



Guide to Mergers and Acquisitions

Frequently Asked Questions

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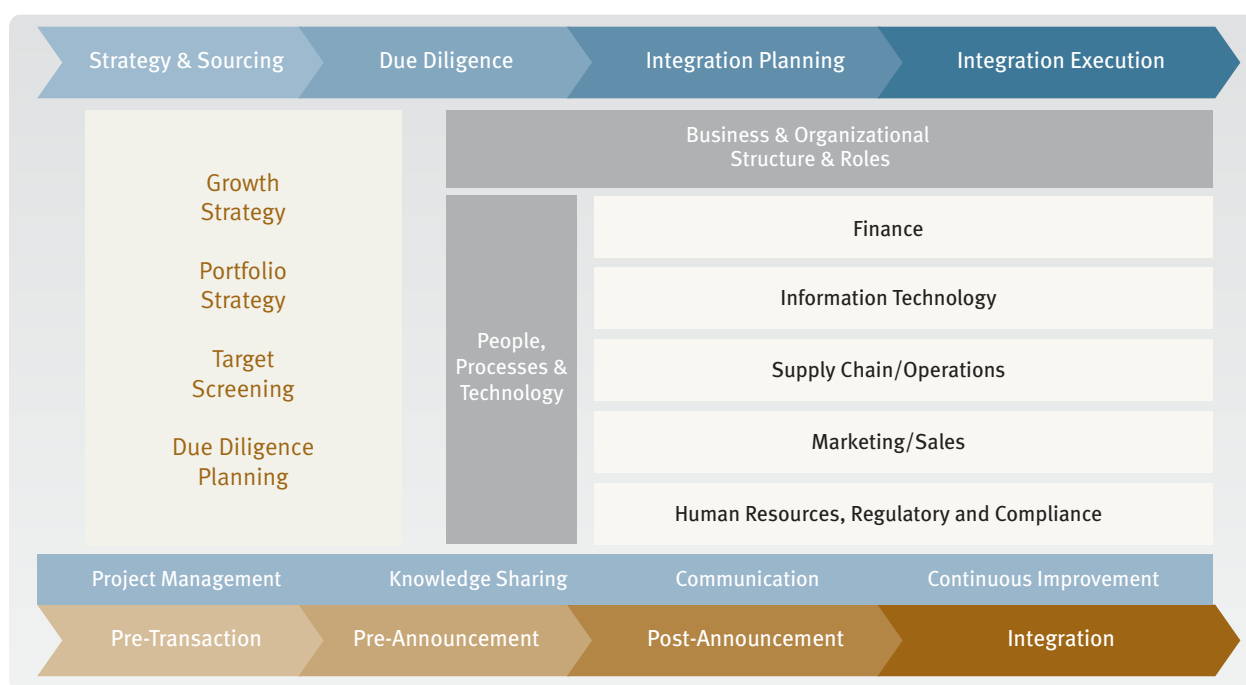
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Introduction

