The two most common pitfalls of post-merger integration

Why the majority of M&A deals destroy, rather than create, shareholder value and how to buck that trend

Mergers and acquisitions (M&A) form a key component of many companies' growth plans. Accordingly, the global market for deals is bustling and immense. In 2012 – a relatively subdued year compared to most of the preceding decade – there were more than 12,500 transactions around the world totalling nearly $2.2 trillion in value, according to Mergermarket.

The 10 largest acquisitions in 2012 were executed by corporates, rather than by financial investors such as private equity firms or sovereign wealth funds. Undoubtedly, these strategic buyers were looking to create value from their acquisitions by realising efficiencies and economies of scale. Management teams all strive to ensure that M&A transactions create value for their companies, but they all too frequently fail.

Academic analyses dating back to the 1980s have consistently found that mergers and acquisitions more frequently destroy value than create it.[1] In 2011, the Cass Business School in London added to this body of research with an analysis of UK M&A activity.[2] It found that some firms with successful acquisition strategies do create significant long-term value for their shareholders. However, these firms are in the minority; most companies fail to realise efficiency synergies and actually see a decrease in profitability within three years of an acquisition.

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Many theories have been advanced to explain the poor track record of M&A deals, including poor planning and due diligence, loss of key personnel and customers, clashes of company cultures, power struggles and management hubris, and lack of relatedness between the merging firms. Despite the scores of management textbooks and analyses written on the subject, The Highland Group has found from its extensive experience helping clients successfully navigate the M&A process that the most common merger problems can be distilled down to two linked factors: operations and people.

PEOPLE

The people problem is largely a result of the uncertainty that M&A creates. Ambiguity can arise from many sources. Many M&A deals derive synergies from reducing costs, and this often involves layoffs and new working patterns. Line management may also change, resulting in the fracture of existing working relationships. Although some uncertainty in the face of change is inevitable, when fear and confusion are drawn out, they may prompt the best people in the company to leave for jobs elsewhere.

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If critical customer relationships walk out the door with departing key personnel, these losses can be devastating. When a mass exodus is combined with headcount restructuring without proper consideration of the impact on operations, large disruptions may occur. These may result in inefficiencies, fire-fighting and deteriorations in quality and customer service.

OPERATIONS

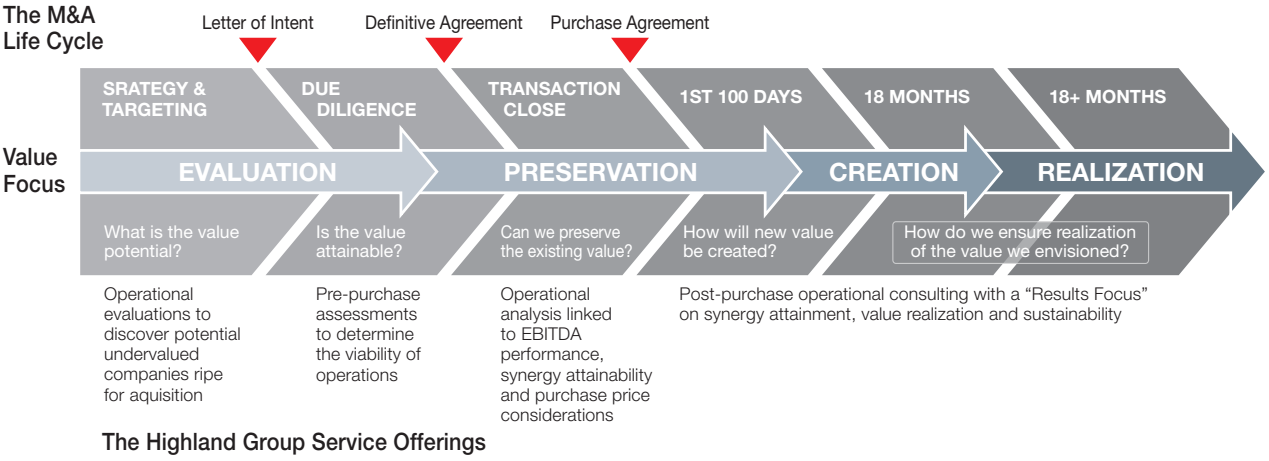
Given the damage that uncertainty can create in a newly acquired business, it is critical to complete the operational integration work as quickly as possible. Once the future-state model has been achieved, people can settle in to their new roles and focus on continuous improvement. From our experience in working in the acquired companies of our clients, we have found that accelerating the integration of acquisitions is therefore critical. It is important to create and widely communicate a target vision of the future state of the rationalised company, together with a bottom-line benefit target. Equally critical is development of a clear implementation plan for actually achieving this vision, whether that involves headcount reduction, more streamlined processes or waste reduction across the supply chain. Sustainability of the future state can then be achieved by the implementation of a robust System for Managing in which everyone understands their new roles, where they fit and the value they bring to the wider organisation.

