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Seven Catalysts for Merger Integration Success

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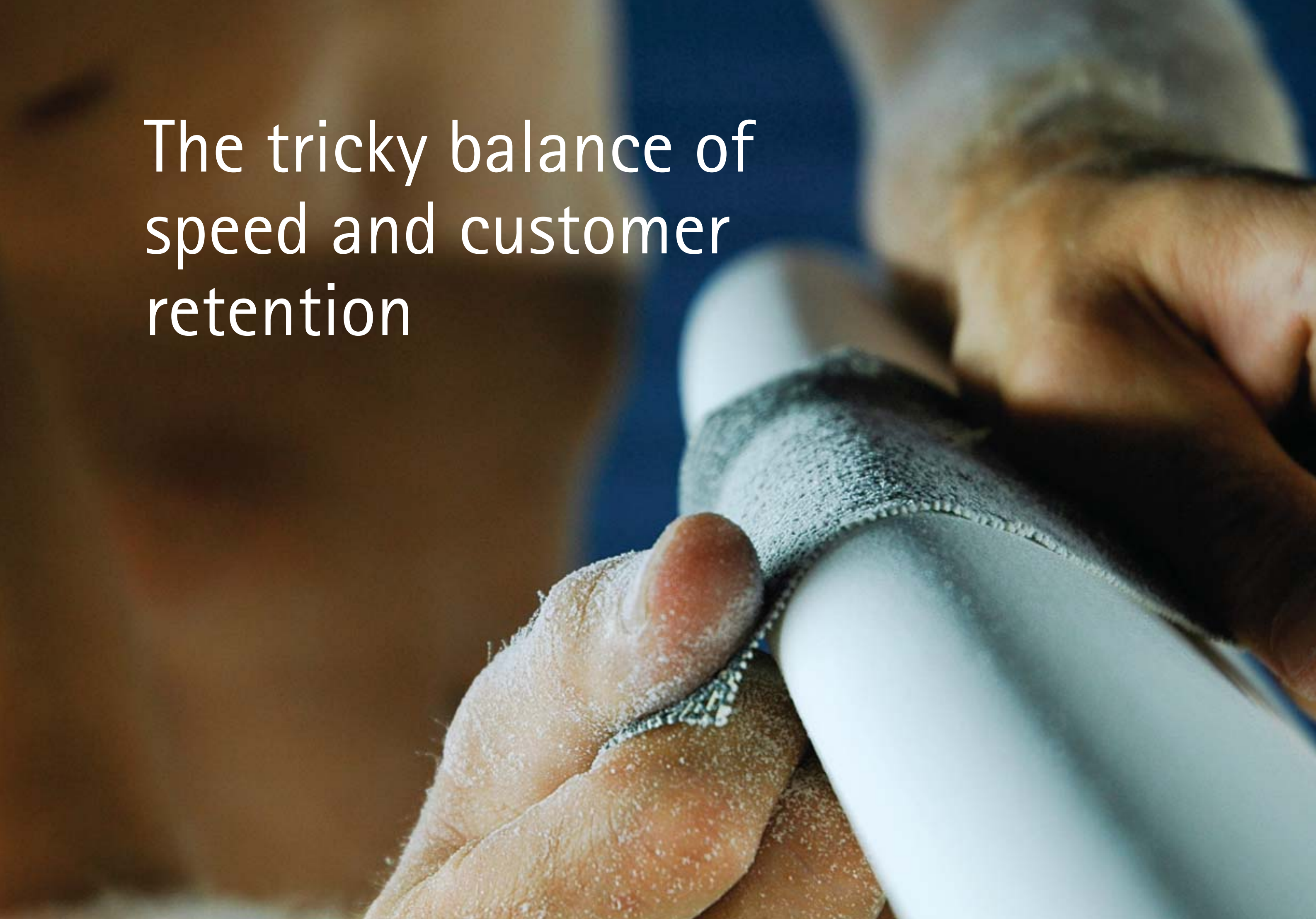
Merger integrations are always challenging, but the current global marketplace represents challenges few have seen before. Over the past several years, mergers have increased steadily in value and complexity. Yet today's uncertain economic environment makes it increasingly difficult for senior executives to focus on both running current operations and integrating an acquired business. Furthermore, the inherent complexity of integration is increased by the cross-border nature of many of today's deals. In short, merger integration is hyper-challenging in a time when deriving synergies is critical to many firms' financial stability.