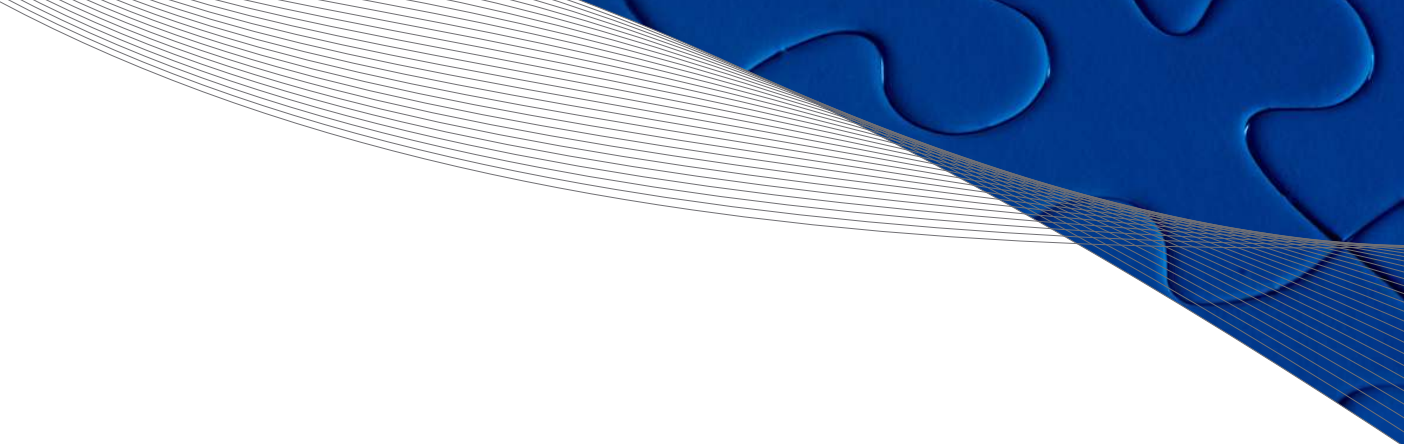
Many organizations continue to increase their earnings through better managing their costs and balance sheets. But as global competition continues to intensify, investors and boards are demanding more top-line growth as a way to further increase shareholder value. Many are pursuing this growth in revenues and earnings through mergers or acquisitions, which are some of the more challenging endeavors any company can or will undertake. These transactions are like assembling a complex puzzle with thousands of unique pieces. Companies considering such endeavors will need to (1) carefully articulate a growth strategy that aligns with their overall corporate strategy (with proper board involvement); (2) identify the right markets and targets; (3) define and execute a thorough but fast-paced diligence process; (4) prepare a detailed integration plan by phases; and (5) follow up with a well-resourced and communicated integration execution across many complex functions, dispersed technologies and geographies to capture the targeted deal values. As discussed further in this guide, it is easy to understand why many deals do not achieve their intended results.



The Mergers and Acquisitions Life Cycle

For these reasons, the need for guidance and lessons learned on managing through these transactions has never been greater. This guide¹ provides a starting point for answering the core questions identified in mergers and acquisitions (M&A) deals – from due diligence to the integration of people, processes and technology, supported by key project and change management enablers. It is designed to serve as a convenient and user-friendly resource that executives and managers alike can consult to utilize the lessons learned and improve the odds of achieving the targeted values of proposed transactions in a timely manner.

¹ This guide is provided for general information only and is not intended to give legal analysis or advice, which should be obtained from appropriate legal counsel or other advisers.



The Mergers and Acquisitions Process

1. What drives the need for companies to consider mergers and acquisitions?

Mergers and acquisitions (M&A) are a key part of many organizations' growth strategies for several reasons:

- They are a way to grow market share, or provide access to new distribution channels, markets and products.
- They may provide the organization with new capabilities, access to technology or know-how, or access to talent needed to drive growth.
- They help organizations capture operational synergies:
 - In industries consolidating due to overcapacity, companies may identify opportunities to achieve competitive advantage through increased scale or scope to improve operations. These cost savings and efficiency opportunities arise through technology, globalization, regulation and other market developments that increase the importance of having larger scale or scope from a competitive standpoint.
 - Companies may look to boost revenue and margin growth through leveraging specific customer-focused initiatives to create long-term value. Customer-focused opportunities typically center on improving the go-to-market strategy and achieving higher revenue goals through specific value-creation pursuits (e.g., broaden product and service offerings, expand geographically, acquire research and development [R&D] and other talent, attain better positioning within the value chain, enhance brand management, and improve the customer experience).
 - Companies may deploy M&A as a strategic tool for transforming the business by creating new ways of doing business to sustain or improve competitive positioning. This can occur through an acquisition enabling the creation of a distinctly new value proposition for customers; altering the fundamentals of how money is made within the industry; creating formidable resource advantages in serving the customer (e.g., people, technology, facilities, channels, brands); and/or making possible the re-engineering of processes for delivering value to customers (e.g., faster, better, lower cost).

In essence, whether or not to pursue a merger or an acquisition is all about having a clear view early in the deal process and throughout the execution of the integration process of the new opportunities to create competitive advantage and value.

2. When is the best time to do a transaction?

The answer is typically when the need meets the opportunity. As noted in the answer to the previous question, a need arises when the board of directors and executive management identify opportunities to achieve or sustain competitive advantage that can be realized through M&A activity. Perceived opportunities could include increased scale, broadened product and service offerings, geographic expansion, acquisition of new capabilities, improved positioning within the value chain, enhanced brand management, and/or improvement in the customer experience. When market conditions are favorable, and necessary

financing and a suitable target with the right strategic fit are both available, the opportunity meets the need. Thus, the entire focus on timing is driven by the enterprise's strategic needs and a market and target conducive to those needs.

