VALUE CREATION IN M&A INTEGRATION PROJECTS

KIRSTEN MEYNERTS-STILLER
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POST-MERGER MANAGEMENT

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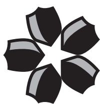

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ABOUT THE AUTHORS

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Dr Christoph Rohloff entered business as managing director and business developer in the printing machine industry. Since 2003, Christoph has advised businesses on how to successfully realize complex change and transition processes. His focus is on risk-based analyses, management systems and post-merger integration excellence.

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PREFACE

The idea behind the book

This book is intended for business integration managers. Its aim is to spread enthusiasm for one of the most challenging areas of entrepreneurial activity – the restructuring of two merged organizations to form a functioning, profitable business.

Merger integration competence covers all aspects of strategic planning, ranging from the management of complex organizational projects to the cultural work involved in change management and leadership development. The book offers practical answers to the many 'how to' questions relating to implementation while also explaining the broader M&A context in which integration projects are rooted, this being of crucial importance for assessing the chances of realizing synergy potential as well as evaluating the integration risks.

Merger integrations are very special projects: they pose an enormous challenge to the organization in general and the integration managers in particular. Generally speaking, they are fraught with over-inflated expectations of making rapid synergy gains; moreover, they are laden with pitfalls inherent to complex organizational change and charged with emotion as well as being influenced by socio-psychological dynamics.

This complicated situation poses risks, and it is no surprise that many merger integrations turn out to be botched jobs. It is not uncommon for managers to lose sight of the more modest targets and run through the integration process mechanically, without detecting the true nuggets among the new strategic business opportunities.

Up until now, many companies, including an increasing number of medium-sized businesses, have embarked on the 'M&A adventure' with insufficient preparation, often lured by the high level of standardization and the good consulting services available on the transaction side. From the transaction managers' perspective, M&A appears to be a professionally handled and easily controllable management field.

But things look quite different on the integration side once the deal has been closed: here, it is not uncommon for companies to rely solely on the relevant business function expertise, without clearly defined project structures or any in-depth experience of integration processes. The technical and cultural mergers run side by side with only loose links between them. The cost of integration is often underestimated, and insufficient resources are made available. Although corporations and 'serial acquirers' have an advantage over 'occasional buyers' as far as the standardization of integration processes and project structuring are concerned, integration management is still not yet fully professionalized in many corporations. Occasionally, this process is taken one step too far. Excessive standardization and process orientation leaves little scope for tailoring the integration project to the individual situation.

This is what inspired us to provide business integration managers with a kind of instruction manual containing the basic essentials for the successful organization of merger integration projects.

The know-how available with regard to post-merger management is currently still diffuse. Although there is now a good deal of literature, including a few standard works, on the M&A phenomenon in general,[1] post-merger management focussing on successful integration work and all its organization-specific facets is not the central theme. Merger integration also lags way behind transaction-related M&A subject matter as a further training and seminar topic in university and executive education. Increasingly, however, international conferences are being devoted to this subject,[2] and, e.g. within the German Federal M&A Association (*Deutscher Bundesverband M&A*) there are expert groups specializing in merger integration work.

Individual case studies on particular aspects of integration[3], e.g. the study of the merger between Daimler and Chrysler or between Dresdner Bank and

[1] Müller-Stewens, Kunisch and Binder (2010), Jansen (2008) and Lucks (2013). An example from the English-speaking world: Davis (2012), Whitaker (2012), Galpin and Herndon (2007) and Lajoux (1997).
[2] Example: The Thought Leader Global Integration Conference held annually in Amsterdam since 2011.
[3] Example for the logistics industry: Bachmann (2008); for public bodies: Sommerrock (2009); for the IT industry: Popp (2013). Examples from literature illustrating individual aspects of integration for the field of HR: Scharfenkamp et al. (2002), Jaeger (2001), Geschwill (2000) and in greater detail: Krusche (2010); example for integration controlling: Bauch (2004); example for cultural due diligence Strähle (2004) and PMI cultural work: Palm (2012).

Commerzbank, are of special interest, as they provide valuable insights into the challenges posed by large-scale integration projects.[4] Empirical analyses, often carried out by the big consulting firms, are frequently limited to assessing deal performance and identifying the key factors in success or failure. The risk study by Gerds/Schewe goes one step further, using its findings to compile practical tips on how to organize due diligence with a view to making merger integration as successful as possible (Gerds & Schewe, 2009).

