Contents

1 Foreword

Acquisitions and mergers involve much excitement, a lot of adrenalin, high emotions and tremendous opportunities: Opportunities to create value and to destroy it. They are rarely friendly transactions, at least at 'the end'. Egos and 'rose-tinted glasses' can prove to be major risks that can lead to serious issues down-stream. Directors and senior managers involved in the process of deals should find this an interesting read, they may even recognise themselves.

It is possible to achieve the expected results, and add-value, with the right mix of;

- calm, business like attitudes
- thorough analysis
- attention to detail and to the risks
- solid objectives
- plans for the short, medium and long-term
- a style that is appropriate to the situation

Sadly, if any one of the above is missing then the value-added will be eroded, and value could be destroyed. This may happen quickly or over many years.

This paper captures Bill's experience of 'acquisitions and mergers', which also holds many lessons for 'commercial partnerships' as well. It reflects on 30 years' experience of different types of change. It focuses on the managerial and change management aspects of the process rather than on the detailed development of business cases and financing.

Bill's style of "*leading from the back*" and helping clients "*understand 'A' and define and attain 'B'*" are equally relevant to acquisitions and mergers as they are to any change programme – it's just that the stakes are typically higher, the environment more volatile, the scope broader and the risks bountiful!

For more information or advice about 'successful acquisitions and mergers', or to discuss specific projects or issues please contact; Bill Pearson, Director, Pearson Management Consultants on 07387 159676 or e-mail bill@pearsonmc.uk.

2 Why acquire or merge, or for that matter divest?

2.1 Acquisition and divestment

Any acquirer has to have a clear, business objective – and it should be the over-riding one no matter what else is driving it. The objective should be the return on investment measured as the return on the capital spent not only on the acquisition but also including any investment or cash that is invested post-acquisition as part of the long-term plan: It can also include the 'exit multiple' that will create the return in the longer-term when the business is sold on. Often it is more esoteric, emotional, vision driven reasons that drive an acquirer; the sole pursuit of which can lead to poor deals: Deals that cost too much, drain energy from the base business of the acquirer and ultimately destroy value and potentially lead to closure or failure.

There are, however, many reasons for an acquisition that should individually or collectively contribute to the over-riding objective

- access to a new geographic territory
- exploiting the combined customer base of two complementary but different sets of products or services
- access to new technology, products, markets, market channels or service-lines
- removal of a competitor
- using spare, or raised, capital to grow a business 'in-organically'. This can be a defensive action fending off an acquisition by another party of the acquirer – which may be counter-productive to value creation
- using spare capacity, usually the acquirer's, to absorb all or part of the work of the other thus improving productivity and hence profitability

The reasons for divesting can be many, here are a few;

- retirement or 'stepping down' of the major owner / shareholders
- refocusing a business on its core activities by divesting 'non-core' ones, including breaking up a business on acquisition retaining only those parts of real value
- selling off an under-performing business or assets to focus capital on more profitable ones
- being sold by a receiver following a bankruptcy – which isn't a divestment but post-deal leads to many of the same activities as an acquisition
- as the final conclusion of the original 'acquisition strategy' when owners feel they have added all the value they can, have optimised its potential 'price' and are seeking to release equity for new opportunities or personal gain. This can be owner managers, private equity houses or a mixture of the two as well as corporate entities.

A divestor is likely to be seeking to maximise the value placed on the business and hence its price, while an acquirer will be trying to pay as little as possible. So, the objectives of the two parties have to be considered, partially at least, in conflict. This can add to the tension.

2.2 A merger

Mergers are rarer and generally more complex. Entities merge to achieve much the same as listed above for an acquisition, but the post-merger balance of power and decisions over exactly how the impact of the merger may affect each party have to be decided. This can be a difficult process, even a game of chess, but ultimately a stronger business should emerge if the right decisions are made. And the risks of merging two different cultures should not be under-estimated.

3 How to approach an acquisition or merger

The simple view is 'professionally'.