If there is a change in market fundamentals driven by technology, globalization, regulation or other competitive forces, M&A may become a necessity. For example, if the industry is converging, management and the board may decide to become an early mover to avoid being left behind.

3. What are the key risk areas in an M&A transaction?

Many studies indicate a high percentage of M&A transactions fail to realize their expected synergies, growth targets and internal rates of return. There is also the risk of an overall drop in productivity over the near term, as the acquiring and acquired entities collaborate to make the acquisition work. This can result in loss of focus on customers, channel partners, employee morale and essential aspects of operational excellence. Turnover of acquired company executives is often high, so there is a risk of losing valuable knowledge capital in any merger or acquisition. Despite the alluring prospects for success cited in the business case supporting the acquisition, many transactions fail to measure up.

The risk of failure can be tracked throughout the M&A process. For example:

All Phases of Process	• Lack of compelling strategic rationale • Lack of shared vision and strategy • Poor leadership • Lack of experience	• Undisciplined deal process • Inadequate resources • Failure to involve appropriate expertise • Unrealistic expectations or assumptions
Due Diligence Phase	• Lack of rigorous target decision criteria • Inadequate and incomplete deal evaluation • Failure to focus on value creation early in the process: – Synergies – Efficiency opportunities – Growth targets	
Integration Planning Phase	• Delaying planning until it is too late • Not using synergies/efficiency opportunities as focal points in planning • Overconfidence in the ability to change or turn around the target • “Blinding” by a short-term focus on cutting costs and retaining people • Lack of attention to alignment and change management issues in planning	
Integration Execution Phase	• Conflicting corporate cultures • Failure to maintain focus and measure achievement of synergies • Undue complexity, delays and ambiguity • Uncontrolled and inadequate execution of integration plan • Lack of disciplined project management and accountability for results • Poor communication	• Lack of transparency • Lack of employee buy-in and commitment • Failure to pay attention to customers, channel partners and operations • Low trust environment • Loss of high-performing employees • Strong resistance to change

While not necessarily all inclusive, the above table illustrates the potential risks and issues emanating from the deal process. Companies emerge as high performers from M&A activity when they recognize the true expected value of their synergy and growth opportunities, and capture that value in the negotiation and integration planning and execution processes. Not having a clear view as to the purpose of the acquisition, both early in the deal process and throughout the integration, can cause the transaction to fail to meet expectations.

4. What common mistakes do companies make during a transaction?

The complexity of the M&A process makes deals ripe for mistakes. The most significant outcomes of missteps are the inability to capture expected synergies; failure to achieve performance expectations; failure to retain customers; and the inability to sustain productive operations. Listed below are 10 common and costly mistakes that can yield these outcomes:

1. **Improper planning** – Failure to screen targets using appropriate criteria aligned with value-creation strategies and targeted synergies.
2. **Failing to move the discovery process along expeditiously** – Time can be of the essence during the discovery process. Unless all aspects of the value proposition supporting the transaction are made clear to both parties in a deal within a reasonable time period, the momentum to consummate the transaction may fade away. From the buyer side, it is vital to leverage the available information, expertise, resources and tools to uncover all synergy savings, efficiency opportunities and top-line enhancements to validate the value proposition and advance the discovery process.
3. **Poor due diligence** – Substantive due diligence is critical to understanding the full picture needed to evaluate an M&A deal. For example, this process can validate assumptions around planned cost and revenue synergies and identify and evaluate their impact, providing the impetus for savings tracking as a key component later in the integration phase to report on progress. It also can reality-test other aspects of the value proposition underlying the deal. Due diligence can focus on strategic, operational and supporting information technology (IT) areas to identify potential opportunities and risks, including exposure to negative synergies. It can uncover potential issues relating to legal and regulatory matters, retention of key employees, soft spots in the target's balance sheet, hidden liabilities, and ongoing initiatives vital to sustaining operations, among other things.
4. **Absence of security over information** – Information security is an important element during the M&A discovery and negotiation period. Both buyer and seller need to secure their business documents that hold sensitive, proprietary or copyrighted information that could be used for competitive advantage if it fell into the wrong hands. Successful M&A transactions are the result of a measured and studious approach to organizing business data. Some information should be made available to all bidding parties, but other documents containing proprietary information need to be reserved for more serious contenders and the final buyer. The failure of a seller to segment this information as the M&A process moves forward increases the likelihood that sensitive business documents may be released at an early and inappropriate stage, increasing the chances they will be distributed to competitors.
5. **Paying substantially more than fair value** – This mistake is on every list of common M&A mistakes. Management cannot enter the deal process without being prepared to walk away from a target. Few, if any, transactions are worth closing beyond the point where the acquiring company's management has a reasonable shot at making the deal work and earning a fair rate of return for shareholders. All too often, unrestrained competitive bidders, management's insatiable desire to top a competitor's offer at all costs, or the chief executive officer's resolve to make the deal overwhelms better judgment and results in paying more than the target is worth.
6. **Inflated expectations and assumptions result in lack of discipline and perspective** – During the discovery process, expectations arise and assumptions are made about the value created by the transaction in terms of synergies, efficiency opportunities, growth targets and return on investment (ROI). Built into the business case and integration plan, these expectations and assumptions should be realistic given the hard data available and the known "red flags." The deal evaluation process should be as objective as possible to portray fairly the risks and rewards presented by the transaction. Once executives have their line of sight on a target and invest substantially in evaluating and negotiating the deal, they can't become so emotionally engaged that they forget to treat it like any other business deal. The strategy is more important than the target.

