

M&A situations can materialize quickly. They can be fluid, and thus they very often conflict with decision-making processes that have been set up for the ordinary course of business (e.g., monthly management meetings, quarterly business reviews, etc.). Additionally, the M&A process evolves through several defined stages, with teams scaling up to meet the needs of each stage. This results in more functional experts, more geographies, and more stakeholders as part of the process, likely leading to confusion. A careful mapping of roles, responsibilities and accountabilities, decision points and deliverables will help avoid unnecessary confusion and the lack of coordination that can be the result of a fluid, fast-moving M&A process. An ancillary benefit of this preparedness is showcasing an acquiring company's own value. Optimal organization presents a portrait of an acquiring company to the target company that is highly favorable. In today's deal environment, acquirers need every advantage they can get.

Clearly Defining the Internal M&A Process: Tales from the Road – "*We recently worked with a Fortune 500 company that had an ambitious plan to acquire a number of smaller companies that could help it improve its position in several market segments. The company had not completed an acquisition in a number of years, and it acknowledged it needed to clarify its approach to coordinating its capabilities throughout the life of a deal.*

Working closely with our client, we helped map the lifecycle of a given acquisition and how it aligned to the specific types of companies it was seeking. For each stage of the deal, we helped the clients clearly define decision-making steps and rights, roles and accountabilities, deliverables and coordination processes. Having implemented a customized approach to managing the M&A lifecycle, the company went on to complete seven acquisitions over a three-year period that resulted in significant shareholder value creation." *—Bob Lavoie*

Deploy the Right Team

Business unit, division, and functional leaders all hold accountability for post-deal performance, and they need to be part of the team as the deal takes shape. Many companies think that having the corporate development team in place is sufficient to get a deal done right. It isn't. The best acquirers include their leaders well in advance of a deal by having them at the table to help develop the M&A strategy. Getting the views of such leaders on synergy opportunities and risks is a necessary input for both valuation and post-close integration. These leaders will need to lead the integration effort and be accountable for synergy capture. Without early and ongoing involvement, leaders and managers may dispute or attempt to walk back any significant synergy targets given to them.

Getting the people aspect of an acquisition right is vital to long-term success. Some acquirers make the mistake of thinking that talent optimization requires only evaluating the acquired company's human resources. This is important, of course, but it is not sufficient. The best acquirers know their own talent, and they know their own talent's performance gaps. Leaders are best positioned to identify and evaluate key talent, and to re-recruit them if necessary. With such information in hand, acquirers are already prepared, in advance of closing on a deal, to make the tough decisions post-close.

Successful acquirers furthermore know how to leverage their subject matter experts throughout the M&A process. They know who their internal experts are, how they can add value, and at what stage of the deal process to leverage their expertise. To this end, they take time to ensure these experts understand their role in the deal process and what will be expected of them. They encourage their experts to speak up about both risks and opportunities to maximize potential insights.

Putting star performers on deal and integration teams is important, but it comes at a cost. Because few companies in today's environment have flex resources waiting around for a deal to happen, getting the best team together often means asking people to work long hours, with their contributions on the deal coming in addition to their everyday responsibilities. But relying on the best people and putting worthwhile incentives in place helps to ensure strong performance. The benefits can be substantial for both the company and its talent, as acquisitions offer up-and-coming managers unique experience and insight into the management and operations of both the acquiring and target company. A well-managed M&A process confers broader perspective than a star is likely to see every day in their normal role, and should be viewed as opportunity for career development.

Deploying the Right Team: Tales from the Road –
"One of our clients, an active acquirer over the years, uses a mix of financial and career-development opportunities to motivate its best performers to drive M&A opportunities. The client ties financial incentives and career development – such as promotions with increased responsibility – to value-drivers such achieving revenue and cost synergies. This approach has resulted in much tighter alignment with value creation, and has proven to be a great morale booster for key managers and personnel – many of whom were required to contribute above and beyond their day-to-day job." —Michael Connerty

Develop Digital "Playbooks"

While not every deal is the same, acquirers can take steps ahead of a deal to develop the playbooks that guide due diligence and integration teams in areas that commonly need to be addressed. "Playbook" is a misleading term, however. The days of the hard-bound, static playbook are over. The modern M&A executive requires a digitally-deployed, responsive warehouse that provides checklists, tools, and default operating model assumptions for a new acquisition on demand. Such digital playbooks help team members think through operational and tactical issues and make sure they understand how their roles and responsibilities align to the overall strategy. In the midst of due diligence or pre-close integration planning, teams will be far more effective in assessing synergy opportunities, developing integration plans, evaluating talent, and other crucial tasks when they have playbooks available as a resource to help guide them.

Institutionalize the Learnings

The best companies are learning organizations. They build into their standard operating practices an approach to learning improvement. Successful acquirers do the same: They take time during and after the close of an acquisition and subsequent integration to learn what worked well and what needs to be improved. A proactive, methodical approach is taken to reach out to participants from the various stages of the M&A process to capture the resulting lessons in a candid and actionable way. Those lessons then inform the acquirer's approach to the next acquisition opportunity. The gap between synergy estimates and realized synergies must be measured and analyzed to see what was done well and where effort may need to be sharpened going forward. A committed institutionalization of the learnings embeds the capabilities a company has just developed more deeply into the organization and clears the way for continued improvement.

Preparing to Win

Few companies start out with M&A as a core competency, but handling M&A the right way can mean the difference between capturing value and destroying it. L.E.K.'s research illustrates that M&A is a learnable skill; companies can improve their chances of a successful acquisition by preparing themselves internally in advance of any deal. Successful acquirers translate their acquisition strategy to their own operations and personnel. They delineate the roles and responsibilities of the deal process internally, ensuring M&A "buy-in" from key business unit, division, and functional leaders, and they incentivize star talent to be involved in the deal. This preparation, coupled with institutionalized learning and well-developed playbooks, accelerates the development of a core competency in M&A that greatly enhances a company's likelihood of success.

For further information contact:

Boston
75 State Street
19th Floor
Boston, MA 02109
Telephone: 617.951.9500
Facsimile: 617.951.9392

Chicago
One North Wacker Drive
39th Floor
Chicago, IL 60606
Telephone: 312.913.6400
Facsimile: 312.782.4583

Los Angeles
1100 Glendon Avenue
21st Floor
Los Angeles, CA 90024
Telephone: 310.209.9800
Facsimile: 310.209.9125

New York
1133 Sixth Avenue
29th Floor
New York, NY 10036
Telephone: 646.652.1900
Facsimile: 212.582.8505

San Francisco
100 Pine Street
Suite 2000
San Francisco, CA 94111
Telephone: 415.676.5500
Facsimile: 415.627.9071

International Offices:
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