**Putting the "Art" Back into Post Merger Integration**

**by Bill Pursche**

*It's time to rethink some Post Merger Integration "Best Practices"*

Over the past decade, the 'perfect storm' of low interest rates, debt availability, private equity and venture capital, cash infusions from IPO's, and the perceived lack of organic growth opportunities have led to an increasing use of acquisitions as a bona fide growth strategy. As a result, the number of deals in the U.S. has grown from approximately 2000 per year in the 1980's and early 90's to over 8000 per year since 1998. And the deals are much larger, tripling in average size from 1983 to 2000; deals of over $1 billion are not only not uncommon, there were over 100 of them in each of the last 5 years. This growth in deals is not simply a US phenomena; in fact, the growth rate in deals is even higher in Europe and Asia.

Twenty years ago, many companies did not make acquisitions a key element of strategy; it was often an afterthought or episodic. Most had never made a large acquisition, and if they had done deals at all, they were few and far between. Today, the world has changed. Some companies do 25 deals *a year,* and others look to achieve 50% or more of their growth from acquisitions.

Yet even with this increase in the number of deals acquirers are still faced with this challenge: Now that they have bought something -- and presumably paid the 'right' price for it --- how do they capture enough value to make sure the deal is a good one? Increasingly savvy analysts, large institutional shareholders, and even individual stockholders are demanding much more accountability regarding the financial logic of a deal -- including expectations of specific information about cost and revenue synergies. And the wholesale failure of some large deals has brought even more scrutiny.



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There are three inter-related activities which form the defining elements of successful acquisitions: buying the right company, paying the right amount, and then capturing whatever value is needed to overcome any premium that was paid. The first is a matter of strategy, the second is (for the most part) one of technical analysis and due diligence, and the third -- the Post Merger Integration (PMI) -- is both an art an a science. A failure of any one will likely result in a destruction of shareholder value.

The great number of deals has fostered three changes in these activities. The first has been clearly positive: many of the transactional elements of acquisitions have long since become a science. These include the almost universal acceptance of cash flow and Net Present Value as a means of calculating value, the optimization of alternative financing and deal structures, and very organized and detailed due diligence processes. The second change has also been positive: the realization that the integration effort is crucially important, and that even the 'best' deals (buying the right thing, paying a good price) would fail if not integrated well. The third change has come about because there have been enough deals to establish a relatively standard process for integration and codify a resulting set of integration best practices. Unfortunately, the formalization of the process and the acceptance of standard best practices has good too far. The pendulum has swung all the way to a totally formulaic approach, and much of the 'art' of PMI has given way to a pseudo-science. Companies are using outdated approaches and are relying on rules of thumb and benchmarks far too often, and are not questioning commonly held beliefs and standards. This has led to the dangerous attitude of taking the integration activity for granted, and few companies are conducting the necessary checkups to review the quality and success of their integration programs.

This fundamental shift in the level of M&A activity requires a totally new thinking toward the entire process, but especially toward PMI. In short, it is time to reexamine many of the accepted post merger integration best practices.

## The best practices of tomorrow

The first change in thinking is to move away from the idea that M&A and PMI are two separate and totally distinct activities. The very name "post merger integration" is problematic -- while it technically describes certain activities which must take place post close, it leaves the impression that the all the preparation for the integration should wait until after the deal is done. It also implies that other critical elements of deal success, such as estimating the complexity and cost of the integration, the alterability of synergies, and the organization implications of the Newco, should only addressed after closing.



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In fact, the probability of deal success goes up considerably when the key elements of PMI are not only started before closing, but when the likely risks and challenges of the integration are considered *at the very beginning* of the M&A process -- when the acquirer is deciding what to buy and what to pay. All of the elements that affect PMI success, especially the culture of the companies, must be assessed and rolled into the synergy value (and price to pay) calculation. In essence, there should not be a separate M&A and PMI process, but a fully holistic approach to the deal, from strategy to target identification to valuation to integration. This involves looking 'downstream' at business core processes, and the nuts and bolts of how things work, and in getting the people who know how to design and implement changes to these systems and processes involved up front, especially during the valuation stage.[1]

The second fundamental mindset change that is required is to move away from only using business development and 'staff' people control the deal and the integration process. This is a corollary to having an holistic acquisition process. By far, the most accurate way of estimating possible cost synergies is to have the people most familiar with the areas where the synergies will come from do the evaluation of revenue gains, cost savings, timing, and possible issues. And the most successful acquirers have the people who will actually be responsible for capturing the synergies do the estimating. Nothing focuses managers more around the specifics of the goals than knowing they will be responsible for achieving them.

The third major change in thinking must be that PMI can no longer be thought of only as a 'scientific' or operational process, but must instead be customized to each unique situation. Ten years ago, formalized PMI processes were still in their infancy -- few companies had done enough deals to really understand what really made for a good integration process. Now the pendulum has swung, with some companies -- and consulting firms -- relying on 'cookbook' approaches to integration, with detailed steps that are to be followed in a very specific order. The thinking seems to be that any deal can be 'made to work' if an exact approach is used. The reality is that while there are many common elements to integration execution (and common pitfalls to avoid) each deal has its own complexities and idiosyncrasies. These include differences in the timing needed to achieve synergies, whether synergies are cost or revenue based, the delays due to regulatory approval, and the degree of overlap in geography and business practices. Instead of using a 'one size fits all approach,' the integration process must instead be customized to the specific transaction. The new best practice is to have an organized and logical approach which includes all of the necessary steps and activities but which is flexible enough to match up to the unique requirements of the deal. The approach should be modified to fit the deal, rather than the deal being forced into the approach.

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New thinking will lead to new best practices. These new approaches will help acquirers take advantage of all the has been learned about PMI and therefore avoid reinventing the wheel every time a deal is done -- but at the same time, leave room for the 'art' of customizing the integration approach to the only deal that matters -- yours.

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Bill Pursche has been advising companies and senior executives for over 25 years. He has been involved in over 300 M&A and PMI efforts in a variety of industries and geographies, including numerous cross border deals. He is regarded as one of most knowledgeable experts in the world in Post Merger Integration and synergies.

Prior to his work with First Call Advisors, Bill was a Partner at McKinsey & Company, Inc. where he led McKinsey's worldwide Post Merger Management Group. While at McKinsey he also founded and led its Mergers and Acquisitions Group (M&A), and its Turnaround (Operational Profit Improvement) Group. His next book *Synergies: The Art and Science of Making 2+2=5* will be published in 2009.

[1] For a more detailed discussion of the holistic nature of the M&A process, and especially how synergy calculation and integration need to be a fundamental element of the early stages of the deal process, see *Building Better Bids: Synergies and Acquisition Prices*, by Bill Pursche. Chief Financial Officer USA (1988).



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