7. **Failure to create focus during the integration process and involve front-line operating personnel** – The time to put in place an integration plan is prior to closing – not after. Emphasis should be on early development of the integration plan so execution can begin quickly once the deal is closed. The integration and business development teams should collaborate closely in developing the plan so it sets a clear road map with action items, key people and responsibilities, and timetables for achieving established goals. There also should be clarity and focus around achieving expected synergies, efficiencies and growth.

Integration execution is a full-time job, with cross-functional participation and the right expertise and resources accountable for results to achieve a focused timeline. If the assigned resources have other pressing responsibilities, execution of the integration plan will suffer due to inadequate attention. A goal-oriented, time-sensitive approach keeps everyone engaged, avoiding procrastination and “integration fatigue.” A focused time period also forces greater cross-functional coordination and involvement of operating personnel on the front lines, reducing missed opportunities and redundant efforts. Frequent integration meetings are often required to keep everyone informed, to foster critical thinking, and to ensure critical decisions are made on a timely basis.

8. **Failure to deliver on expectations resulting in post-acquisition issues** – With the presumption that expectations and assumptions are realistic, M&A transactions break down when they don’t see results. The promised savings, efficiency gains, revenue increases and returns need to remain front and center during the integration execution process. This means realizing visible “quick wins” as early as possible and demonstrating progress during the first 100 days and thereafter over a reasonable time period. When results aren’t achieved, energy and momentum are lost, management loses credibility and employee commitment deteriorates as “integration fatigue” sets in. Distractions can lead to loss of customers and decline of strategic business relationships, resulting in damage to the core business. Because a poor line of sight on target synergies can result in disappointment, strong governance provided by a centralized project management office (PMO) is needed to keep everyone focused and on track.
9. **Forgetting that culture matters and failing to get the “people issues” right** – Even if efforts are made to ensure the target’s culture and the acquiring company’s culture are compatible enough to make the transaction work, there will always be cultural and people issues to address. As human capital is critical to the success of any acquisition, the name of the game is winning hearts and minds. Identifying, motivating and incenting the requisite talent for success is a key driver of deal value, as it results in retention of the people who make the business work. While it’s important to ensure the leaders of the acquired company are on the same page, it’s just as critical to engage quickly the personnel whose work and knowledge contribute to the company’s success – such as the product developers, engineers, plant operators, salespeople and service personnel. If these personnel aren’t treated well financially; if they fail to fit into the combined entity from a cultural standpoint; if they aren’t provided opportunities to participate in leadership and managerial capacities within the post-acquisition organization; or if they fear their futures are in doubt, they could walk.

The people who will be especially critical to post-integration success must be embraced early and given some insight into the future – and what their place in that future likely will be. Shortsighted reductions in operating costs that result in terminating the essential “functional experts” needed to execute the business plan after the deal is done will lessen management’s credibility. From a labor perspective, advance and even informal consultations with unions during the deal process may reduce execution risk. Finally, a communications plan targeting key internal and external stakeholders is needed.

