



Integration

The Real Deal

And now the latest business news . . .

It's merger Monday again, and keeping in line with the recent flurry of deal announcements, another megamerger was announced today: this morning, industry leader ABC Company announced an initial agreement to merge with industry giant XYZ Corporation. During a joint press conference, the two companies' CEOs described the combination as "a true merger of equals." The two went on to state, "It's too early in the deal to begin planning for integration, but we are confident that the new company will be stronger together than either company could be on its own. This combination will benefit everyone involved, including our customers, shareholders, and employees alike. We will communicate more about the merger to our stakeholders as we have more information to share. Our plan to combine the two companies is essentially to ease the changes in. We will freeze the two organizations for at least a year, and once things settle down we'll see what we have in the way of products, operations, systems, and people. Once our employees and customers get comfortable with the new entity, we'll then start integrating the two businesses."

Sound familiar? Announcements like this have appeared in the business media so frequently recently that M&A deals have again become part of daily business. After the wave of downsizing and cutbacks that occurred after September 11, 2001—during 2002 and into early 2003—M&A activity has steadily increased for the past several years (see Exhibit 1.1), rivaling the pace of transactions before 9/11.

Exhibit 1.1
M&A Volume, U.S. and U.S. Cross-Border Transactions, 2000–2006

Year	Deals	Value (\$bil) ^a
2006 ^b	7,036	861.6
2005	11,013	1,234.7
2004	10,296	823.2
2003	8,232	530.2
2002	7,411	441.6
2001	8,545	683.0
2000	11,123	1,268.6

^aValue is the base equity price offered.

^bAs of Aug. 20, 2006.

Source: Mergerstat.

BUYER BEWARE!

In spite of the renewed high deal volume, most M&As still fail to accomplish many of the strategic objectives so optimistically projected in the initial announcements. Ultimately, for a merger or acquisition to be considered a success, it must increase shareholder value *faster* than if the companies were separate. The completion of a deal does not ensure the success of the resulting organization. In fact, many M&As result in a net *loss of value* due to problems created by the combination. Research on M&A performance generally concludes that companies which grow through an M&A strategy do not perform as well as firms that grow “organically”—that is, through internal initiatives. For example, on September 3, 2001, the day prior to Hewlett-Packard’s announcement of its acquisition of Compaq, HP’s stock price

was \$23.11. After the announcement, HP's stock dropped to \$18.87 and stayed pretty much at that level for the following three years, selling at \$18.70 on September 21, 2004—down over 19 percent from its preacquisition selling price (Wheelen and Hunger, 2006).

Overall, poor M&A results may be attributed to a number of factors—paying too much, poor strategic fit, incomplete or haphazard due diligence, and ineffective integration efforts—but they all point to the same basic fact: *it is much easier to do a deal than to implement one*. The “real deal” is that integrating one business with another is inherently demanding, even for the most experienced acquirers, and companies must manage the process exceedingly well if the effort is to succeed.

Indeed, beyond all the statistics and optimistic press announcements, real organizations are being disrupted, real employees are being displaced, and real shareholders are being disappointed—not for lack of effort, but largely for lack of effective planning and integration. A relatively clear set of factors has been found by various researchers to be consistently associated with poor integration efforts:

- The University of Dallas Graduate School of Management's survey of 124 managers and executives from twenty-one different industries (Galpin and Herndon, 2006) identified *communication* along with *leadership and decision making* as the two most common aspects of M&A integration needing improvement.
- A study of 190 CEOs, CFOs, and other top executives experienced in global acquisitions (Watson Wyatt Worldwide, 1998a) found that *cultural incompatibility* is consistently rated as the greatest barrier to successful integration but that research on cultural factors is the kind least likely to be conducted as an aspect of due diligence.
- A 1992 Coopers & Lybrand study (see Carleton, 1997) reported that in one hundred failed or troubled mergers, 85 percent of executives who were surveyed said that the major problem was *differences in management style and practices*.
- A 1996 British Institute of Management survey (see Carleton, 1997) also reported underestimation of the difficulties involved in *merging two cultures* to be a major factor in failure.
- In a 1997 Mercer Management Consulting study (see Lublin and O'Brien, 1997), *poor postdeal integration* was the major failure responsible for the fact that, in deals worth more than \$500 million, only 43 percent of some three

hundred merged companies outperformed their peers in total returns for shareholders.

