# The intelligent clean room: ensuring value capture in mergers and acquisitions

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Information about the authors can be found at the end of the article.

When Cingular Wireless and AT&T Wireless Services closed on their $41 billion merger in October 2004, the new entity hit the ground running. Training programs were launched, call centers were staffed with thousands of temporary customer service representatives to handle an anticipated spike in inquiries, and the two companies' IT systems were combined. And it all happened before the end of the first post-merger day of business.

How could so much be accomplished on day one? Credit exceptional post-merger integration planning and execution. The two companies had meticulously designed their *de novo* entity, starting shortly after the merger was announced and continuing for the eight months leading up to the close – all the while remaining in full compliance with US Department of Justice rules governing mergers and acquisitions (M&As).

Not all such transactions go so well – and the costs of a merger done badly can be enormous. A 1 percent loss in return on investment can lead to hundreds of millions of dollars in lost shareholder value. But mergers and acquisitions are hardly new; and most companies now have both M&A and post-merger experience. Why are there still problems capturing value?

One major reason is that in many ways the entire M&A process is becoming a relatively mature ''utility''; it is harder to create value by having a unique skill in valuation, post merger integration, or synergy capture. As a result, it is difficult for potential bidders to differentiate themselves through their bids (because companies tend to calculate similar synergies) or even via post merger integration (companies use similar processes and assumes similar ability to capture synergies). This is leading to the risky approach of creating winning bids by overestimating synergies and underestimating the complications of the post merger process.

A totally new way of thinking about the entire M&A process is needed, one that results in valuations, synergy estimations, and planning that are specific and unique to the acquirer, and that will ultimately result in the highest potential value capture.

Through our client work with more than 350 post-merger integration engagements during the past five years, as well as careful study of the larger M&A universe during that period, Accenture has learned what separates the best transactions from the mediocre (or worse) ones – and has developed a series of new tools and techniques for creating value in M&A. The most successful M&A transactions we have observed are characterized by the superior execution of an explicit value-capture strategy, which we call the ''lifecycle approach.'' To achieve this, top managements in the most successful transactions have relied on four key principles:

## Treat M&A as a holistic process

Many merger partners treat pre-deal and post-deal processes as discrete, often using entirely different teams before and after the transactions have been completed. This results

DOI 10.1108/02756660510597092

in vague accountability, unnecessary handoffs, and a disconnect between the valuation and the financial goals of post-merger integration. We have seen instances where the teams working on the synergy capture in the post-merger integration process had no idea what level of synergies were needed to recover the premium that was paid for the acquisition, making the chance of a successful deal remote. A more successful, integrated approach treats the M&A transaction as a lifecycle – a single, connected and integrated process – that begins with pre-deal strategy (goals, target identification, valuation), progresses through deal execution, and continues with post-merger integration.

A holistic approach can even help save a company money before a deal is struck. Bids are better informed because they are driven by downstream thinking and defined in terms of a target return on investment and the plans to realize it. And during execution, synergy targets are better aligned with the required premium. As a result, post-merger integration is focused on the key value-creating drivers that made the deal attractive in the first place.

## Focus on value creation, not just integration

In our experience, most acquiring companies focus their post-merger attention on bringing the two entities together as quickly as possible. Yet we believe that the goal of post-merger integration should be value creation, not just integration, and that post merger activities should be prioritized according to the value they create. For example, if the greatest value in a merger is cross-selling opportunities to the new base of common customers, as is often the case, the integration process needs to enable and ensure the rapid transfer of customer information and the development of integrated account plans. Lower-value activities can be postponed. This value-creating approach to post-merger integration is more akin to business transformation in its emphasis on unlocking value through meticulous planning and the process of proactively designing a new organization.

Many companies organize their post-merger integration activities on a functional basis rather than a value-added basis. While many functional activities must be consolidated (such as bringing databases together and rationalizing policies, procedures and IT systems), not all integration activities yield equal benefits. Blindly and aggressively integrating various functions and businesses without regard to a value-creating hierarchy can actually destroy value.