10. **Lack of transparency during the integration process** – While there is understandably much secrecy during the discovery, evaluation and negotiation processes up until consummation of the deal, the integration process is a different matter. The integration team must keep people informed; otherwise, people will make their own assumptions and spread speculative misinformation around the

organization. Keeping people informed of the status of any integration effort with key metrics is discussed in more detail in the section on Change Management.

Deal success is driven by defining and deploying a repeatable, scalable and evolving M&A process. A mature process instills the appropriate discipline to drive successful acquisitions, from deal sourcing through due diligence, integration planning and integration execution.

5. What types of resources are needed to complete a transaction?

A variety of resources are needed to consummate a transaction successfully. Subject-matter expertise is needed in legal, accounting, finance, human resources (HR), tax, supply chain, operations, IT, risk/compliance management, process redesign, brand management, project management, and change management to conduct due diligence, integration planning and integration execution. Consultants can be used to fill resource and subject-matter voids, where necessary. Since every company's needs are different, look for consultants who offer a flexible business model that allows them to engage in M&A transactions at any stage or level of involvement.

6. What are the regulatory and tax considerations of a transaction?

There are many regulatory and tax considerations in an acquisition, requiring timely legal and tax advice. From a regulatory standpoint, legal advice should be obtained early in the discovery process on the applicable laws and regulations governing M&A activities, depending on the jurisdictions involved (e.g., federal and state in the United States and applicable foreign countries) to determine whether regulatory filings and/or approvals are necessary. These include securities laws, tender offer rules, industry-specific regulations, foreign shareholding restrictions, and applicable labor and antitrust laws.

In the United States, for example, will the transaction require antitrust approval from the U.S. Department of Justice (DOJ) and/or the Federal Trade Commission (FTC)? Will it require approvals from the U.S. Securities and Exchange Commission (SEC), Federal Communications Commission (FCC), or other federal agencies? From an industry perspective, many new regulations affecting the financial services industry have been enacted since the financial crisis; hence, from an M&A standpoint, it will be necessary to consider the more stringent capital requirements.

For cross-border transactions, it is important to determine as early as possible whether there are any general or industry-targeted antitrust issues or other restrictions on M&A. Filing thresholds differ across country jurisdictions. Accordingly, any antitrust issues should be cleared with the relevant authorities prior to the execution of any cross-border M&A transaction. Acquirers should include in their due diligence process a review for any bribery or corruption issues. Particular attention should be given to the nuances of existing local and international anti-corruption legislation. If any bribery or corruption issues are discovered, legal counsel should advise on the appropriate resolution with the appropriate authorities and on structuring the transaction.

From a tax perspective, tax expertise should be obtained to provide advice on whether the transaction is taxable, the estimated tax cost, and whether the deal can be structured in a tax-deferred manner. For example, transfer taxes (such as stamp duty and value-added tax [VAT]) are a factor in considering whether to structure an asset or stock purchase. The target may have carryover tax attributes to consider, such as asset basis and net operating losses, as well as tax risks which may flow through to the acquirer post-acquisition. There may be elections available to step up the target's asset basis. To improve the tax benefits related to transaction debt financing, it may be possible to structure the deal to push down the debt financing to the target to reduce the tax burden of the acquirer (and possibly the target) through the interest deduction.

The tax laws in applicable U.S. states and foreign countries, including international trade, customs and tax laws, may be relevant. For cross-border transactions, some emerging market countries have made

tax changes to attract more foreign direct investment. It is important to know what those changes are, if any. To maximize whatever tax options are available, effective tax planning is a must to structure the transaction properly to incorporate tax synergies in the deal valuation. It also may be useful to plan an exit strategy to reduce tax exposures post-divestiture. To execute tax planning, the tax team must collaborate closely with the chief financial officer and the integration team from the deal's origination through closing and beyond.

The regulatory and tax considerations and their handling must be reviewed with and approved by the board of directors. In addition, approvals may be required by shareholders and lenders.

7. What is the board's role in a transaction?

As noted earlier, many studies peg the rate of failure of M&A transactions in fulfilling expectations somewhere between 70 and 90 percent.² Such performance is unacceptable in just about any endeavor. However, over time, old lessons in M&A failures continue to be relearned by many companies. The question arises as to the board's risk oversight role³ in overseeing the process of screening, selecting and pursuing M&A candidates, closing M&A transactions, and integrating merged and acquired entities, with an emphasis on reducing risk in M&A activity.