Take the financial services industry as an example. Global financial services mergers and acquisitions significantly increased in volume, deal value and cross-border activities between 2002 and 2007. During this period, the average number of deals per year increased almost 100 percent from 62 to 122. During the same period the total transaction value grew by more than 400 percent from $89 billion to $381 billion. And the percentage of M&A deals worth more than $500 million that were cross-border rose from 16 percent to 40 percent.[1]

Perhaps, then, it is no surprise that approximately 50 percent of M&A deals result in "partial" or "substantial" value erosion[1] mainly due to problems encountered during integration. In other words, the chances are that one in two integrations will fail. Value creation is dependent upon effectively tackling the challenges posed by a number of factors ranging from overall macro-economic conditions and cultural differences to the operating model of the newly formed entity, time available for integration and newly acquired customer base. Ultimately these challenges must be managed both expediently and with full focus on customer retention.

The tricky balance of speed and customer retention



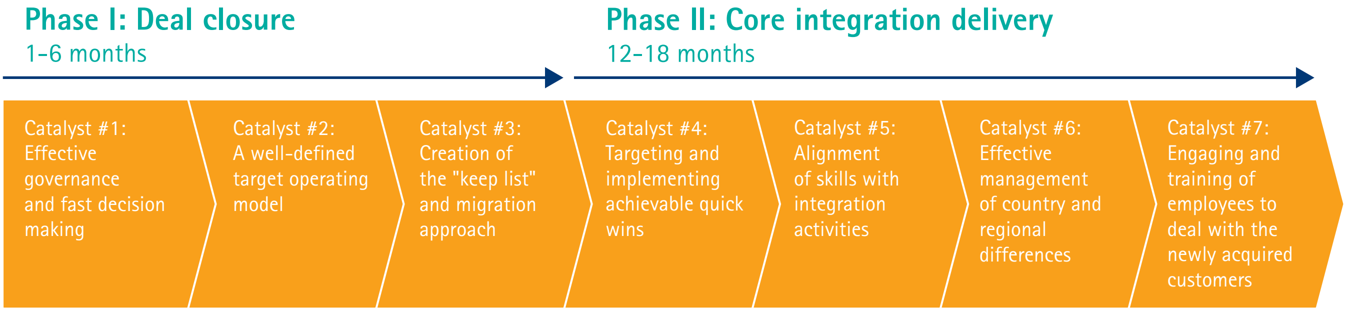
Speed is an important factor in determining the success of a merger not only because the time value of money is an important determinant of net present value and return on investment, but also due to an often rapid erosion in organizational energy to deliver planned benefits. Broadly speaking, the sooner the companies are integrated the faster expected synergies are captured and revenue stream uplifts are achieved. If a company takes too long or there is a delay in capturing the value, it can destroy the business case justifying the acquisition or merger.

However, going too fast can have the opposite effect. A rushed integration can alienate customers, leading to decreased revenue and a failure to meet business case projections or failing to deliver due to poor planning and control. In recent Accenture research of US banking customers, the negative impact of mergers on customer satisfaction and loyalty were clear. Respondents were asked if their primary bank had recently merged and how that affected their attitudes towards it. Only 25 percent of respondents whose financial institution had merged strongly agreed that they were committed to staying with their primary bank versus 42 percent for those who had not experienced a merger. Overall satisfaction had decreased by 14 percent for customers experiencing a merger versus 8 percent for those who had not. And, among customers of merged banks, loyalty deceased by 20 percent and trust decreased by 22 percent.[2]

Companies that are conducting merger integration have to find a balance between synergy realization and customer attrition. Rapid integration can realize immediate synergies but sometimes could also drive away part of the acquired customer base, for example as part of converting brands and rationalizing distribution. On the other hand, slower integration can have a lesser impact on acquired customers and employees but it is generally more expensive, making the business case for the merger less viable.

In one case we analyzed, a merger between two large banks rushed technology implementation and neglected to fully consider customers' channel preferences. The integration team quickly deployed branch-based technology and failed to invest in the acquired company's direct channel technology. This ultimately resulted in part of the acquired customer base switching banks. In another case, the merged entity delayed technology implementation waiting for business customers to be fully ready to integrate with the new technology. This delay, aimed at preserving customer retention, resulted in a negative merger synergy impact of $1.5 million per month. As these examples clearly show, balance between integration speed and profitable customer retention is essential.

