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Post-close excellence in large-deal M&A

The most successful large-deal transactions follow four key practices during integration execution.

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You cannot judge a deal by the market's response to its announcement. Neither can you predict its success based on investor reaction at closing. It is only after the first 12 to 18 months of integration and after companies have reported the performance of their first year that the markets can reliably predict the success of the deal.

This finding is based on our recent review of 248 large deals over the last ten years. We found that 79 percent of those whose total return to shareholders outperformed their market index in the first 18 months were still above the index three years after close.

What did CEOs do differently in those successful deals? To better understand what made those deals successful, we surveyed experienced integration practitioners at the twice-annual Merger Integration Conference, and we also surveyed a broader population of 305 public company leaders, conducted in-depth reviews of investor transcripts and public financials in 29 of the Global 2000's[1] large deals, and spoke with individuals who led some of those deals. We observed that companies going through successful large deals follow four key practices that help their total returns to shareholders (TRS) outpace the market index, their synergy achievement to exceed public commitments, and organic growth to continue unabated (Exhibit 1). In this article, we detail these practices.

Protect business momentum

While integration creates value from synergies, this should not come at the cost of disruption to the existing business. Successful acquirers are able to keep growing revenue on a pro forma basis within the first year, whereas unsuccessful deals see a decline or "dip" in revenue (Exhibit 2).[2] This dip is almost always due to a failure to protect the business momentum.

View the integration from the eyes of the most important stakeholders. It's useful to apply the lens of major stakeholders, including key accounts, distributors, and front-line managers. Companies tend to take a horizontal, or functional, approach to integration planning, with, for example, finance, IT, and HR each developing its own plan. Successful integrators use the stakeholder lens to ensure planned transitions are as seamless and that the full journey is considered, not just for Day 1. These companies create an end-to-end experience that consolidates the "pain" and spreads out the "delight." For example, nine months into the integration of two industrial companies, the leaders refreshed the integration plan for the second and third year of the integration. This included refreshing more than 300 integration initiatives and identifying areas in which businesses or functions were experiencing too much change. While developing the salesperson experience journey, management found that the sales force was best left to focus on settling the organization and delivering on cross-sell imperatives. This meant reprioritizing the new customer relationship management (CRM) rollout, site consolidations, and new HR processes to a different time.

Exhibit 1

There are four keys to post-close excellence.

Protect business momentum	Accelerate synergies and integration	Institutionalize new ways of working	Catalyze the transformation
72%	>50%	60%	>10%
of successful deals maintain organic growth and "skip the year 1 dip"	of public synergy target achieved in the first year for successful acquirers	of practitioners feel they should have put more resources on culture and change	excess total return to shareholders in select companies that captured transformational synergies

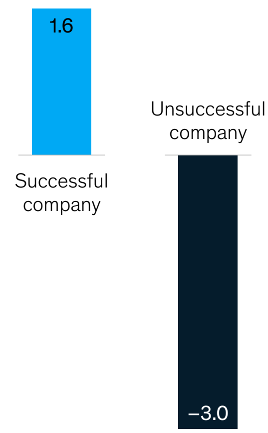
Source: Analysis of Large Deals from Global 2000 (n = 29); 2019 Survey at Merger Integration Conference

[1] Our data set of 2,000 large global companies.
[2] Analysis of large deals from Global 2000 (n = 29).

Exhibit 2

Successful companies continue growing during year one.

Pro forma growth[1] during the first year as a combined company, %



[1]Organic growth.
Source: Analysis of Large Deals from Global 2000 (n = 29)

Protect the base at all costs. "We would start every meeting talking about protecting the business, then cost synergies, then revenue synergies, then finally transformational opportunities," the head of integration at a healthcare organization recalls. "This was true across every integration team, and for every functional owner and line executive. It was with this implicit hierarchy that we were able to exceed all of our objectives." Leading acquirers systematize this dialogue with scorecards that track the performance of the base business and alert top management to issues such as account loss, declining customer satisfaction, or unwanted sales force departures.