References

1. For example, Dyer, Kale and Singh 2004, Marks and Mirvis 2001
2. "The Economic Impact of M&A: Implications for UK firms", M&A Research Centre, Cass Business School, 2011

Time and again, we have found that only by considering both people and operations holistically can an acquisition be integrated rapidly and with full achievement of the expected benefits. A wise management team is one that understands that the value-creation work begins – not ends – when the deal closes.

Accelerating Merger & Acquisition Value Realization – An Overview of The Highland Group's Approach



CASE STUDY – Post-Merger Integration Subsidiary Turnaround

As the body of academic research shows, there are more examples of failed post-merger integrations than successes.

In 2012, The Highland Group was invited to lead the turnaround of a subsidiary company of a global food manufacturer. Although the acquisition was completed years earlier, the acquirer had failed to act quickly and implement new ways of working. As a result, the subsidiary had been lossmaking since the acquisition despite several attempts to improve the business. The client had consequently been considering divesting the subsidiary.

When our consultants arrived, they found that no System for Managing existed, meetings lacked structure and accountability was unclear. As a result, low factory operating efficiency and fire-fighting were pervasive. Moreover, the engineering organisation, which was responsible for maintaining the manufacturing assets, was dysfunctional. Unplanned breakdowns were therefore common, which compounded the operating efficiency problem. Given the issues in manufacturing, the company attempted to maintain reasonable levels of customer service by growing its inventory of finished goods. As a large proportion of the company's product was sold frozen, the additional storage cost a significant amount annually to maintain.

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The Highland Group established a number of cross-functional workstreams to tackle the issues in manufacturing. Our consultants employed several tools to drive up OEE (Overall Equipment Effectiveness) and reduce unplanned breakdowns of the manufacturing lines. They improved the maintenance organisation and installed a schedule of preventative maintenance. In addition, they implemented a set of key performance indicators, which were displayed on live performance boards. Most critically, the team implemented a robust System for Managing to ensure clarity of roles and responsibilities and ensure sustainability.

As a result of this project, manufacturing was stabilised – while raising OEE from 68% to 80% – and third-party warehousing of excess inventory was minimised. The project brought the subsidiary back into profitability, delivering an additional annual €5.6 million to EBIT for our client and ensuring the survival of the business.

The Highland Group is a global operational consulting firm committed to delivering measurable financial results for its clients. Founded in 1990, the firm serves industry-leading companies around the world from its offices in Europe, North America, South America and Africa. The Highland Group's senior professionals bring extensive business experience from a wide variety of industries and disciplines, including cost optimisation, engineering, maintenance, sales and marketing effectiveness, shared services, working capital management, supply chain management, finance and accounting, private equity value creation, warehousing and distribution, organisational development and more. The firm's collective expertise, combined with its "needs-based" approach, ensures solutions are custom-tailored to help its clients meet their goals and realise their full potential.

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