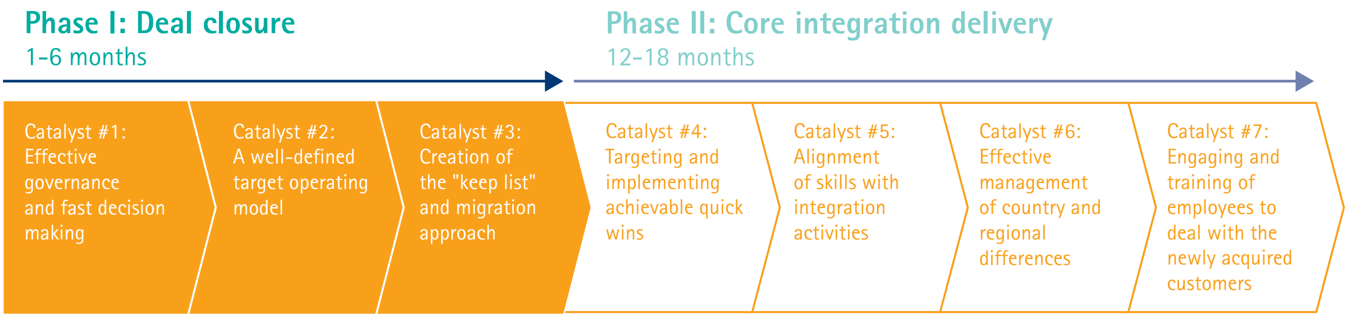
Seven catalysts for merger integration (MI) success



Accenture conducted research on numerous mergers and acquisitions to gather concrete real-life lessons learned on what can catalyze or inhibit the merger integration process and ultimately increase or subtract shareholder value in the newly combined entities. From this effort we have identified seven factors that materially affect the speed of integration and synergy capture while helping the company maintain a focus on customers and ultimately enable the success of integration.

These factors, which we call "MI catalysts," are different for different stages of integration. Typically, merger integration activities start after the deal announcement and last for 12 to 24 months depending on the size and complexity of the integration effort. For simplicity we divide this time into two phases that follow deal announcement: deal planning/closure (on average lasting between one and six months), and core integration delivery (on average lasting between 12 and 18 months following deal closure). During deal closure, which is primarily devoted to mobilizing and planning activities, catalysts are linked to scope control, accountability and decision making. During the core integration delivery phase, which is primarily devoted to managing change and implementing the combined entity structure and operating model, catalysts are mainly related to allocation of key resources to high-value activities.

MI catalysts during deal closure (the first one to six months)



Catalyst #1: Effective governance and fast decision making

Accenture experience has shown that integration success is positively correlated to how effectively activities are led, prioritized and coordinated and, therefore, how design and implementation decisions are made. In one case we analyzed, we found the acquirer took more than six months after the acquisition announcement to agree on the target legal entity structure. This had inevitably paralyzed decision making, grinding most integration activities to a halt. In another case, the integration work started quickly by assigning accountabilities to a divisional director in each country without the overall governance having been either agreed to or implemented. Although activities were progressing fast due to the reduced scope complexity and clear divisional accountabilities, the pace led to duplication of work and missed synergy opportunities. And in a third instance, the leadership team appointed two project managers per work stream (one per company), which led to frequent delays and confusion over decision making.

A tight governance structure is especially important to balance the different and sometimes conflicting priorities of multiple stakeholders within and outside of each company. In one case we analyzed, there were 26 stakeholder groups for a single integration work stream, all with different expectations on what the work stream should achieve and how it should be managed. This arrangement severely complicated decision making and delivery activities.

There are a number of elements of integration governance that make it more successful and the integration more expedient. Top management must agree on decision making authority and accountability very early in the process. And, the approach to managing the integration must be transparent. The integration program must stick to the principles agreed and, if conditions change and a change in those principles is required, it should be properly communicated and understood by all stakeholders. In a climate where there is mistrust and misunderstanding due to cultural, social and language differences, maintaining a very strict fact-based approach to decision making will speed up activities. Furthermore, this will provide the necessary information and objectivity to build trust and credibility among the skeptics.