The board's role is different depending on whether a transaction is an acquisition or a sale. Management typically drives M&A activity on the buy side with the board reviewing and approving proposed transactions and advising on strategic fit, pricing, financing, structuring, due diligence, integration plans and disclosure, as dictated by the circumstances in each case. The high failure rate noted above suggests that the board's role should emphasize evaluating the assumptions underlying pro forma post-merger financial statements and assessing important risks and uncertainties against the upside opportunities posed by the transaction within the context of the organization's risk appetite.

The board has always had a broad role in championing good governance, overseeing strategy-setting, monitoring enterprise performance, overseeing risk management and advising management. These roles are relevant to overseeing M&A transactions. The discussion below is from an acquiring company's perspective.

As directors are responsible for approving a company's strategic plan, they should evaluate proposed acquisitions in the context of that plan and the organization's risk appetite. Therefore, the board should understand the strategic underpinnings of a proposed M&A transaction to evaluate management's assessment of the deal's benefits (e.g., cost savings, additional revenues through expected synergies that create new ways of doing business, cost-effective entrance into new markets, performance improvements through cost reductions, or resource acquisition to command higher price points). If the strategy envisions growth through acquisitions, the board needs to satisfy itself that the management team includes individuals with the requisite skills to execute transactions and integrate the acquired businesses. In effect, the board should be constructively engaged with executive management in formulating the company's M&A strategy and ensuring any M&A activity is consistent with the strategy.

Directors need to understand the risks inherent in the deal and the cultural and people issues involved. Most important, directors need to understand, and agree with, why the deal is being done in the context of strategic fit and incremental value-add. Directors must be careful with situations where management is emotionally invested in growing the company and potentially could lose objectivity in pursuing acquisition candidates. In addition, there may be significant risks of inaction that warrant careful consideration, particularly given changes occurring in the marketplace. The extent of the board's involvement in specific acquisitions depends on the magnitude of the transaction and the risks and uncertainties it presents to the organization.

² "The Big Idea: The New M&A Playbook," *Harvard Business Review*, by Clayton M. Christensen, Richard Alton, Curtis Rising, and Andrew Waldeck, March 2011: www.hbr.org/2011/03/the-big-idea-the-new-ma-playbook/ar/1.

³ Our focus here is on the board's risk oversight responsibilities and is not intended to examine the legal fiduciary responsibilities of the board.

Before approving the deal, the board should carefully review management's integration plan to ensure there is clarity around why integration is necessary, how it is to be achieved, who is leading the integration efforts, and what obstacles could frustrate execution of the plan.

In summary, when M&A targets are brought before the board, it's important that directors evaluate the transaction using a strategic context. In addition, directors must be satisfied that they're sufficiently involved in advising management in a timely manner on complex and risky M&A transactions warranting close board oversight.

8. What are the key phases of a transaction?

There are several key M&A phases:

- **Growth/portfolio strategy** – A company's M&A strategy should be a subset of its overall corporate growth strategy. The M&A strategy should provide a road map for corporate development, clearly articulating the expected value and contribution of M&A to the overall growth strategy. It facilitates the dialogue between executive management and the board of directors, enabling them to develop a shared view as to the role of M&A in executing the strategy. It defines the key "drivers" or "accelerants" that M&A can trigger in executing the strategy; defines funding and other constraints; profiles the desired strategic fit and criteria for screening acquisition candidates; and determines the company's acquisition valuation methodology. The strategy pulls all of these factors together to provide transparency for stakeholders to review and approve in the context of the risks and rewards of M&A pursuits in executing the overall growth strategy.
- **Due diligence** – This critical phase examines a potential M&A target to validate the prospective deal's value proposition; identifies material future matters that may affect deal valuation; discovers potential synergies and opportunities for structuring the transaction and assesses their impact; reviews current policies and processes to identify factors to consider in integration planning; analyzes the market and target to assess the players in the industry and emerging long-term trends; identifies potential risks and negative synergies; and facilitates an understanding of the target's underlying value to influence structuring of the deal and financing, particularly when large bid-ask spreads exist due to significant risks and uncertainties.
- **Integration planning** – This phase lays out the road map for delivering the synergies, efficiencies and growth promised in the transaction business case and is focused on delivering the expected value and transformational opportunities, versus merely combining two companies. The integration plan is developed by the integration team in collaboration with the business development team, consistent with the view that the integration process begins early on with the due diligence process to prepare the integration approach and establish focused, chartered integration teams, and continues through the ongoing management of the acquired entity immediately after the deal closes. The integration plan focuses on sustaining ongoing operations and managing the cultural differences between the acquiring and acquired entities; satisfying existing customers and business relationships (e.g., strategic suppliers, channel partners); identifying the critical decisions that must be made (including when they must be made); retaining key employees; maintaining labor relations and productivity; integrating different corporate cultures; and organizing the processes for delivering the expected value to shareholders. The plan articulates what must be done and the decisions that must be made post-acquisition on the first day, each week, the first 100 days, the first year, and thereafter.