3.1 The deal makers

Larger companies tend to have a small team, or an individual, in their corporate HQs focused on acquisitions and divestments. They are usually reporting to the Director who has responsibility for Strategy. In this environment, it is likely that a 'watch' is being kept on potential targets and strategic analyses such as SWOT, PEST, PESTLE etc are being undertaken and updated. Often the 'climate' of a sector will also be under scrutiny. When the timing is right a move may be made. This situation often arises with quoted companies and there are regulations around communication and share-holder information.

Medium and smaller companies will not typically have these 'strategic' resources within their businesses. Senior Directors or managers tend to have the subject of 'structural' changes thrust upon them – often in an ad-hoc manner as situations arise.

Where a Private Equity partner is involved it will have access to the required resources and, as it is usual for them to be involved with funding and benefitting from a deal, they usually take a lead role in the process of acquisition.

But all of the above are just the deal finders, deal speculators and/or financiers. Their work is often 'Private and Confidential', and is the precursor to potentially years of post-deal effort. Deal makers have one basic goal – a good deal. This is hard, detailed work that can become all consuming. It can preclude the preparation work for the short, medium and long-term plans – with these being replaced by some assumptions in a financial model.

3.2 Due diligence

If the buyer has paid for, completed and assessed an in-depth process of due-diligence, then there are likely to be many queries and potential reservations. The advantage with this is that the buyer is going in to the closure of the transaction with 'eyes-wide-open'. This typically creates some post-deal priorities based on a 'good' understanding, and hopefully mitigating some major risks that could unravel some of the value – which has hopefully been factored in to the business case and the price!

In many cases though acquirers go in with 'eyes-wide-shut', trusting to their own cursory due-diligence and any that is a pre-requisite of any external financiers. This due diligence is typically of limited scope focused on the value and ownership of assets and the nature of contracts; commercial contracts, property ownership and leases, working capital and cash, debtors/creditors, and major liabilities e.g. pensions. Work to assess these can involve the minimum of 'visibility' of the acquisition process – often being completed in a 'code-named data-room'. Often little, or insufficient, due diligence is completed in operational areas, skills and capabilities, customer satisfaction, capability of information systems etc which require a much more 'visible' and 'forensic' approach – which may be undesirable: It can unsettle staff, unions and potentially the market.

Mergers by the nature of their more 'mutually appreciative' beginning can tend to be more analytical in the preparation stage with more information being exchanged. However, in situations where two competitors are considering a merger care is taken in sharing information that could be of use to one of the parties should the deal fail to conclude. Legal protections can be placed around this subject but companies will still tend towards caution until a 'point of no return' has been passed. The process also has to be compliant with relevant anti-competition legislation.

3.3 Build and test to destruction a cash-flow investment model of the business case

Cash-flow models are an invaluable tool. They enable the impact of assumptions on cost savings and business growth to be scaled and phased. They force the consideration of the incremental ongoing costs and the size and timing of one-off costs and benefits that the post-deal business will require or deliver e.g. investments, redundancies, income from asset sales, grants.

It is good practice for someone who is independent to the deal to build the cash-flow model. Someone who isn't tied in to the process of the deal. An experienced transformation manager who can add-value to and challenge the assumptions.

Once a base case model has been developed that shows the financial results;Internal Rate of Return, Return on Capital Employed, Net Present Value, Incremental EBIT, Payback time; it should be test to 'destruction' – that is what parameters or combinations of parameters could bring the financial case down. Sensitivity parameters are typically; costs increase 25%, benefits decrease by 50%, these two combine, benefits occur one year later, the three combined. A table showing the resulting financial parameters should then be reviewed. The risks and issues that could drive these deteriorations to the plan should be reviewed and mitigating actions proposed. Where these actions include additional costs e.g. incentives to staff they should be added to the base case. The Directors of the acquiring business and any financial backers then consider the risk/reward balance. Their eyes are 'wide-open'.