Clear communication of target synergies and alignment between roles and work streams is also key to success. Delivery and execution integration accountabilities must be clear from the onset with one person responsible for achieving a particular set of synergies. In the same spirit, integration budget approval and management responsibilities (including draw down for each integration business case) should be assigned to a very limited number of executives (one or two) who act on behalf of the CEO. Although tracking of synergies should be done centrally, integration synergy targets also work well as stretch "business as usual" targets.

The creation of an independent multi-function control team also enables faster and more effective business case creation and approval. This team's role is to speed up critical tasks, facilitate and drive key technical and functional design decisions and ensure that tactical solutions are directionally correct. Having a central project management team office also can be integral to success—especially in a cross-border integration program. This team is typically responsible for proactively driving all integration activities and tracking synergy targets by managing key actions, risks and issues, work stream reporting and coordination of all the disparate stakeholder groups.

Although effective governance is not strictly correlated with customer retention, making sure that all stakeholders' views, including the customers, are represented in any integration board or committee will help balance the decisions and assess the impact on potential customer attrition and loss of revenue.

Catalyst #2: A well-defined target operating model

Developing and communicating a clear and unambiguous target operating model as soon as possible has proven to be a key enabler to a successful integration. However, in our recent experience we have often found that companies, given the complexity of the newly formed combined entity, tend to delegate the task of producing a target operating model to a division or individual business units. This limits potential alignment across the newly combined entity and risks sub-optimizing critical operating model decisions.

An effective approach to creating the target operating model is a series of workshops facilitated by a central team (often outside advisors) to take input from divisional design authorities. By forming a small central team to drive the process at the enterprise level, companies can go faster and significantly reduce the risk of delivering a partial solution. High-level operating model decisions should be made as soon as possible regarding:

- Functional vs. business unit vs. regional dominant organization
- Target customers and markets
- Distribution: whether or not to maintain competing brands and whether sales and service will be customer or product centric
- Product manufacturing: the level of product duplication per brand
- IT and operations locations: where the hubs will be located and what sourcing strategy will be adopted (for example, global versus regional versus local)
- Enterprise functions: the level of centralization and shared services

This high-level operating model definition should quickly be followed by a more detailed target operating model design.

This is not an organization chart and it is not an IT application mapping. It is a set of revised core processes and related performance measurements on how the combined entity is going to manufacture, sell and service products to customers.

When producing a detailed target operating model, the team should be very clear on end-to-end process flows and avoid letting the IT systems lead the way (thus leading to the need to implement a number of costly manual workarounds to make up for inevitable gaps). Whether it is opening a new account, returning a product or inquiring about charges, these customer touch points must operate effectively. A critical step to achieve that is a rigorous and thorough inventory of touch points and how exactly they will work. Customer-facing employees must be thoroughly trained on the new processes so the processes can be executed flawlessly as soon as the new company is launched.[3]

Catalyst #3: Creation of the "keep list" and migration approach

Typically cost synergies, outside of organization restructuring and supply chain streamlining, are achieved by removing duplicate brands and products, migration of the lesser of any comparable IT core systems or applications to the more efficient of the two companies' systems, and possibly the introduction of more efficient systems.

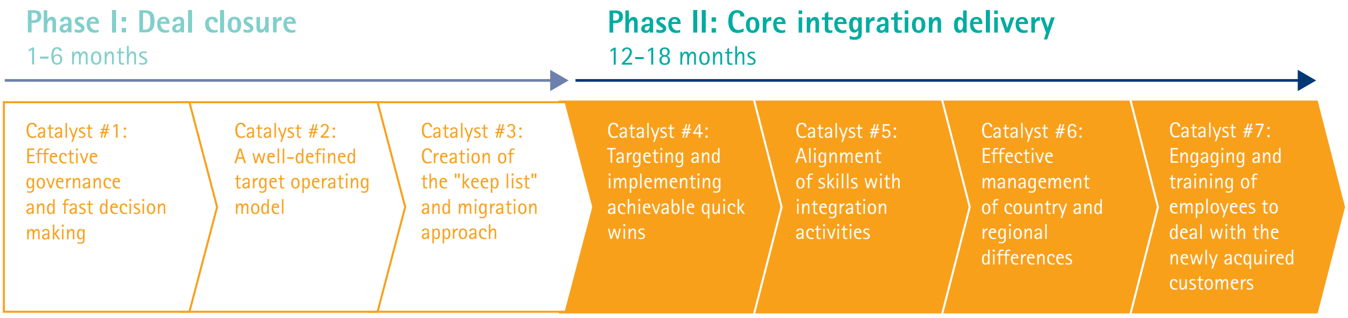
Key to ensuring work gets done quickly and without emotional attachment is to agree as soon as possible what will be kept and what will be decommissioned and why. The sequence of activities to carry out the task should be as follows:

- Confirm the target set of brands and products for the combined entity, mainly considering growth, profitability and customer experience.