- **Integration execution** – This phase typically requires the most time and resources during any transaction and also has the most risk. After the deal is closed, the baton is passed from the business development team to the integration team. The integration team provides the energy, discipline and focus for executing the integration plan. They also focus on ensuring the synergies, efficiencies and growth promised in the transaction business case are delivered and, to that end, measure and track progress and manage the change issues.

Merger integration entails all the risks commonly encountered by a business, plus the additional risks specific to bringing two organizations together. Every deal is unique, but the biggest risks to achieving the expected results are typically loss of customers or order volume to competitors, business interruptions (e.g., due to inability to ship orders or production disruptions), loss of key personnel and underachievement on savings projections. Each are discussed in more detail below.

- **Project management** – The M&A PMO supports acquisitions throughout the deal process, from due diligence through execution. As a centralized group providing governance and coordination over the activities of decentralized teams, it is responsible for: reviewing deals and developing the business case for deal pursuit, consistent with the strategy; collaborating on an ongoing basis with legal, accounting, tax, operating personnel and other staff involved in the deal process; gathering, analyzing and synthesizing the target fact base; organizing and presenting at meetings; planning the due diligence process, compiling due diligence lists and ensuring they're addressed by the right people and that the findings are summarized and communicated appropriately; coordinating the negotiation process; collaborating with and managing external advisers involved in the deal process; providing common tools, processes, and risk oversight to integration execution teams to ensure expected synergies, efficiencies and growth are delivered as promised and any new opportunities are identified and maximized; and collaborating with the legal team and others on authoring deal-related documentation, such as bid letters, process letters, confidentiality agreements, purchase agreements, and keep lists.
- **Change management** – Maximizing human capital once the acquisition is consummated is critical to deal success. Often, this entails integrating cultures and managing change within a consistent governance structure to deliver the expected synergies, efficiencies and growth underlying the deal's business case. Change management is all about supporting the integration process by: identifying cultural strengths and weaknesses, and how to leverage the strengths and overcome weaknesses presenting barriers to change; securing employee and stakeholder commitment through a shared and inclusive vision and effective organizational structure; providing the necessary employee training; designing and implementing change management plans; managing cultural issues of the new organization through appropriate prioritization, transparency and accountability; and tracking progress over time.

The next section discusses these phases in greater detail.



Key Phases of M&A Transactions

Due Diligence

9. Why focus on due diligence?

Conducting a thorough due diligence effort for an acquisition is more important now than ever. With the increase in corporate litigation, shareholder activism, heightened scrutiny of boards of directors and more disclosure obligations, companies cannot afford to make a mistake in an acquisition and assume unexpected liabilities. At the same time, acquisitive companies do not want to lose out on targeted acquisitions by overburdening a potential target with diligence requests that could derail a deal. A due diligence effort therefore must be carefully planned and executed so it can be conducted efficiently with the least amount of unnecessary intrusion.

10. What should be the focus of due diligence efforts?

In the M&A context, due diligence traditionally has been defined as the legal, financial and operational analysis a buyer undertakes to validate the seller's presentation of their company, focusing primarily on identifying the buyer's risks if they acquire a company. Increasingly, experts have challenged this risk-focused approach as too narrow in scope.

The most critical element when planning a due diligence effort is for the diligence team to understand the business objectives behind the acquisition. This understanding will help the team to prioritize the diligence effort and determine what information is important to review, and what can be skipped. A top business objective should be to determine the targeted sources of value in deals, which are often categorized as either combinational or transformational.