Consider the case of a $1 billion US technology company that had struggled for years before being bought by a much larger, more profitable company. The acquirer's merger team was astounded to find that the smaller company was sourcing and procuring many components for 10 percent to 20 percent less than the larger company. That unanticipated capability, incorporated into the parent company's business model, produced huge savings. Had the procurement function of the target company been dismantled to speed up integration, the capability and the potential value it represented would have been lost.

## Accelerate merger planning and execution

The period from the time the deal is announced through the first 12 to 24 months of post-merger integration is critical. Yet, for the top 20 deals announced from 1998 to 2003, the average time to close was ten months. National and transnational regulatory reviews, as well as intense shareholder scrutiny, increase the time from announcement to closure. Broadband provider Comcast announced its $72 billion acquisition of AT&T Broadband in December 2001, but it was not until November 2002 that the deal was approved to close. Lengthier reviews have a number of implications for the companies involved, all negative. These delays have direct financial impact. For an acquirer expecting to reap $500 million in yearly cost savings from an M&A transaction, a one-month delay reduces the net present value of the deal by more than $150 million (assuming a 10 percent cost of capital). A seven-month delay costs nearly $1 billion in lost value, or approximately $3.5 million per day. There are indirect financial repercussions as well, such as postponed business strategy implementation, diminished employee morale, and workforce or customer defections.

During Unilever's $26 billion acquisition of Bestfoods in 2000, senior management understood that there was value to be saved by setting a tight agenda to ensure the delivery of the targeted synergies. The acquisition was announced in June of that year, but required approvals not only from US and European regulators, each of which took about four months, but also from agencies in nearly every other region in the world, including the Middle East and Africa. The longest took nearly 18 months. In the interim, Unilever began to plan for day one following final approval, for the first 100 days of the merger and for post-merger integration. The plan focused primarily on communications and high-profile appointments. The plan for the first 100 days addressed operational continuity. In addition, Unilever developed parallel assessments for its functional integration needs and its business integration needs, then combined the two into a single detailed work plan. On the day the deal closed, all three plans were implemented. The Unilever approach produced, among other results, €100 million in synergies over and above stated targets – ahead of schedule.

BP used similar accelerated post-merger integration planning when it purchased Veba Oel AG in 2002. The company intended to take operational and financial control of Veba and apply BP policies across the new organization, avoiding business interruptions in the process. BP achieved major integration milestones on schedule and the synergies during the first year exceeded expectations. The company was able to achieve this using three tools: synergy project charters, integration contracts and internal audit reviews. The charters defined the overall scope, costs and benefits of each synergy project. The contracts were a formal commitment to the synergy plan and were signed by the business unit leaders and functional unit leads. Contract signing was considered the formal passing of accountability for achieving the synergies to the businesses and functions. In the internal reviews, auditors would assess the processes and governance structures to ensure the synergy goals would be achieved.

To systematically accelerate value creation, Accenture has developed an approach which takes advantage of the ''dead time'' between closing and delay to jumpstart the merger

### The intelligent clean room

Successful execution of the lifecycle approach to post-merger integration boils down to tactical excellence. One of the most effective M&A tactics is what Accenture calls the ''intelligent clean room.'' Earlier clean rooms were narrowly defined due-diligence mechanisms with which third-party experts could examine sensitive information on prospective M&A partners in a physically separate and legally isolated space. Rather than waiting until the deal formally closes, the intelligent clean room concept allows the detailed, side-by-side company analysis and integration planning before approvals are finalized. The analysis is done by third parties, not company employees, so the prospective merger partners can continue to act as competitors as required by US Securities and Exchange Commission rules.

Working within SEC limitations, the source and priority of many high-value synergy initiatives can be determined. Intelligent clean room processes can include the building of detailed financial models for assessing cost synergies on a business-unit basis or even a line-item basis, creating tools for tracking synergies, assisting the legal teams with regulatory findings, setting up post-merger governance models, and administering the overall project calendar.

For the Cingular Wireless and AT&T Wireless union, Accenture designed and conducted intelligent clean room pre-merger planning to capture maximum value in the critical first two years of post-merger operations. During the eight months from announcement to close, Accenture examined key aspects of the combined companies' business, modeled against value-capture objectives and assigned priorities. The process covered areas ranging from retail distribution to billing processes to advertising effectiveness.