- A study by the A. T. Kearney consulting firm (see Lublin and O'Brien, 1997) reviewed 155 M&A deals in multiple industries and determined most failures to be *people related*.

As the data overwhelmingly suggest, organizations know the root causes of failed mergers, but they still are not doing much to manage the issues involved in successfully integrating an M&A deal. Even in companies where there has been painful personal experience of deals gone wrong, it is the rare executive who has led an organization to create anything more than a rudimentary plan for integration. Sadly, in spite of overwhelming evidence of the importance of effective post-deal integration, organizations and executives continue to fail.

WHY DEALS ARE DONE

Despite the risks and horror stories, M&As are here to stay. Driven by globalization and economic or strategic barriers to organic growth, M&As have become the primary means by which many companies attempt to grow revenues quickly. Largely because of these drivers, today's deals are fundamentally different from those that figured in previous waves of merger activity (see Exhibit 1.2).

	1980s	Today
Reasons	Financial play	Operational leap
Risks	Overleveraging	Integration
Targets	Diverse	Similar
Prizes	Hard assets	4 Cs: customers, channels, competencies, content
Mandate	Stabilize	Exploit instability
Market	Forgiving	Merciless

In past decades, M&As tended to be primarily financial transactions aimed at gaining control of undervalued assets, which were then often resold or left to stand alone as independent entities. The target was often a dissimilar industry or a business line distinctly separate from the acquirer's main business. Price premiums were less common, and integration was not a primary value driver; as a result, there was more room for mistakes. The main risk involved taking enough cost out of the business to ensure sufficient cash flow for debt service. Today, the typical merger or acquisition is quite strategic and operational in nature. Executives are buying an installed customer base as well as new and better distribution channels and geographical markets. They are buying organization competencies and an infusion of talent that leverage and extend strategic opportunities, and they are gaining control over competitors' products and services. They are also consolidating business units or industries in a down cycle, to increase revenue and share price. The differences don't stop there, however. Given the all-out race for globalization, not to mention the constant short-term pressure for earnings growth, desirable targets are fewer in number, demand for them is much greater, and price premiums are far more common. There is less margin for error in actually achieving the economic projections of the deal. Costs must still be driven out of the business, but now without any sacrifice of the ability to capture revenue-generating synergies. Moreover, in contrast to the past (when acquisitions normally could be integrated over a longer period, perhaps two or three years), today the businesses must be merged as quickly as possible—often within six to twelve months after the close. Managers and employees, instead of having to survive only one or two M&A transactions in their careers, must now be ready to do deals routinely, incorporating new businesses as a matter of course, one right after another, and often with multiple transactions occurring simultaneously. When the heightened expectations of Wall Street are factored in, it is clear that failure to integrate the businesses properly after the deal has closed can lead to disaster, as in Quaker Oats Company's acquisition of Snapple Beverage Corporation, one of the more ill-fated M&A deals in corporate history, in which Quaker Oats lost \$1.4 billion in just twenty-seven months. Quaker's strength in supermarkets and mass distribution was a poor match with Snapple's convenience-store market. The new owners of Snapple replaced a popular ad campaign with new marketing programs that immediately flopped. Further, Wall Street considered Snapple's purchase price to have been about \$1 billion too high. All these factors and more resulted in a \$1.6 million loss for every day that Quaker owned Snapple.

It is no longer sufficient just to buy the right company at the right price. Today's deals start there, but they also demand effective execution of the right integration plan.

INTEGRATION: AN EXPERIENCE-DRIVEN SKILL SET

At a recent meeting in a major manufacturing company—a meeting called to prepare the integration plans for the fourth M&A deal in eighteen months—the CEO issued only one directive: “Give me an integration team that knows the drill.” Indeed, managerial and organizational experience has long been referenced as a factor key to a merger's success, and this concept has been further refined in a recent study by Singh and Zollo (see Pandya, 1998). Based on findings from more than five hundred bank mergers, the Singh and Zollo study is the largest to date on postacquisition management. The study concludes not only that past experience is the key to managing a successful merger but that this is true in two distinct areas. The first area, which the authors call “tacit knowledge,” consists of subjective experience and exists largely in the minds of key executives. The second area, which they call “codified knowledge,” consists of written procedures that a company articulates in the form of routines or norms that guide integration actions and decision making during the formation and implementation phases of the M&A deal. (Examples of codified knowledge might be procedures and guidelines for structuring the new entity and reconciling different practices with respect to compensation and benefits, or process models and instructions for staffing and selection.)