- Confirm which core platforms will best support the revised product set, mainly considering product innovation, time to market and technology strategy.
- Identify gaps between the product and service offerings of the merged companies and determine whether or not to close them. This can be a particularly painful activity if not managed effectively with a pre-determined set of decision making principles. An approach that worked well in some of the cases we analyzed was to start with the assumption that no gap will be closed unless regulators require it or the gap will create a significant loss of revenue due to customer attrition.
- Determine whether the migration approach will be by product, by customer or by market. Early communications once the approach is determined will help to manage customer expectations on changes resulting from the integration activities and to gather early feedback on customers' readiness.

These "keep list" and migration decisions must be made pragmatically and not be led solely by IT or business considerations—and as a general rule, it is important to focus on the areas that make the most difference. In mergers, the 80/20 rule is especially important to avoid diversion of time and energy when both are at a premium. One way to do this is to create a task force comprised of an independent small team of advisors (IT, business and product specialists) and led by no more than two top executives with decision making responsibility who report to top management. Our experience has shown that companies that took a task force approach and pragmatically forced themselves to agree to a "keep list" before the closure of the deal achieved a faster and smoother integration with better chances of success. Having decided very early on what brands, products and core systems to keep and what to decommission enabled clearer sequencing of integration activities and effective integration planning.

MI catalysts during core integration delivery (the first 12 to 18 months following deal closure)



Catalyst #4: Targeting and implementing achievable quick wins

Planning for and achieving tangible performance improvements in the first few months of the integration process are critical to building and sustaining momentum. Many acquirers believe that putting in place new management, policies and processes in a company that had suffered from poor management will drive fast and strong results but unfortunately this is not always the case.

There are, however, a number of areas that frequently produce synergies without affecting the overall integration speed and should be considered for their potential:

- Pricing – Leverage the newly formed combined entity to revise pricing to customers. This can positively affect revenues in the very short-term and reduce customers attrition by, for example, offering discounts or free trials on new offerings.
- Procurement – Leverage the newly formed combined entity to reduce the total value of contracts by targeting key suppliers for simple discounts or contract term reviews.
- Property – Consolidation of offices and venues is often a strategy that can pay off quickly.
- Credit control – Improve working capital by targeting accounts receivables and proactively looking at improving the timing and accuracy for bad debt provision (very banking specific).
- Sales – leverage sales force to cross selling existing products through the other organizations channel/sales force.

Our recent experience in merger integration has shown companies that plan for quick wins in the five above areas often overachieve in their targets and use the excess cost synergies captured to close gaps in more difficult and complex areas such as IT and operations integration.

Catalyst #5: Alignment of skills with integration activities

Assigning the right people to the right integration activities is an obvious maxim. Unfortunately, because of time constraints and lack of resources, or simply underestimating the integration challenge ahead, this does not always happen. We found that, in some cases, organizations make implicit assumptions about resourcing that can lead to integration execution delays or even failure.

One such poor assumption is that change and transformational activities can be successfully carried out solely by IT or operations project managers. Integration can be considered a transformational change activity that requires a certain level of expertise and skill to be carried out successfully. However, most companies are ill-equipped to manage change, particularly at the scale required in cross-border integration.

A second poor assumption is that integration expertise in one industry sector always works in a different sector. In one case we analyzed, for example, the acquirer was very experienced in retail bank integration and assumed that it could apply its expertise to capital markets. What the company overlooked is that in capital markets core systems are generally more complex and customized and the business is organized around individuals, while retail banking systems are generally simpler and business is mainly organized by products that tend to be more commoditized.

A third poor assumption is that integration expertise in one country always works in a different country. In one case we analyzed, the acquirer was very experienced in integrating companies in the same country and overestimated their ability to influence activities and decisions in another country, leading to tangible delays and missed delivery milestones.