Accelerate synergy capture and integration

CEOs must keep a constant focus on synergy capture well past Day 100. Companies whose TRS outperformed the market index over the life of the deal captured a run rate equal to 50 percent of their public synergy target in the first year alone.[3]

Implement value-based governance to track the full equation of synergies. Companies must establish a robust governance model that tracks synergies from execution to financial statements. Corporate leaders need transparency to the full synergy equation, including the ability to manage leakage. This transparency promotes rigorous dialogue on the integration progress, improves synergy forecasting, and provides actionable insights to drive improvements. A strong financial discipline and resourcing is critical: our survey of 305 public company executives revealed companies that report very effective finance capabilities were twice as likely to meet their M&A value-creation objectives than those with ineffective finance capabilities (Exhibit 3).[4]

Consider the example of a large healthcare company. Over 2.5 years, a dedicated team of financial analysts tracked synergies captured in the integration. The effort was led by a talented finance executive who had both the access and the respect of the top executives. He was able to play the role of thought partner to these leaders when synergies came up short. This comprehensive approach resulted in the company exceeding its predeal synergy commitment by 40 percent, adding an additional $100 million in savings.

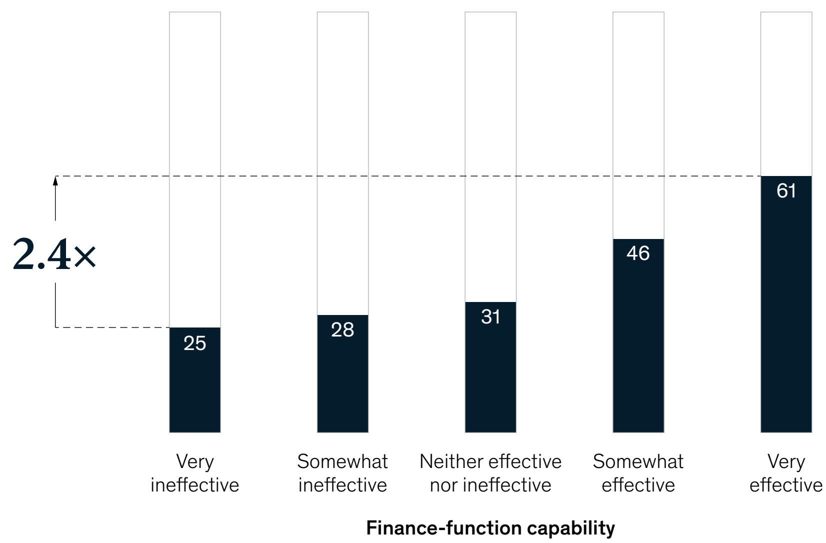
Ensure line leaders own synergies. Business-unit and department heads must commit to their synergy targets. While the integration management office plays a vital role preclose, making the integration plans stick requires ownership from the accountable executive. Top acquirers build synergy targets into operating budgets that exceed the public target. They are also diligent about the transition of not just synergy targets but also the specific synergy initiatives. They establish a hand-off process that goes through detailed milestones linked to financial impact and include the people, capital, and capabilities needed to achieve.

[3] Analysis of large deals from Global 2000 (n=29).
[4] 2016 McKinsey CFO Survey (n = 305).

Exhibit 3

An effective finance function improves synergy capture.

% of respondents reporting that their company's integrations meet value-creation objectives, by finance-function capability



Source: 2016 McKinsey CFO Survey

Institutionalize the new ways of working

Many CEOs underestimate the complexity of shifting the combined organization to new ways of working. In our survey at the Merger Integration Conference, 60 percent of acquirers expressed regret that they did not dedicate more resources to culture and change management during the integration process.[5] Successful acquirers dedicate these resources to getting the right accountability system and managing change in critical processes.

Make new behaviors nonnegotiable. Operating-model and cultural changes need to be supported by clear employee expectations and consequences. This consistency requires building a high-functioning accountability system. For example, one CEO determined that promoting diversity was critical to the combined company's future and started by updating its new values to set clear expectations. Then progress toward diversity targets was an aspect of every senior leader's competency scorecard and was discussed in performance reviews. In turn, these leaders rewarded the same behaviors in their teams. Moreover, it also allowed the organization to more directly address opportunity areas.

Change the critical process tied to deal value. It is vital to signal to the organization the new way of working at the process level. For example, by changing the approval levels, metrics, and expectations in the capital allocation process, a company can increase the flow of capital to new project innovation. The processes that are critical to get right most often include direction setting, growing the company, and running the business (Exhibit 4). The involvement of senior leaders is critical to ensure that the processes support the desired new behaviors.

[5] 2019 Merger Integration Conference Survey.

Exhibit 4

Changing critical processes can help support desired new behaviors.