Every deal presents different challenges, of course, and requires customized adaptations of generic integration processes. Nevertheless, a structured approach to integration, and its skillful application by managers who “know the drill,” have proved their ability to help organizations maximize the value of their M&A deals. When a structured integration process is well managed, the organization can achieve significant results. Executives and integration managers who have worked with us to apply a disciplined, accelerated, results-oriented approach to their integration efforts cited several positive outcomes of well-managed integration, including the following:

- *Faster integration.* “We have accomplished more in two months working through a structured integration process than we did in two years trying to work through integration unsystematically on our own.”

- *Lower costs.* “Our integration teams, including people directly affected by the changes, were able to get involved and identify cost-saving opportunities that our executives and deal makers could not have found on their own.”
- *Executive alignment.* “By the end of the ‘Executive Summit’ planning session, our synergy opportunities were clearly understood by the entire leadership team, and synergy capture was assigned to integration project teams responsible for planning and execution.”
- *Achievement and surpassing of projected synergies.* “Our original plan projected \$100 million in cost synergies to be achieved in the first 18 months after deal close, but we actually achieved \$120 million in synergies within the first 12 months of integration. The financial analysts were particularly impressed by our synergy identification, planning, and tracking process used to focus the organization’s efforts on synergy capture.”
- *Protection of productivity and maintenance of customer focus.* “The merger-integration scorecard process highlighted key operating, financial, customer, and organization issues that were most prone to disruption during integration and gave executives an early warning of where to focus attention in the successful day-to-day running of the business.”
- *Smoother transition.* “The process works. It keeps the entire organization focused and moving forward in a fast, efficient, and well-coordinated way.”
- *Faster and more effective responses to workers’ questions and concerns.* “One of the most positive things is that we have honestly addressed the ‘me’ issues and other concerns of the workforce. Our clear and open communications helped employees understand what was going on and see that we had a well-defined, objective process for planning the integration and resolving issues that affected them.”

THE DEAL FLOW MODEL

One global acquirer that now averages ten or twelve deals per year summarizes their M&A situation as follows:

Executives have historically focused exclusively on making the deal. Then they throw the whole process unceremoniously over to the business unit managers to integrate, all the while maintaining the same

expectations for performance and participation in a myriad of other, equally high-priority corporate initiatives. As a result, every integration we do is different. For most, our process resembles Sherman’s march on Atlanta: we win the territory but leave far too much in ruins. For others, no integration happens for the first year or so, and then managers try to slam-dunk some business-process decisions on the acquired business just because they bought the right to, and without any rational case. Others ignore the business process entirely and focus on “management seances” and “love-ins.” As a result, we end up reinventing the wheel every time and hope for the best.

Most executives are subject-matter experts with regard to their specific functional responsibilities, but they have surprisingly little context knowledge of the entire “soup-to-nuts” process: the components of the transaction and their completion, the elements of due diligence, and the integration phase. Exhibit 1.3 shows the Deal Flow Model, a framework for conceptualizing the fundamental stages of the deal process. Exhibit 1.4 shows how managers can use this high-level M&A transaction model to generate lists of stage-specific items for further detailed planning. Thus, for each of the six major stages in the model—*formulate*, *locate*, *investigate*, *negotiate*, *integrate*, *motivate*—the organization can create specific activities and products as needed to establish strategy, document policy, map processes, manage training, and so on. Managers in charge of a company’s M&A activities should incorporate issues and risks pertinent to each suborganization or major