The intelligent clean room for Cingular and AT&T Wireless was significant for its use of explicitly defined ''leading indicators'' – anticipatory metrics such as dramatically increased call center volume or product returns. One working (and ultimately correct) premise, for example, was that traditional post-merger integration timelines to integrate systems and fix problems would be too long if customer defections ran high. The Cingular-AT&T Wireless team made preemptive use of daily and weekly interim data to identify and address problems before they became serious issues.

### Best practices

Some of the best practices employed by M&A experts include lifecycle principles such as these:

- Create overlap in the teams responsible for transaction valuation and synergy capture. Nothing results in more accurate estimates of post-merger performance than having them prepared by the people who will have to achieve them.
- Define synergies around value levers and activity-based cost efficiencies, instead of functions (for example, by reducing supply chain costs by two percent, rather than having functions cut expenses by some arbitrarily prescribed percentage).
- Formally incorporate time-delay calculations into the valuation process, placing a premium on the anticipation and preemption of delays during the pre-approval process.
- Remember that systems and people seldom automatically scale up to a larger size. Use selective redundancy, doubling up or retaining executives in interim integration teams or as coaches in order to avoid unsustainable workloads.
- Consistently and actively ‘‘re-recruit’’ the best and the brightest of both organizations, to minimize the loss of key personnel during the tough integration work through painful organizational decisions.
- Avoid vague definitions of success and establish a post merger process that has a clear focus on measurable value creation. Create PMI goals that are easily understood and financially driven, and ‘‘bake’’ the synergy targets into the ongoing operating budgets of the business.

integration process. This approach is called the ‘‘intelligent clean room’’ (see the box) and it results in not only a tremendous capture in value from reducing the time to implement merger changes, but also a mitigation of the business risks inherent in any deal.

## Use culture as a value-creation tool

Accenture recently asked the *Economist* to survey senior executives and managers on the topic of post-merger integration. ‘‘Cultural differences and cultural resistance’’ were cited most often by respondents as the thing that surprised them most during the post-merger integration process. This confirms our own experience, which suggests that even some management teams that identify cultural fault lines early on in the M&A fail to incorporate their insights into the design of their post-merger integration.

There are exceptions. One global chemicals company captured value in a series of major acquisitions by using a consistent process to identify cultural intangibles, such as unwritten rules, in its acquired companies. It then compared the acquired companies’ cultures with its own to understand how employees would react to various situations. Based on this in-depth understanding, the company then created tailored change management programs. The chemicals company recognized that changing organizations can be stressful for employees. As a result, it consistently tried to make decisions on leadership changes quickly so that individuals understood their new roles. Because the company considers training and support to be critical, new employees spent up to 15 percent of their time in training during the first year after the acquisition. High-tech communication was key in helping new employees quickly feel that they were a part of the chemicals company. To this end, the company installed standard workstations with intranet access, videoconferencing capabilities and satellite links at its acquired companies, all within four months following its acquisitions.

The most successful acquirers of the future will see culture as a tool in three ways. First, they will look at cultural differences during the target identification and bidding phases, assess the potential impact of those differences, and incorporate their analysis into the valuation

**“The most successful acquirers of the future will see culture as a tool.”**

## How do we define success?

One might expect wide consensus about what defines M&A success: incremental cash flow returned in the form of increased shareholder value. But this is not the case. A recent survey of senior executives about how they measure M&A success indicated that only nine percent of them defined ''success'' as an increase in the free cash flow over the premium paid. More than 40 percent defined success in non-financial terms such as market share or portfolio expansion. While these are important goals, they are not measurable – and even if the company was successful on these measures, the deal could still destroy value. These non-financial strategic definitions are only valid if they have a financial basis and can be clearly translated into financial outcomes.

and bid. Second, they will try to avoid the pitfalls common during pre- and post-merger planning, and actively incorporate the elements of each company's culture that best support the desired combination. Finally, they will proactively use culture to create value through the use of high-visibility retention, promotion, termination and structural organizational design decisions.