Our recent experience in dealing with merger integration has shown that companies that focus on assigning the right skills to the right job and close potential skill gaps by acquiring them in the external labor market, tend to achieve better results.

Catalyst #6: Effective management of country and regional differences

Preparing upfront and continuing to invest in understanding and managing cultural, regional, social, and language differences has been found to be particularly effective in helping the integration process. Such an effort creates cohesion among cross-border teams, breaks down trust barriers, and reduces misunderstandings that could hamper progress and require time and effort to clarify.

The nature and type of regional differences vary wildly—from how risk is perceived, performance is rewarded, the style of management and how decisions are made; how local regulators work and influence decisions; language, cultural and historical background; currencies and so on. Generally speaking, we can classify these differences into three groups: company cultural differences, geographic regional differences and language differences.

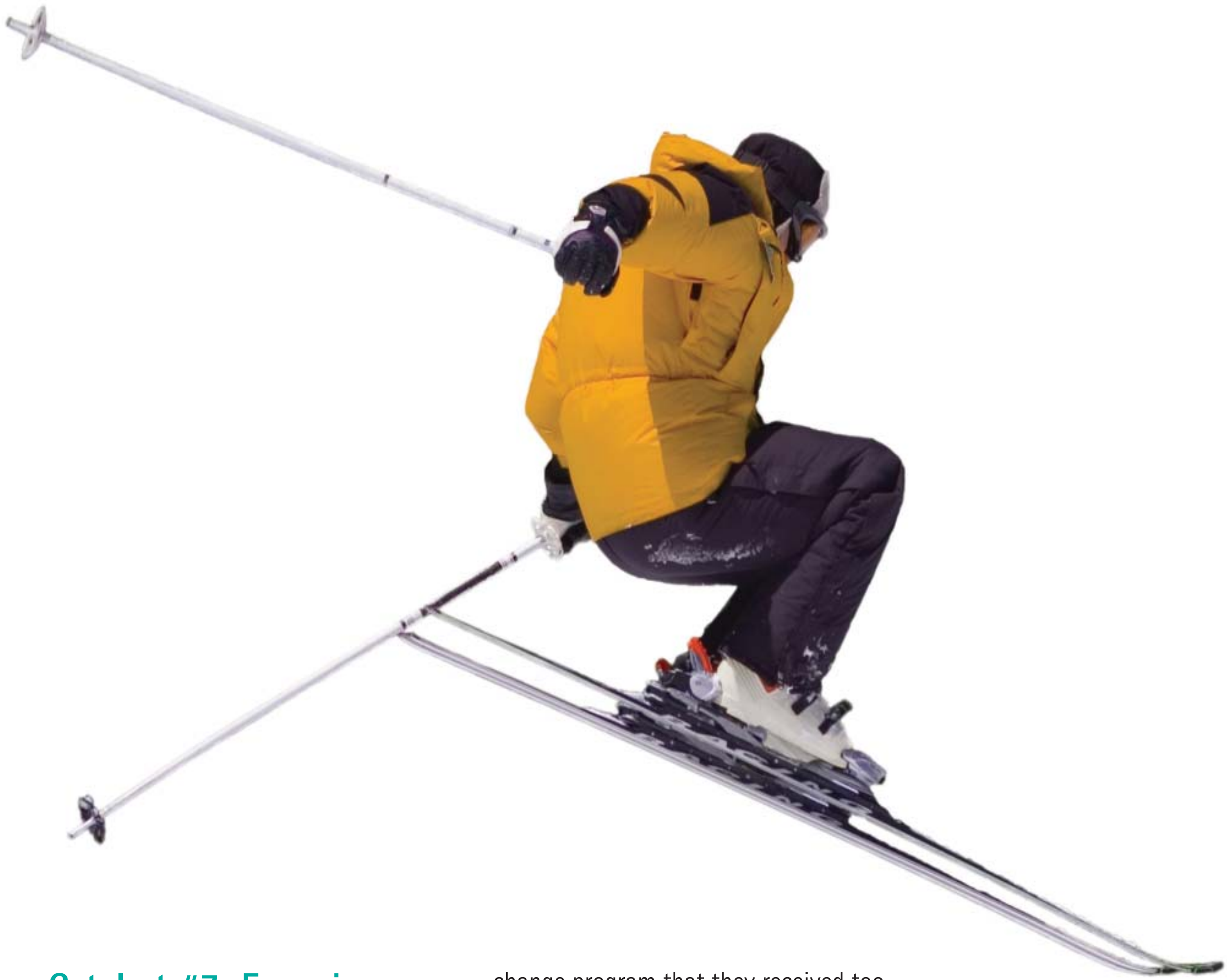
Companies' cultural differences manifest themselves in such things as management style and performance management. These differences are a major source of employees' attrition if not managed early enough. Issues can range from seemingly small differences such as the expectation of working hours or communication styles, but can quickly snowball into larger issues among the workforce.