It is nevertheless important to note that every merger is *unique*. As integration consultants and authors of this practice-based manual, we are hence unable to provide a universal guide to all conceivable integration constellations. Based on our own observations and those of our fellow consultants as well as an analysis of the existing literature, it is, however, possible to identify certain factors in the planning, organization and methodology that have greater bearing than others on the success of merger integration projects.

In this book, we aim to pool the merger integration know-how already available, close at least the most important gaps in the skill and knowledge base, demonstrate how integration can succeed, and provide a candid overview of everything that needs to be done. The challenge of the book format lies in having to depict the synchronicity and interdependence of numerous events and activities in a sequential manner.

The increasing company demand on the consultancy market for professionalization in post-merger management stems from the pressure to minimize the risk of failure in implementing mergers in the light of increasing transaction frequency. This phenomenon is comparable to the process that has led to change management being viewed in a different way and gaining widespread acceptance as an essential component and success factor in organizational and change projects. Back in the 1980s and 1990s, companies faced massive internal pressure for change in order to improve the efficiency potential of their own organizational structures, processes and IT systems. It was only by professionalizing internal change processes within the framework of change management, which has since become a generally recognized practice, that companies were able to achieve this efficiency internally.

[4] For the merger between Allianz and Dresdner Bank, see Große Peclum, Krebber and Lips (2012); for the merger between Daimler and Chrysler, see Grube and Töpfer (2002).

Professional post-merger management competence is following this trend on account of the increasing necessity to achieve and maintain significant synergy effects in merging organizations.

This book is aimed at a wide range of target groups within businesses:

- *Project managers*: Leading project managers and integration managers are generally nominated on the basis of their specialist role. Alternatively, experienced organizational project managers are made available by the key departments, such as HR or Organization Development. Many corporations pool all their integration experience in central PMI communities and specialist departments. These experts are often consulted for support and advice with the operative implementation of the integration at local level.
- *Project participants*: Responsibility for the implementation of a sub-project lies mainly in the hands of specialist staff and executives from middle management. For many, a forthcoming merger means extra pressure on top of their normal workload, often with little practical integration experience.
- *Decision-makers responsible for mergers*: The top-level management staff and the head of department responsible for the deal in question generally have experience in handling transactions and have already assisted with or been in charge of a number of acquisitions. In their case, an in-depth understanding of integration dynamics and how to shape them can provide valuable information for the transaction phase; in particular, it facilitates a realistic assessment of the volume of resources needed for integration (and requiring costing), as well as raising awareness of the need for management staff to stay focussed on the integration project over its entire duration – generally a matter of several years.

Our readers will have to grapple with some quite challenging perspectives. The increasing complexities of organizational reality cannot be blocked out or trivialized, system theory approaches can facilitate a better understanding of the dynamics involved and greater proficiency in managing permanent conflicts of interest when conducting merger integration can help to put minds at rest.

At the same time, this book serves the very pragmatic purpose of providing concrete tools that have already proved their worth over the course of numerous integration processes.

We would like to thank all those who have taken part in our merger integration seminars as well as our consulting project contacts, who have assisted us in enhancing and perfecting many of the approaches discussed here. Our thanks also go to Christoph Stiller for his help in compiling the manuscript and charts.

Kirsten Meynerts-Stiller, Christoph Rohloff
Neu-Isenburg, April 2019

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PART I

INTRODUCTION

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1

MERGERS ARE BACK IN BUSINESS

The buying and selling of companies or parts of companies as a strategic option has become mainstream business practice. But do companies have the necessary skills for the job?

Globalization and the associated speed with which companies nowadays expand their business activities, adapting them to new markets and competitors and strategically reorganizing their business fields at an ever-increasing pace, makes the prospect of achieving these adjustment processes solely via organic growth appear very ambitious, if not impossible.

In many cases, the adjustment processes necessitated by increasingly volatile market conditions can only be realized by purchasing or relinquishing business shares or certain business divisions – be it for the purpose of tapping into new regional markets, achieving an appropriate size for the business field, developing an important skill base within a reasonable time frame, or for one of numerous other reasons precluding a lengthy organic growth process.

This applies, in particular, to companies in industrial countries, where organizational growth is inadequate to generate the sales dynamic and investment confidence required in the face of competition from the up-and-coming business giants in the emerging countries (Lucks, 2013, p. 3ff).

In recent years, there has also been a significant increase in cross-border transactions on the part of Chinese investors, who are keeping a particularly keen eye on Germany's medium-sized business landscape while cultivating their traditional links with Great Britain via Hong Kong (*M&A China/Deutschland*, 2014).