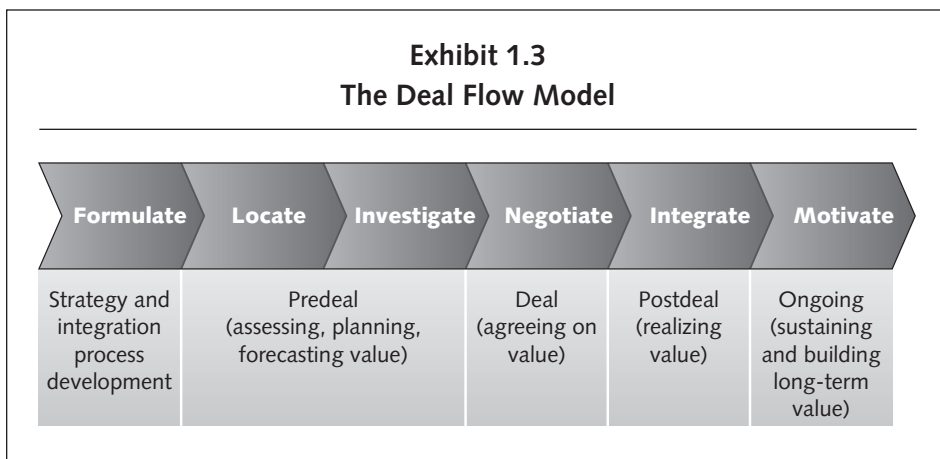


Exhibit 1.4 Map of M&A Process and Issues

Deal Flow Model

	Formulate	Locate	Investigate	Negotiate	Integrate	Motivate
Key Activities	<ul style="list-style-type: none"> Set business strategy Set growth strategy Define acquisition criteria Begin strategy implementation 	<ul style="list-style-type: none"> Identify target markets and companies Select target Issue letter of intent Develop M&A plan Offer letter of confidentiality 	<ul style="list-style-type: none"> Conduct due-diligence analysis <i>Financial</i> <i>People/cultural</i> <i>Legal</i> <i>Environmental/Operational</i> <i>Intellectual capital</i> Summarize findings Set preliminary integration plans Decide negotiation parameters 	<ul style="list-style-type: none"> Set deal terms <i>Legal</i> <i>Structural</i> <i>Financial</i> Secure key talent and integration teams Close deal 	<ul style="list-style-type: none"> Finalize and execute integration plans <i>Organization</i> <i>Process</i> <i>People</i> <i>Systems</i> 	<ul style="list-style-type: none"> Long-term alignment of "organizational levers" with business strategy to sustain future organizational success <i>Rules and policies</i> <i>Goals and measures</i> <i>Rewards and recognition</i> <i>Training</i> <i>Communications</i> <i>Customs and norms</i> <i>Organizational structure</i> <i>Ceremonies and events</i> <i>Management behaviors</i> <i>Physical environment</i>
Issues and Risks	<ul style="list-style-type: none"> Costs Channels Content Competencies Customers Countries Capital Capacity 	<ul style="list-style-type: none"> ROI/Value Strategic fit Cultural fit Timing Leadership fit Potential synergies Viability 	<ul style="list-style-type: none"> Liabilities Human capital retention Human capital elimination Viability of financial aspects Integration issues Synergies and economies of scale ROI 	<ul style="list-style-type: none"> Price Performance People Protection Governance 	<ul style="list-style-type: none"> Speed Disruption Costs Revenues Results Perception <i>Shareholders</i> <i>Public</i> <i>Customers</i> <i>Employees</i> 	<ul style="list-style-type: none"> Sustainable organizational improvements, changes Industry evolution, revolution Competitive pressures Continuous workforce shifts (evolving demographics and shifting preferences)

business unit into the generic Deal Flow Model. Likewise, those in charge of deal activities also need to capture knowledge from each new deal and add it to online and hard-copy libraries, in order to provide a living resource pool for subsequent deal makers and integrators at the company. The sections that follow describe and discuss the six stages of the Deal Flow Model.

Stage 1: Formulate

In the first stage, the organization must set out its business objectives and growth strategy in a clear, rational, and data-oriented way. This should include more than the CEO's directive to "become a \$1 billion company" in x number of years; instructions like these can do much to bias an organization to do a deal, any deal, just to stay off the boss's blacklist. Instead, top executives should establish specific criteria, based on the objectives that they have determined and on a strategy of growth through acquisition, to describe what a viable target company would bring to the party. They should express these criteria in terms of such goals as market share, geographical access, new products or technologies, and general amounts for financial synergy. In strategy development, it is often important to help the CEO's direct reports gain clarity about what the strategy means for them personally and develop specific action plans for implementing that strategy.