Regional differences occur by the very nature of employees residing in different countries. Key areas for integration consideration are differences in the regulatory environment and compliance obligations between regions (for example, the Markets in Financial Instruments Directive (MiFID) is much less prescriptive than US regulations and, by definition, needs more interpretation to be implemented as rules into systems) and customers' preferences (for example, in the banking industry, UK customers tend to prefer direct channels for sales and servicing while southern European customers such as Spanish and Italian tend to use branches more). Rate exchange stability, growth in local countries and overall regulatory environment can materially affect the results of integration.

Language differences are also a major source of misunderstanding during integration activities, and if not managed effectively, can lead to delays and reworking of decisions and increasing the level of frustration of the teams on the ground.

Cultural, regional and language differences can be effectively managed through workshops and "away-days" focused on breaking things down into specific actionable elements. These workshops are also useful to provide awareness and support the building of a cohesive team and, therefore, are often best facilitated by external advisors. For this approach to work however, the cross-border teams must invest time, resource and emotional commitment for the duration of the integration activities. Too often this is done as a one-time activity following deal announcement and it fails to deliver the expected benefits.

Typically, the workshop-based approach can be successfully complemented by hiring a small number of bicultural, or even bilingual, integration experts, (approximately 5 to 10 percent of the integration team's size), who will work within the program at either the central or work stream level to provide the necessary coordination among different groups and, consequently, significantly reducing misunderstandings and speeding up decision making on critical activities.



Catalyst #7: Engaging and training of employees to deal with the newly acquired customers

According to a recent Accenture study, the most influential contributor to decreased customer satisfaction is the service and attitude that customers experience during the transition. Whether it is inadequate training or lack of enthusiasm, most customer-facing employees do not put their best foot forward for the customers of the new combined company. Two challenges must be overcome to deliver on customers' expectations following a merger: winning the hearts and minds of all employees and preparing employees to face the customers.

In particular, the integration program leadership must communicate early and often. In fact, we never have heard from employees after a merger or a change program that they received too much communication. The program leadership also must tell the truth. The new management team either establishes or destroys trust very quickly, typically in the first two weeks. Telling employees that nothing will change is usually a recipe for lost credibility. Being upfront with fact-based plans and expectations, even unpleasant ones, builds trust. And, the program must train employees on how to deliver consistent and frequent tailored messages to customers regarding new processes and procedures.

The attitude and commitment of front-line employees are key determinants of the success of mergers. Frustrated or confused employees usually actively or passively vent with customers. Investing to win front-line employees' hearts and minds, and training them to succeed, will ensure employees are working positively to retain and recruit customers.[3]

Conclusion

Not surprisingly, the focus of many top and middle managers today is on quickly improving their company's capital structure and market valuation, addressing the level of government participation and above all, returning to profitable growth as fast as possible. Amid such demands it is easy to see how management attention can be diverted from a merger integration program. Yet speed to value is essential for merger integration success. By using the preceding seven merger integration catalysts, companies can more effectively balance speed and customer retention for integration success and, thus, position their organization for profitable growth and high performance as the market rebounds.

About the authors

Andy Tinlin, a senior executive in Accenture Strategy, leads the company's global Mergers & Acquisitions group. With nearly 20 years' experience in consulting, Mr. Tinlin currently works with the boards of leading clients to help address their strategic and operational issues in areas such as growth strategy, M&A and business transformation. Before joining Accenture, Mr. Tinlin held a number of management positions in commercial organizations. He is based in London.

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Resources

1 Internal Accenture research

2 Accenture research 2008 – "Consumer attitudes towards the current banking environment in the US"

3 "Customers Hate Mergers", Accenture 2005

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