3.4 Build an Integration team and approach

The approach adopted to the pre-deal activity of deciding whether to buy/sell or not has an impact on the preparation process for post-deal activity. Experience suggests that once a deal is looking to be a 'dead cert' that an Integration Manager should be appointed by the acquirer, or jointly by merging companies. Depending on the scale of the deal there may need to be a small team assembled. A few weeks before 'closure' of the deal the Integration Manager and the team should start to prepare the Programme Plan and Work Breakdown Structure of projects that will be required. The scope and objectives of the Programme should be aligned with the business case and assumptions of which it is comprised and the assumptions about the costs should be clearly stated with the overall cost of implementation (excluding deal costs) forming part of the decision-making process about the deal.

The Integration Manager should also complete, or be party too, a thorough assessment of all of the risks and opportunities. And the actions associated with these should be embedded in the overall plan. An ongoing review of risks and opportunities should also be scheduled led by the Integration Manager. Eyes may have been wide-open but consideration of what can/could/could still go wrong keeps the feet of the excited deal makers firmly on the floor.

4 Pre-deal planning

At some point the lawyers, financiers and parties involved in the deal will start to target a 'deal date', or 'day zero' as an Integration Manager views it. Usually at midnight on this date the business' ownership will transfer or merge. Usually there is around two weeks' notice of the 'first' deal date, or 'zero day -14'. Often the deal is delayed – with negotiations taking longer than planned.

There are some priorities that need to be considered for day zero and the few days following it. Preparation for, and approval of these actions occurs progressively from day -14 to day -1.

- Communications need to be prepared and agreed for the main stakeholder groups which may comprise; the stock exchange, the employees of the businesses, customers, suppliers, Unions, national and local communities, Government agencies, the press.

- If consultation processes are going to be required with employees, which is frequently the case, they need to be prepared for. Who leads? What are the escalation routes for issues? What are the company's proposals, what would the impact be? Is any documentation required for Government e.g. HR1 – notice of redundancy in the UK. Are employee representatives in place or will they have to be appointed? Are redundancy policies and integration incentive plans understood, or at least are the assumptions documented, and are estimates of their cost included in the business case?

- Who are the key customers or users and suppliers? What messages are to be given, by whom and when. Are there any contractual issues that need to be managed and closed out in the days following the deal?

- How will the integration project be launched? How is it affected by the above processes?
- What is the process for finalising the organisation chart of the resulting business? How does this align with, or is driven by, the consultation process?
- Are there any break-clauses or notice periods in any key contracts e.g. property, fleet, customer or supplier contracts that have to be dealt with quickly post-deal

All of these items along with any mitigating actions for the major risks should be logged, accountabilities and responsibilities agreed and they should form part of the overall integration schedule. Typically, a day by day plan is prepared with day 1 and 2 becoming hour by hour plans to ensure that logistically, tactically and legally, the required steps are actioned in the correct sequence.

The approach for managing the integration process should also be agreed; project teams, steering board, escalation routes and authority levels. The lack of a clear process, defined up front, can cause chaos and poor decision making in the hectic days following a deal when adrenalin and emotions are high. Mistakes can be made, sometimes costly ones, if this is not addressed clearly up front.

5 Post-deal 'value preservation'

The Integration Manager should be able to manage the immediate post-deal activities like a 'conductor of a symphony orchestra' or as 'the leader of a military operation', to coin some phrases. If the immediate post-deal activity is 'like herding cats', to coin another phrase, then value will already be being destroyed.

That isn't to say there won't be the odd 'wrong note' or 'misfired gun' – there will be: We are dealing with people post-deal. Lots of them. Individuals, teams, sites. Employees, customers, suppliers. And the one thing for certain is that people rarely behave as you would like them too when under stress. And a post-deal period is stressful. People don't like change and deals cause lots of it, some real, but a lot made up. Where 'fact' and 'clarity' are missing 'rumour' and 'dis-trust' will thrive - *more value being destroyed.* Once a post-deal activity has gone off the rails it is difficult, if not impossible, to rein it in. And the impact will be felt in the acquired and acquiring business. People in both entities are capable of rumour generation and dis-trust.