One aspect of strategy formulation that historically has been left out of the discussion is the determination of a specific method for conducting the merger transaction and the subsequent integration. Many corporate M&A departments perceive their domain to be exclusively that of secretly finding target companies and signing the deals. In our experience, however, this dated approach does a tremendous disservice to the organization. The most effective M&A functions we have seen take a much more holistic approach, working with the CEO's office and with people in organization development, HR, and the business units to map the entire M&A process, define specific roles and responsibilities, and manage the knowledge-capturing process. We cannot overemphasize the importance of accomplishing these tasks before the deal is started; once the proverbial train is out of the station, it is too late to effectively create and refine these process tools and expectations.

This phase of planning carries with it all the typical strategy issues and risks as they apply to the specific M&A context. The organization should evaluate in advance what the ideal target company looks like in terms of various factors, such as the following:

- What type of cost structure does the ideal target have?
- What market channels would this target provide?
- What kinds of organizational competence and capabilities would provide maximum leverage and the greatest number of synergies?
- Are there strategic customer accounts or market segments to be gained?
- In what global regions or countries can we build additional capacity through this target?
- What is the optimum capital structure?
- What are the sources for new acquisitions?
- Will the ideal target be a business operated as an independent holding (in the portfolio approach), or does the organization intend to integrate the business partly or fully into its day-to-day operations?
- If a joint-venture structure is to be used, what type of governance process and composition will ensure sufficient autonomy of the new enterprise while providing the parent company the desired degree of involvement?

Stage 2: Locate

After executive staff and M&A team members have set and clarified the strategic template, the search for desirable target companies follows a much more focused and logical path. Initial financial and operational analysis leads to initial conversations between executive staffs. Initial conversations lead to high-level identification of potential synergies by the deal team. With continuing interest from both parties, the acquiring company ultimately defines and submits the initial deal parameters, terms, and conditions as part of the letter of intent and the secrecy agreement.

Sophisticated acquirers have learned that it is necessary, at this early stage of involvement, to scope out many high-level recommendations and guiding parameters for the integration process and for the subsequent new organization (or, as we shall call the generic merged organization throughout this book, the Newco organization). Most letters of intent do an adequate job of describing the desired objectives and giving an overview of the proposed financial and operational aspects of the transaction. They include quite specific details on such items as the assets and business units involved, the equity positions of the parent company, the assumption-of-debt requirements, intercompany supply agreements, employee liabilities, taxes, technology transfer, indemnification, public announcements, and other essential terms and

conditions of the nonbinding understanding. However, equally clear agreement is just as necessary at this early stage regarding essential issues of integration, culture, and organization of the Newco (that is, new company), such as the following:

- *In the case of a joint-venture arrangement, the governance structure of the partnership and specific issues for approval, input, or advisory notice from the parent companies.* In one case, for example, governance issues were left undefined until late in the process of negotiating a definitive agreement. There were major differences in each party's expectations about the number of people, and the specific individuals, who would serve on the partnership's governance committee. There was also such substantial disagreement over the parent company's role in setting Newco policy, budgets, senior-level staffing, and other major issues that the deal nearly fell apart. As a result, early statements indicating that the Newco organization would be a stand-alone entity were reversed by the majority parent company's mandate that the new company be managed as a wholly owned subsidiary. Perceptions in the Newco organization also shifted, from excitement about becoming a freestanding entity to bitterness and open hostility toward the majority parent company for turning the deal into an outright acquisition.
- *The overall process to be used for determining top-level organizational structure and staffing decisions.* For example, organization A was process-oriented. This company preferred a competency-based selection process, with involvement from external management psychologists and board members, to develop consensus on the most qualified candidate for each senior leadership role. By contrast, organization B used a command-and-control approach, with minimal documentation. Selection was typically based on whom the CEO knew and wanted on his staff. The result of this difference was disagreement over the high-level structure and staffing process, which degenerated into a "swap meet" in which both organizations gained at least some representation, but not necessarily the best candidates for the requirements of the Newco organization. Within the first year of the Newco organization's operations, one vice president left abruptly over "cultural differences," and the CEO fired another for cause.
- *Agreement on the basic steps and provisions of the integration process to be used, including mutual participation, formation of key task forces, planning phases, and leadership roles.* Company A, for example, was an experienced acquirer with a defined process model for integrating new businesses. Company B, the

new joint-venture partner, was conducting its first major expansion. Assumptions made by both parties resulted in two different sets of expectations, created during extensive internal communications, about the announcement of the deal and the integration plans. Neither organization was willing to reverse its position overtly, and the “hybrid” integration process that resulted was dysfunctional from the outset.