In the North American markets, there is a long tradition of mergers. Major merger and acquisition waves started to be seen as long ago as the nineteenth

century, and back in the 1970s M&A volumes reached significant levels (Müller-Stewens, Kunisch, & Binder, 2010). Consequently, the topic acquired disproportionate importance for the general public. In the early 1990s, over 45% of the working population in the United States was personally affected by mergers and had gained first-hand experience of them in the course of their working lives (Jansen, 2000c).

In Europe, a number of large-scale acquisitions spring to mind, such as Thyssen/Krupp or Mannesmann/Vodafone, but up until the turn of the millennium, acquiring businesses was not part of standard corporate culture. The very term 'takeover' met with hostility in public discourse, and negative intentions were ascribed to acquiring companies.

Around the turn of the millennium, this perspective changed both in Europe and elsewhere. The number of mergers and acquisitions (M&A) increased significantly; this trend was backed by the level of liquidity available at the time, and despite a number of crises in the period between 2000 and 2007, the total volumes continued to increase. In many cases, however, mega mergers were responsible for driving up the figures. In Central Europe, names that spring to mind are Daimler/Chrysler, Dresdner Bank/Allianz, VW/Porsche, Commerzbank/Dresdner Bank or Deutsche Bank/Postbank. Admittedly, some of these merged entities have already been and gone, while others are talking of splitting up again, as in the case of Deutsche Bank and Postbank in the spring of 2015.[1]

1.1 THE NEED TO IMPROVE INTEGRATION COMPETENCE

Since that time, it is not just the mega mergers that have been dominating the market and the headlines, but numerous relatively average 'purchases' involving companies of all sizes. The purchase of companies, business divisions or start-ups has come to be regarded as a natural strategic option, not just for corporations, but for medium-sized businesses as well, and is hence a frequently used instrument (Lucks, 2013, p. 14). This trend is being backed by the availability of liquidity coupled with new forms of financing in mature capital markets.

[1] Cf. press release from the Deutsche Bank dated 27 April 2015.

Since back in the 1990s, the transaction side of the market, i.e. the side concerned purely with the purchasing process, has undergone considerable professionalization. The big consulting firms have established their own M&A departments, banks have started to play a key role in this 'multimillion-dollar game', large law firms have become important players in business acquisitions and even national and international legislation and case law has attempted to master the huge complexity of the valuation procedures along with the contractual arrangements and the risks associated with business acquisitions.

This know-how is now readily available on the market for purchase, although many large- and medium-sized companies have long since compiled their own resources on the subject.

This is the positive news. However, the value of an acquisition is not generated on conclusion of the purchasing process. With the exception of a few rare cases where the focus is on accounting issues such as losses carried forward, the targeted value of a business acquisition is not generated until the subsequent integration and implementation phase has been completed. Irrespective of how deep or broad the integration needs to be in order to achieve the aims of the acquisition, the mere capacity to carry out integration in a professional manner is the decisive factor.

And now for the less positive news. Mergers can turn companies into extremely fragile entities and lead them into very volatile times. They pose the biggest entrepreneurial and organizational challenge for businesses and have a major impact on corporate reality. Nowhere else is the destruction of value so great than in the case of failed mergers, and numerous studies have shown that more than 50% of all mergers fail to achieve their original objectives (see Section 3.1).

This failure is not just due to weak strategic decision-making, but mainly to a poorly organized integration phase on conclusion of the purchase agreement. The capacity to make a success of the post-merger phase differs considerably from one business to the next.

The integration capability spectrum is reflected in how companies view themselves and in their structural prerequisites for post-merger integration. It ranges from businesses that see 'the careful integration of new staff in the company' as being their core skill to companies that have established clear structures and processes. The latter would say of themselves: 'For handling integration processes, we have our own methodology and highly qualified

managers and staff, who are experienced in merger activities'. Further along the spectrum, there are companies that consider the merger to be over and done with on conclusion of the purchasing negotiations and live by the motto: 'Get on with it, but don't spend too much time or money'.

The ability to make a realistic assessment of the costs involved in integration is a core M&A skill and a clear competitive advantage: companies capable of purchasing other companies *and* integrating them in a professional manner grow faster than companies with purely organic growth.

It is fair to say, however, that merger integration competence is not something that can be acquired within a short space of time. Firms that are already well on the way to acquiring a certain degree of integration competence are all too well aware of this. In most cases, the decision to improve capability in this field and go to the trouble of learning new skills stems from the painful failure of previous acquisitions. Organizational learning curves of this kind resemble exponential functions; they make the distinction from the competition increase disproportionately over time and are hard to replicate.

