

# Is Post Merger Integration Dead?

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Twenty years ago, few acquirers used a formal post merger integration (PMI) process to capture synergies and integrate operations. Their efforts typically were ad hoc. There also was little centralized planning: Decisions about when and how to integrate were made by individual business-unit heads or functional leaders. It also was rare for synergy targets to be established and tracked, and rarer still for them to be publicly announced.

Today, companies know that a rigorous post merger process is essential to capturing value from a merger or acquisition. And although PMI is still a challenge to execute, most businesses adhere to similar, "best-practice" PMI concepts and perform similar PMI activities. Among those key concepts are the need for an overall integration plan; the deployment of integration teams; the need to baseline and identify synergy targets; and the importance of upfront organizational design. Principal activities include creating team charters; conducting rigorous analytical assessments of integration options; preparing detailed implementation plans; and tracking synergies.

Paradoxically, this upsurge in PMI proficiency has a downside: Sophisticated acquirers can no longer differentiate themselves by excelling at "traditional" post merger integration. Simply put, they are unable to parlay strong PMI capabilities to justify higher bids on a target company because other bidders are also likely to have similar PMI skill levels.

This change in the typical acquirer's skillset is not surprising. Much the same thing occurred with valuation. Before the mid 1980's, companies used a variety of valuation methodologies, many of which were at odds with the goal of value creation. As a result, those with

superior valuation capabilities often could justify higher bids because they were better at understanding how to measure intrinsic value. Many valuation methods are still in use today, but there is widespread agreement that some form of discounted cash flow should be the basis for valuation. However, because most companies now use similar discounted-cash-flow valuation models, the range of target intrinsic values has narrowed. And to a great degree, this has curtailed companies' ability to leverage their valuation capabilities. In effect, valuation skills — like PMI—have become somewhat of a utility

The value-creation contribution of PMI also has been compromised by the growing amount of time it often takes for a deal to close. Long closing periods sabotage companies in a host of ways: Business strategies get delayed. Company morale suffers and many employees leave. Worse yet, many organizations adopt a "wait and see" attitude, which blunts decision making and blurs their focus on customers and the business in general. Savvy competitors also take advantage of an adversary's lame duck timeframe by making an example of the merged company's lack of clarity and stability.

### Dead or Alive?

If PMI is becoming a utility, and the opportunity to quickly capture synergies has been negated by long closing periods, does this mean that PMI as we know it is dead?

The answer is yes and no. As a way to create deal value, traditional PMI has expired. Companies no longer can assume that the post merger capabilities they bring to an acquisition have greater value-creation potential than those of competitive bidders. Of course, some skill differences will continue to exist.

But in general, it has become dangerous for bidders to assume that PMI acumen justifies raising bids.

However, as a necessary component of successful deals, PMI is very much alive. More than ever, companies must have a PMI process that ensures their ability to capture the synergies that made the deal attractive in the first place. In fact, the tighter bid ranges that PMI sophistication engendered also make it extra important that acquirers get PMI right the first time. Not only can small delays seriously undermine cash value, they also are acutely visible to the market, which (more often than not) punishes transgressors severely.

Increased PMI sophistication and the likelihood of rapid market retaliation mean that Wall Street now expects companies to achieve their synergy targets. In fact, it frequently expects companies to exceed their targets and become differentiated players overnight. A good example is Cingular Wireless' recent acquisition of AT&T Wireless. On the very first earnings call, Cingular announced that it was already ahead of its synergy targets—creating earlier than anticipated benefits for its parent companies, SBC and BellSouth. However, analysts questioned Cingular on its churn and new-customer growth.<sup>1</sup> Clearly, they were placing a premium on how competitive Cingular was going to be out of the gate against rival Verizon.

In a traditional sense, HP also did a great PMI job with Compaq. The former's stated cost-synergy target of \$2.5 billion was achieved a full year ahead of schedule. And in the end, the new HP delivered 1.5 times its initial synergy goals. However, the markets continue to be underwhelmed. They are focused on HP's ability to drive top-line revenue growth across its current and emerging businesses plus continue operating margin improvements.

## Reincarnating PMI

Does all this mean that companies can no longer create differentiated value from PMI? Not necessarily. But it clearly will be necessary to change how they think about merger planning. The mindset, in other words, will have to change from post merger planning to pre merger planning and post merger execution.

Simply put, tomorrow's most successful acquirers will act more holistically: They will position M&A as a single, integrated, lifecycle-focused process that begins with strategy (goals, target identification, valuation), progresses through deal execution, and concludes with pre and post merger integration. This coordinated, big-picture approach will bring high performance within reach by linking synergy goals to premium recovery; tightening focus on value capture rather than just integration; and maximizing synergy-capture through accelerated merger planning. Holistic M&A also will help companies do a better job of identifying targets and formulating bids. That's because they will be better able to recognize impediments to post-close integration and synergy formation – cultural differences and regulatory delays, for example.

Holistic thinking also removes the artificial separation between pre and post merger planning, making it possible for companies to conduct many traditional post merger planning activities before the deal closes. For example, acquirers cannot conduct business or make pricing decisions before approval and closing. But they can launch many of the planning processes needed to begin capturing synergies.

One important way to enhance and accelerate pre-close planning is to expand on the "clean room" concept—evolving it from a repository of raw data to an "intelligent" venue where

analyses of competitively sensitive information are done before, instead of after, deal closing (see sidebar). Set up with the right processes and controls to ensure compliance with government and exchange regulations, such clean room activities might include:

- Deciding which systems need to be integrated or decommissioned.
- Identifying opportunities for contract rationalization.
- Estimating savings from consolidations of physical assets.
- Determining how synergies will be captured.

Even without an advanced clean room, acquirers still should be working to complete a greater percentage of post merger planning activities before deal closing. Especially critical are plans for dealing with customers – not only communications, but managing the entire customer experience. Planning also could begin earlier to realign sales force territories, design and forge the right NewCo culture, and identify/retain the most desirable employees.

## A New Core Competency

Pre merger planning creates real value. For an acquirer expecting to reap \$500 million in yearly cost savings from a deal, speeding up synergy capture by one month increases the deal's net present value by more than \$150 million (assuming a 10 percent cost of capital). And that doesn't include the benefits associated with reduced customer turnover, better employee morale and fewer opportunities for competitors to attack the business.

So in the final analysis, PMI isn't really dead. But traditional PMI thinking must evolve into something else – something better integrated and more holistic. To make that happen, companies that understand

## The Intelligent Clean Room

Successful execution of the lifecycle approach to merger integration often boils down to tactical excellence. And 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. Accenture has updated the concept through the application of a value-capture perspective.

Rather than waiting until the deal formally closes, the Intelligent Clean Room allows detailed, side-by-side company analysis and integration planning before approvals are finalized. The analysis is usually done by third parties, not company employees, to minimize risk and to enable the prospective merger partners to continue acting as competitors, as required by US Department of Justice rules.

M&A's role in achieving high performance will reposition PMI as:

1. The integrated combination of pre merger planning and post merger execution.
2. A core competency, like strategy development, branding or marketing.

So instead of applying "dead thinking" (waiting for post merger integration), they will be focusing on "comprehensive merger integration"—both pre and post deal.

<sup>1</sup> According to a December 2004 interview with Stan Sigman, CEO of Cingular, the company will show "steady, continuous improvement to reach industry-leading metrics, including churn and margins, by the end of 2007."

#### **About the authors**

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