- *High-level reconciliation of major discrepancies regarding executive compensation, employee benefits, and incentive compensation plans.* For example, company A was a traditional European employer, compensating executives with a relatively modest base salary and extensive perquisites. Company B was a progressive fast-growth company that relied heavily on stock-based incentives for managers. There were some early attempts to define high-level guiding principles and action steps for researching and resolving concerns about compensation, but management postponed resolution of these issues. As a result, company B abandoned a potentially favorable deal before either party was able to conduct an objective review of alternatives.

An important task of this phase is mutual identification of potential synergies. Historically, many organizations have undertaken this task with complete independence from the other party’s involvement, but this norm is now changing under pressure from the increasing difficulty of finding and executing an economically viable deal. As a case in point, one organization was recently pursuing a joint-venture partner for a low-cost, commodity-oriented business segment. Price premiums for several potential targets were high because of current industry margins, but the industry itself was beginning a global down cycle. The majority partner, rather than risk the losses that could have resulted from an assessment of what it alone perceived to be the realistic synergies, facilitated a brainstorming and planning session with a team composed of its own key managers and those of a potential partner. With counsel from both sides in attendance (as protection against the disclosure of any specific information, which would have constituted an antitrust violation), the parties mutually identified and validated twenty-seven “first pass” synergies worth an estimated \$80 million. Managers from the two companies, working together for the first time with their respective functional counterparts, creatively sought ways for the two companies to increase revenue and cut costs by combining their operations. The session attendees gained high-level agreement on key assumptions, exclusions, and terms of the deal that would be required in order

for these synergies to be captured. The result of this exercise was enough consensus for the deal to be made and for both parties to commit themselves to moving forward collaboratively.

Stage 3: Investigate

The third phase of the model relies on thorough due diligence to explore every possible facet of the target company, in as much detail as practical prior to finalizing the definitive agreement. The acquiring organization must therefore conduct due diligence in the financial, operational, legal, environmental, cultural, and strategic arenas. The due diligence team should summarize key findings for executives' review, and the team should identify any potential deal killers or "showstoppers." The management of the acquiring company uses due-diligence findings to set negotiating parameters, determine bid prices, and provide the basis for initial integration considerations.

A word of warning: given the fevered pace of merger activity, as well as increasing industry consolidation (such that organizations and executives know each other), there may be a temptation to hurry the fact-finding process, omit key parts of it, or gloss over it in the rush to do the deal. Resist this temptation. Much has already been written about the \$14 billion merger in 1997 between HFS, Inc., and CUC International, Inc., to form Cendant Corporation. Roughly four months after closing the deal, Cendant disclosed that it had uncovered massive accounting irregularities at the former CUC. Widespread fraud was alleged as two managers filed affidavits indicating that senior CUC executives had ordered CUC managers to "invent" as much as 61 percent of CUC's 1997 net income. The day after the allegations broke, Cendant's stock price slid 46.5 percent and knocked \$14 billion off Cendant's market capitalization. According to the *Wall Street Journal*, by August 1998 Cendant had lost another \$20 billion in market value, Cendant's chairman had resigned, investors had filed at least seventy-one lawsuits, and nine of fourteen directors who had come from CUC had resigned (Nelson and Lublin, 1998). This may be a particularly grotesque example of failure to exercise due diligence, but wise acquirers will rightly want to redouble their own efforts in this regard. Consider that a company's financial data are typically the most carefully scrutinized of all the preacquisition information that is reviewed; therefore, if errors of the magnitude found in the case of Cendant can be made when the validity of this information is assumed, it is important to ask where else the organization may be at risk from unsubstantiated assumptions:

- *Market.* How large is the target's market? How fast are specific segments growing? Are there threats from substitute technologies or products? To what extent is the market influenced or controlled by governments?
- *Customers.* Who are the target's major customers? What are their purchase criteria: price? quality? reliability? Do buyers of product X also buy product Y, and do they buy both through similar channels? Are there unmet needs? Are changes in buying behavior to be expected?
- *Competitors.* Who are the target's major competitors? What is the degree of rivalry? What are the competitors' respective strengths and weaknesses vis-à-vis the target? What barriers to entry exist for new competitors? How will the competitors try to exploit the merger or integration issues to their own advantage?
- *Culture and human resources.* Which key people must be kept, which core areas of competence should be retained, and how possible is it to do either? Are there major cultural discrepancies with the target? If they could cause major defections or other losses of productivity, is the organization willing to resolve them? If so, at what cost? What are the historical biases or expectations that must be dealt with before the acquiring company can gain credibility with the acquired company's workforce and inspire its confidence?

Missing the boat on any of these issues can be just as damaging as a discovery of fraudulent revenue-recognition practices. Only after the acquiring organization has conducted this level of detailed evaluation is an executive team adequately equipped to make intelligent decisions about the level of integration that will be required to achieve success with a specific deal.

In our work, we are frequently asked how to apply an overall method of integration to a particular type of deal (such as a joint venture or a small outright acquisition) or to a particular size and scale of transaction (such as the acquisition of a major global division of another company). The answer is almost always "it depends" because, unfortunately, few general principles are robust enough to be meaningful. Consider that for every fully integrated "merger of equals," we find another merged organization that is more effectively left as a separate holding company, and that for every "bolt-on acquisition" of an autonomous business division that is left to stand alone, we find another division that is more effectively integrated in full. Most experienced acquirers find that the determination of the desired level of integration depends less on the industry, the business cycle, the scale, or the type of transaction than on the specific business goals anticipated from the transaction,

the specific context and complexity of the target, and the risks or obstacles to integration that management must successfully address.

Exhibit 1.5 shows the approach that one acquirer uses in capturing the specific due-diligence issues for each new deal into a strategic decision-making process directed at achieving the key desired outcomes and the desired level of integration. With this approach, the M&A team and the cross-functional deal teams work together to plot, in the far-left column, the primary integration-related issues or areas to be considered. The process includes separate pages or sections for organization-wide issues, specific functional and process-related issues, and major opportunities for synergy. For each integration-related issue, the teams must identify specific strategic or cost-related business goals made possible through the transaction. Initial dollar estimates are encouraged; typically at this stage, however, they are not yet completely validated. On the basis of the strategic goals, the teams consider three broad categories of potential integration, and eventually they place each major issue into one of these three categories, to reflect the level of integration required for obtaining optimized results. Although many different kinds of categories and many definitions of integration could be used, this acquirer has discovered, over time, that these three tend to encompass most of the types of integration issues the company typically encounters:

- *Full integration.* All areas and processes companywide (or function-wide) are to be merged and consolidated. All management decisions for the acquired business (or function) will be integrated into the parent company's processes, with appropriate "best-practice" knowledge.
- *Moderate integration.* Certain key functions or processes (sales and marketing, for example, or manufacturing) will be merged and consolidated. Strategic planning and monitoring of the function will be centralized as an element of the parent company's processes, but day-to-day operations will remain autonomous.
- *Minimal integration.* Selected corporate and staff functions will be merged and consolidated, primarily to achieve staffing synergies and cost-efficiencies. All strategic and day-to-day operating decisions will remain autonomous and decentralized, with agreed-on requirements for reporting to the parent company.

In the far-right column, a deal team captures the risks and obstacles likely to be encountered. If the team anticipates any showstoppers or deal killers, they evaluate alternative integration scenarios or revise strategic goals to make them more realistic.