## Conclusions

*Keywords:*
Corporate strategy,
Acquisitions and mergers,
Integration,
Shareholder value analysis,
Business performance

As more and more companies opt to supplement organic growth with mergers and acquisitions, the earlier stages of M&A transactions are becoming relatively mature, commoditized processes. Differentiated performance and, ultimately, successful mergers will increasingly depend on the later stages of M&A transactions. This will be particularly true of post-merger integration, where the relentless and accelerated pursuit of value creation is still underappreciated – and under practiced (see Figures 1-6 for further insights).

**Figure 1** Plenty of M&A activity is expected within a year

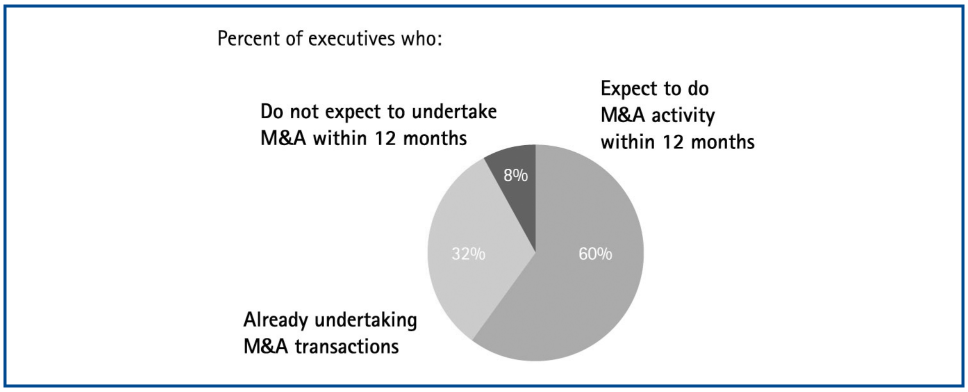



**Figure 2** Executives see M&A as part of a company's ongoing growth strategy and as a means to diversify and compensate for fewer efficiency gains