Coping with all this simultaneously is undoubtedly the biggest challenge facing managers in their day-to-day work and is described in more detail in Chapter 4 as 'merger management competence'.

Organizational integration competence is only available to a limited extent on the external consulting market. External service offerers extend the 'workbench' so to speak by assuming responsibility for a wide range of subtasks, notably in the field of IT or on behalf of the Project Management Office. However, a shortage of internal competence can only be substituted by external competence within limits.

Integration processes are massive interventions in corporate reality. They call for project management skills that can be deployed quickly and for socio-psychological realities to be handled properly; they often put a strain on the capacity of the entire organization while also leading to a high level of insecurity and distrust among staff employed with both the target company and the acquiring company.

External consulting support can help in providing experience-based knowledge and implementation tools. However, external support can only be genuinely effective if the expertise provided is accompanied by a readiness on the part of the company itself to implement the integration process with due diligence. Ideally, therefore, external consulting should only play a supportive rather than a steering role in integrations.

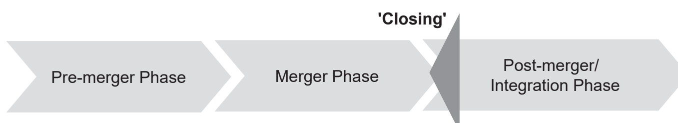
1.2 TERMINOLOGY SHAPES REALITY

Interestingly, the perspective from which the merger process is viewed is reflected in the terminology. All the public interest and attention, including that of the management, is focussed on the transaction phase, the conclusion of which is termed the 'closing'. In many companies, perception of what is really important follows the same approach. Where this is the case, the closing elicits a big 'sigh of relief' that the feat has been accomplished and the merger closed. The company promptly turns its attention to other operative issues, freeing up the resources that have been tied up in the transaction team and allowing the employees involved to resume their day-to-day duties. Nothing could be more fraught with risk than this kind of approach.

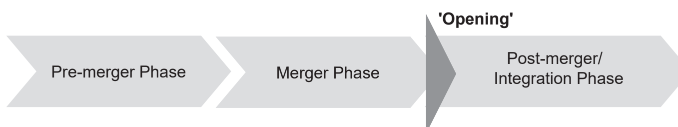
The major challenge for the organization is not encountered until after the closing, during the implementation phase. It generally ties up more manpower and resources than planned for in the pre-merger phase. This massive feat is often given too little thought despite jeopardizing the company's very survival. And the clock is ticking. Unlike other internal reorganization processes, which can usually be scheduled for a favourable point in time by the management, the closing represents the 'starting shot'. The integration phase has to get underway now, with no chance of postponement. Therefore, the 'closing' is actually an 'opening' into the decisive phase for achieving the ambitious merger goals (Fig. 1.1).

The same applies to the term 'integration'. This choice of language signalizes an approach that can prove a hindrance in the 'growing together

Fig. 1.1: Terminology Shapes Reality.



The **Closing** of a deal is not an invitation to rest or an end in itself, …



… but the kick off for the actual race!

phase'. Integration is often associated with incorporating something new in something that already exists. One part integrates while the other stays the same. This perspective can prove explosive and generate a dynamic of its own that is difficult to control. Moreover, it does not usually reflect reality. In order to grow together in changed organization processes and structures, both sides need to adapt. Consequently, this book often uses the words 'implementation' or 'implementation phase', while not completely discarding the commonly used term 'integration'.

1.3 EVERY MERGER IS UNIQUE

Mergers differ in terms of their objectives, the scale of the target company, the integration strategies, the maturity of the merging businesses, their existing procedures and many other aspects. This makes every integration phase all the more unique. In time, however, typical patterns emerge for individual companies owing to the fact that, within any one entity, similar goals, integration strategies, project approaches and many other standard procedures are pursued in the course of acquisition and integration activities.

A 'playbook' setting out a de facto standard for future merger integration projects based on previous experience of integration processes can provide answers to around 80% of all questions relevant to the integration approach. As a result, such companies will be left with far more time to attend to the remaining 20% of decisions, which need to be taken with a great deal of care and thought.

It is hence a matter of striking the right balance between establishing a standard integration procedure in order to take pressure off the system and avoiding the pitfall of over-standardization that ignores the system's ability to adapt to the specifics of any given situation and prevents clarification of important issues.

1.4 A FOCUSSED PERSPECTIVE OF STRATEGIC MERGER INTEGRATIONS

This book aims to assist integration managers in recognizing the full spectrum of the challenges they face, thus enabling them to prepare themselves properly