Exhibit 1.5 Strategic Integration-Planning Analysis

Integration Issue or Area	Desired Integration Objectives and Outcomes		Level of Integration Required to Accomplish Objectives	Risks and Obstacles to Achieving Integration Requirement
	Strategic	Cost Reductions		
Information systems (IS)	Use comprehensive enterprise-wide systems capability to replace multiple legacy systems		Full: must consolidate the two IS organizations into one and rationalize existing platforms and applications	<ul style="list-style-type: none"> • Negative synergy due to capital investment in years 1–3 • Target company's partially completed module, which now may be irrelevant • Different IS philosophies and approaches as complication in planning
Leveraging combined product portfolio to all customer accounts	Estimate 10–15% increase in gross sales	Staffing synergies from redundant regional sales leadership	Moderate: centralize marketing leadership and product support, with field sales force integrated and reassigned	<ul style="list-style-type: none"> • Timing: no full access to customer account, product, and price information until after deal close
Maximizing target company capability and market share in Division X	Gain immediate leadership position in new segment		Minimal: consolidate nonstrategic staff functions	<ul style="list-style-type: none"> • Must retain intact management team for division • Will likely require senior VP status for division lead, with direct report to CEO
Culture	Maintain primary characteristics of acquirer's culture while learning from target's strengths		Moderate: redefine core organizational processes in keeping with strategy	<ul style="list-style-type: none"> • Sales organization not perceived to be as customer-responsive • Very strong commitment to open communications with employees
Manufacturing	Leverage best practices	Purchasing efficiencies	Moderate: leave plant-level leadership intact	
Staff functions	Add M&A team resources	Potential economies through shared services	Full: consolidate headcount to corporate and shared service locations	<ul style="list-style-type: none"> • Current HR delivered through highly visible and involved field HR; no prior experience with other models

Stage 4: Negotiate

This stage includes process steps and requirements for successfully reaching a definitive agreement. Deal teams are briefed by due-diligence teams, and, together with senior executives, they formulate the final negotiating strategy for all terms and conditions of the deal. Considerations include price, performance, people, legal protection, and governance.

A particularly difficult aspect of many deals is the business of gaining agreement on the terms and conditions of transition services. Bridging arrangements are commonly provided by one organization to the other for various staff or functions, as a practical means of facilitating a more effective transition. For example, partner A buys payroll and benefits-administration services for the newly acquired employees during the first year, for an agreed-on fee for service, whereas partner B agrees to continue operating the technical-support function of a sold asset for six months, until the new function has been fully integrated.

Conceptually the task of bridging may be simple, but in practical terms it is immense. For example, one company reported getting “burned” on a recent deal because the deal team that created the services agreement had insufficient representation by subject-matter experts who used or provided the services being negotiated. The next time around, this company created cross-functional deal teams staffed with senior subject-matter experts who were able to stipulate the specific services that would be required and to analyze the various cost structures and fees that were being proposed. The company also established a high-level internal “peer review” so that the deal teams could have a fresh look from other subject-matter experts, to validate the service requirements and associated costs. Finally, subject-matter experts (such as actuaries) were used to prepare negotiating routines, conduct practice sessions for the negotiators, and, in some cases, attend relevant sessions of the final negotiations.

Stage 5: Integrate

The fifth stage of the model, as already suggested, should be customized to each organization and adapted to each specific deal. This is the actual process of planning and implementing the Newco organization’s processes, people, technology, and systems. In determining how to resolve the myriad issues that arise at this stage, the merging organizations must carefully consider such questions as how fast to integrate; how much disruption will be created; how disruption can be minimized;

how people can be helped to continue focusing on customers, safety, and day-to-day operations; and how best to communicate with all the stakeholder groups (shareholders, employees, customers, and the general public). We will discuss these and other integration issues in detail throughout the remainder of this book.

Stage 6: Motivate

The sixth stage of the model is geared toward maximizing the long-term value of the Newco organization. Once major integration activities are complete and most if not all of the projected synergies have been achieved, management's responsibility shifts to the demands of propelling the organization forward in order to achieve ongoing performance improvements. Long-term motivation of the newly combined workforce is a topic for other books (see Katzenbach 2000, 2003). However, suffice it to say that well-managed integration sets the stage for long-term workforce motivation and sustainable Newco success.

The Deal Flow Model represents these six stages as linear. When the model is applied, however, these stages are almost always interlinked. As a case in point, consider GE Capital, a well-known and successful acquirer of literally hundreds of companies. These transactions have resulted in a substantial increase in GE Capital's workforce, the rapid globalization of its businesses, and a doubling of its net income. To support this type of growth, the company has conducted a coordinated and continuing campaign to develop competitive advantage through its organizational ability to integrate and manage acquisitions. Ashkenas, De Monaco, and Francis (1998), writing about GE Capital, state, "Acquisition integration is not a discrete phase of a deal and does not begin when the documents are signed. Rather it is a process that begins with due diligence and runs through the ongoing management of the new enterprise."