To preserve the value in the immediate days post 'day zero' the managers of the now 'single' business should

- Have prepared a plan and been following it
- Review those risks that have a forecast 'impact date' within the days following day zero and make sure that they have been mitigated, or that suitable corrective actions have been implemented

- Be visible and approachable, with eyes and ears open and communication being derived from the same 'hymn sheet'
- Ensure that employees identified as 'key' in the acquired and acquiring business have quality time with whoever they feel they need to speak too
- Follow and be compliant with all laws; contract law, employment law, financial regulation
- Have met, and explained the rationale for the deal with those individuals and entities that make up the bulk of its sales and those strategic suppliers to whom they are beholden on to provide them with goods and services
- Have met with employee representatives and explained the rationale for the deal and the proposals for the business. This may be the start of legal consultation on restructuring

But above all managers need to be professional, do what they promise to do and 'be there' for their people (I deliberately didn't type employees as in the period immediately post-deal business can take on a very surreal, 'human' focused period).

6 Post-deal 'shock'

While the managers are busy '*preserving value'* – hopefully in a controlled manner - there is something else going on: 'Business as usual', or potentially 'unusual'. If its 'unusual' then more value could be being destroyed – especially if it negatively affects customer loyalty. But putting that to one side – business as usual is potentially enough of a problem.

The acquiring managers will most likely have already been less focused on their own business for several weeks, or even months. Performance could already have been dropping off: *More value slipping away*. So, when the deal is done – which most people won't have known about but may have guessed, or started rumours about – *yes more value leaching* ! - they might expect that their seniors will return and life can get back to 'normal'. Except that often isn't the case. In acquisitions, the senior managers of the acquired business may have left as the deal was signed. The acquiring managers now have two businesses to run. That is unless they had a plan, have executed it, and management positions have been filled quickly – *preserving value*. If this hasn't happened then they are spread across two businesses – one of which is new to them and will require a lot of immediate attention. Let's say that post-deal 70% of their time is in the acquired company and 30% in their original business. This is dilution of senior management – a risk that has become an issue, potentially *destroying value*. And don't forget travelling time and the fact that the 70% has probably been long, stress filled days. Mistakes will be made. Deadlines will be missed. Satisfaction of employees will fall.

So, the 'shock' that acquirers have to be well prepared for is the dilution of their time, the effort they will need to put in and the impact – or *lost value* – that this could lead too.

With a good plan this can be averted, and even turned into a positive. Acquiring managers need to;

- appoint and trust a high quality, experienced, Integration Manager
- consider their 'number twos', take them into their confidence as much as they can or need too, ask them to 'step up' – even for a short period – give them authority, trust them and reward them
- consider as part of the risk assessment the 'shock' that may occur and put actions in place to mitigate it
- ensure they aren't on holiday! (seems obvious but you would be surprised!)
- explain to their families and dependents what is coming up and apologise in advance – I'm sure divorces have been triggered by post-acquisition trauma
- discuss and agree how to work together and to support each other through this phase and to put in place pre-agreed thresholds above which the situation would be deemed untenable and have a reserve plan ready to implement

7 Summary

Acquisitions and mergers can be, and often are successful – many however do not create their full value or return. Thorough analysis pre-deal, the preparation and testing of an investment case, good planning pre-day zero, preparation for post-deal shock and using an Integration Manager to provide independent, challenging, but aligned support all contribute to an increase in the degree of success. Assessing risk and opportunities to preserve value is a measured way of viewing the potential impact of an acquisition on the acquiring business, the one that is being acquired and the leadership team that has to bridge the two.

8 Contact

For more information about creating successful acquisitions or mergers or to obtain advice on specific projects or issues please contact; Bill Pearson, Director, Pearson Management Consultants on 07387 159676 or by e-mail at bill@pearsonmc.uk.

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