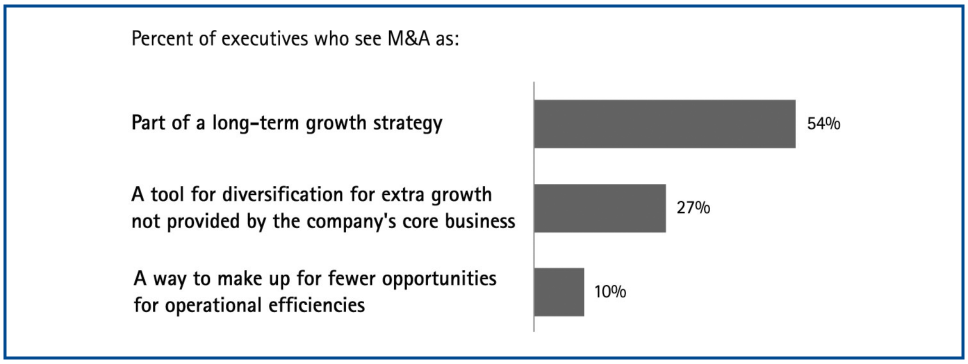


**Figure 3** Executives see revenue gains as the main source of value creation from M&As

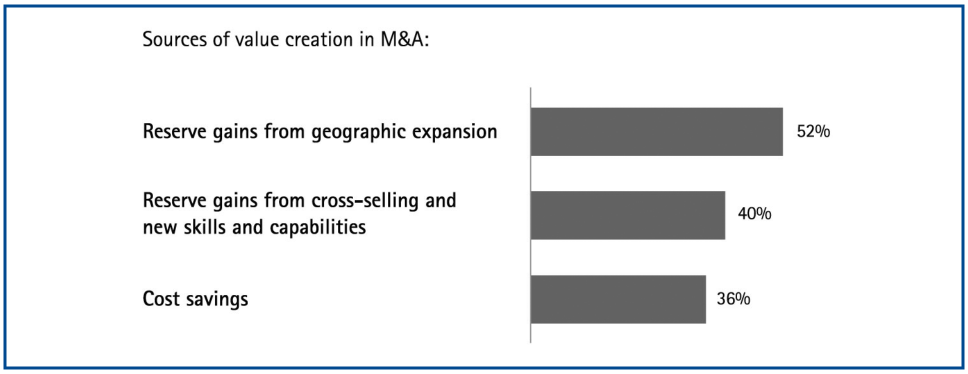



**Figure 4** Recent M&A activity has been considered by half the executives polled as successful

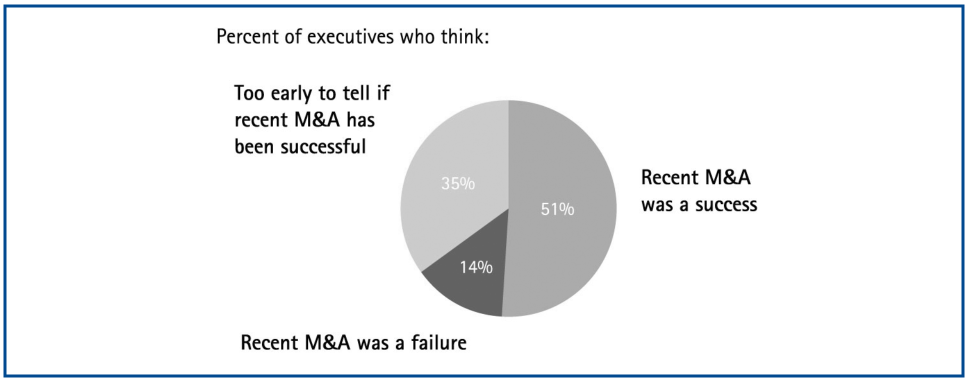



**Figure 5** Culture and the ability to adapt to change are critical to success

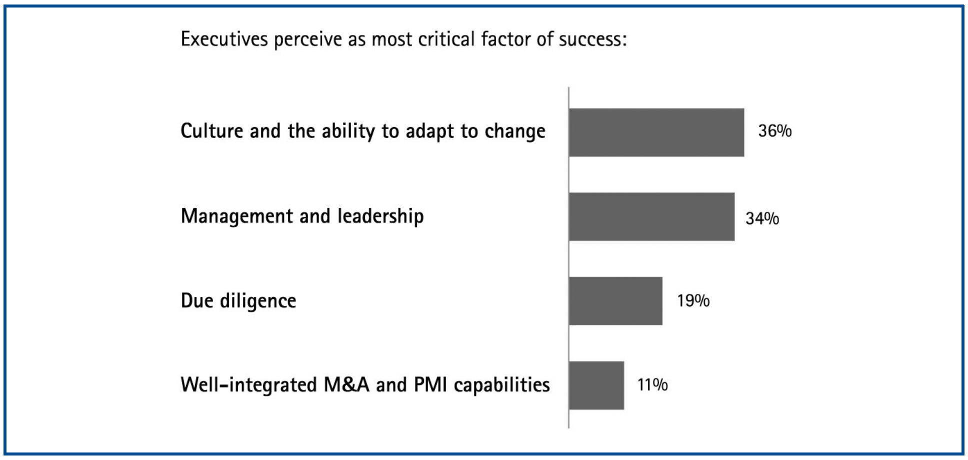
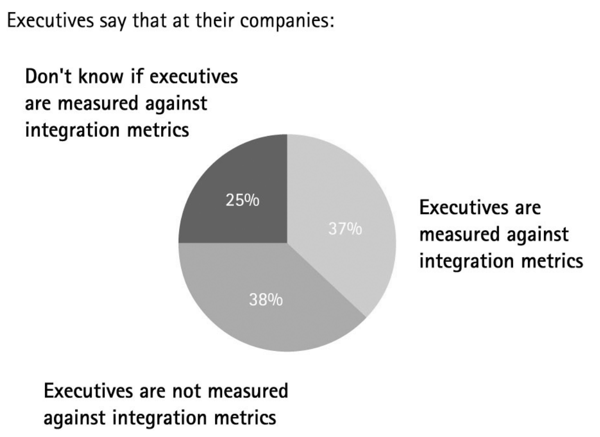


**Figure 6** Many companies still don't measure executives against integration metrics

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