Direction setting
– Capital allocation
– Strategic planning/budgeting
– Management processes and decision making

Driving growth
– Account planning
– Innovation
– Revenue management
– Demand generation

Running the business
– Order to cash
– Procure to pay
– Hire to retire
– Performance management

When one company bought a smaller competitor in hopes of scaling its entrepreneurial sales model, for example, the management appointed the target's sales leader as the new global head of sales. Within the first 100 days, the sales leader identified several sales processes that enabled TargetCo's culture and performance, such as adopting the target's compensation structure (higher bonus and lower base pay) and embracing an approach that enabled sales reps to provide customers with quotes on the spot rather than taking a week or more to do so, as was the practice of the acquirer's team. As a result, the acquirer's sales force became more entrepreneurial and nimble, which immediately raised the company's overall sales performance.

Catalyze the transformation

To achieve the full potential of the combination, CEOs pursue transformational synergies that require significant enterprise-wide, structural change. Some of the most common examples include embracing outsourcing, launching new business models, or adopting disruptive technologies. Our analysis of large deals found that select deals delivering 10 percent TRS above the market index over the life of the deal followed several important practices.[6]

Dedicate significant management focus for a multiyear duration. A multiyear transformation requires significant management attention throughout its duration to deliver the anticipated benefits. This commitment must be visible and clear to both employees and investors. Take the example of a manufacturing company that wanted to launch an enterprise shared-services transformation to capture more than $100 million in savings in the second year of integration. The organization comprised powerful business units with embedded functions reporting to business-unit heads—leaders who did not want to relinquish functional control. Without the full backing of the top management team, the initiative got off to a slow start. Once the leadership publicly committed to the vision and outlined the expected returns, they were able to rally the full organization and reach the financial targets (albeit later than the original timeline).

Select, expand, and build new capabilities. Transformational initiatives often require new institutional skills and talent beyond what the leaders may have originally envisioned. Successful acquirers seize these opportunities. In some cases this may mean protecting and expanding capabilities from one legacy company across the NewCo. In the context of a leading airline merger, realizing the full potential demanded that the acquirer scale the target's operational excellence capability across the full organization. "It took persistence to prove it out, and long-term focus to consciously rewire our ways of operating," the integration leader recalls. "Multidiscipline task forces, led by the acquirer's operations executives, focused on building the new day-to-day capabilities until they became second nature."

[6] Analysis of large deals from Global 2000 (n = 29).

In other instances companies choose to build and propagate new capabilities. When one such company wanted to develop stronger execution capabilities, it launched an enterprise-wide training program that covered skills such as prioritization, driving accountability, structuring project plans, and meeting deadlines. While these skills were seen as common sense within the organization, they were not common practice. Their company-wide deployment established a unified “execution language” that helped to spur progress from the corner office to the front line. What’s more, it was positively viewed as an investment in employees’ skills in the new organization.

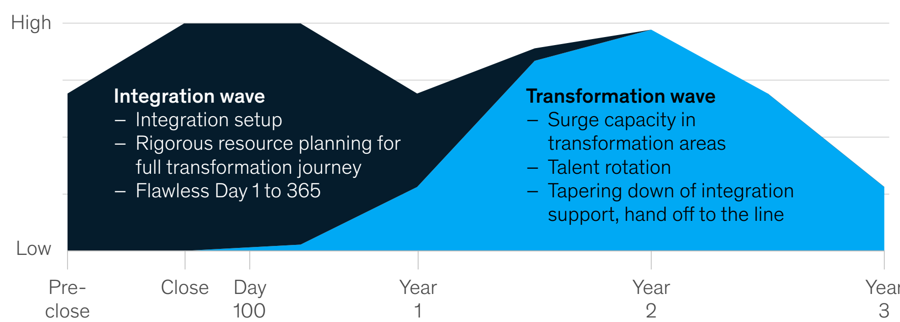
Refuel for the next wave. The pathway to a large-scale transformation leads through several phases of integration, stabilization, and transformation, and each one requires refueling the resources and refreshing the priorities and governance. Despite a common perception that the intensity of an integration decreases over time, in some cases more or different resources are needed in successive phases than in initial ones. Companies must make these decisions up front and balance the trade-offs of early personnel-based synergies against sufficient resourcing for transformational actions. For example, when one company refreshed the transformation road map months after close, it found that although it had captured the expected synergies from the merger, it needed an additional 50 employees to achieve the objectives of the full transformation (Exhibit 5). The new talent not only injected new energy into the leadership but also reprioritized activities and helped ease organizational fatigue.

Even with all the right planning before a deal’s close, a merger’s success is not assured without a well-executed integration. The first 12 to 18 months serve as a test of the acquirer’s ability to execute on the deal’s promise. Applying the four practices laid out above can help companies achieve positive investor, customer, and employee response, as well as superior shareholder returns and a strong foundation for long-term growth.

Exhibit 5

Multiwave view of resources to support a large-deal transformation.

Illustrative staffing wave



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