11. What is the difference in these types of targeted values?

Combinational synergies rely on merging operations, resulting in economies of scale. These synergies are less risky, easier to quantify, and more easily managed with a repeatable process (such as benchmarks). They are also typically the kind of value most often used in valuations. Not surprisingly, most integrations work predominantly on combinational synergies – often underplaying more complex and more profitable sources of value.

Transformational synergies, in contrast, typically come from unlocking one or more long-standing constraints on a business. This change can come from the impact of the merger itself or the role it plays in “unfreezing” the organization. But because transformation usually involves more complexity, it also can have a significant impact on an organization's resources. Management needs to focus on a handful of targeted functions, processes, capabilities or business units that can make breakthrough performance possible and financially worthwhile.

12. Based on the above, what are some due diligence best practices to consider?

- **Speed is a critical driver of success.** Identify the key decisions and don't let them languish. Research suggests that organization and people issues are essential to the success of most acquisition integrations. Proactively address these issues, which include:
 - Culture assessment/alignment
 - Leadership assessment
 - Talent retention
 - Benefits and compensation rationalization
- **Identify the M&A value drivers** early in the process and translate them into an M&A vision and scorecard.
- **Start detailed integration planning during due diligence.** The primary deliverable of due diligence should be the 100-day plan. Therefore, the 100-day plan should not be focused as much on figuring out “what to do,” but more on “how” to realize the targeted synergies and deal drivers identified during due diligence.
- **Drive accountability.** The senior management team must remain accountable for the success of the deal and for achieving the targeted synergies. Success cannot just be delegated to an integration project leader and his or her team.

13. Who should be part of the due diligence team?

Most due diligence teams include, at minimum, legal and accounting expertise, with additional resources assigned to cover HR, IT and other areas of operations. The exact makeup of the team will vary due to many factors: the nature of the deal, the industry, geographic location, the buyer's size, access to resources, and level of M&A expertise and experience of the team.

There are two key factors to keep in mind when building an effective due diligence team:

- Relevant and timely industry experience is crucial and should be considered across all areas of due diligence, including legal, accounting and operations.
- Lead roles should be staffed by people with in-depth industry and functional experience.

14. Are checklists helpful during due diligence?

Checklists are helpful for guidance, but should not be used to just “check the box.” The key to due diligence lies in asking the right follow-up questions at the right time. A well-defined due diligence process and tools such as checklists are important, but the right level of experienced resources is necessary to ask the right follow-up questions, which will provide the right answers.

15. What is a typical deliverable of the due diligence process?

In connection with understanding the objectives of the transaction, the due diligence team also needs to work with the business team running the transaction to reach a common understanding as to the work product they expect the due diligence effort to produce. The final work product delivered at the conclusion of a due diligence exercise can vary widely, and no two deliverables are ever identical.

On one end of the spectrum, the due diligence team may be asked only to highlight problems that have been discovered, either with the target organization itself or that may be faced during the integration process. On the other end of the spectrum, some companies prefer to receive a very detailed report, often hundreds of pages long, that summarizes in detail each and every contract. Most due diligence efforts end up somewhere in the middle.

At a minimum, a comprehensive analysis of the target's financial performance should be centered on three distinct areas, which include:

- **Quality of Earnings:** Because financial statements include the use of estimates and may contain nonrecurring or unusual income and expense items, it is important to determine whether the current financials are an accurate representation of the target's true earnings power. Generally, items to consider should include:
 - Do the target's earnings closely approximate cash flows, and if not, why?
 - What accounting treatments does the target utilize in relation to its peers, and what is the reasonableness of estimates?
 - What is the fundamental driver of earnings and which historical items should be excluded from assessing earnings quality?
 - How realistic are the target's projections in light of historical results and its operating environment?
 - What is the required capitalization of the entity, and what are the future capitalization requirements?
 - Is the target subject to any off-balance sheet or contingent liabilities that were not disclosed by management?
- **Financial and Operational Trends:** A focus on identifying and analyzing key financial and operational trends that are important to gauge the likely future earnings power of the target. Generally, buyers should consider:
 - What are the key factors that are driving margin compression or expansion, rate of cash conversion, and return on invested capital?
 - What is the impact of regulatory change on the target's earnings potential?
 - What is the target's performance with respect to key performance indicators (KPIs), and what is the quality and reasonableness of the benchmarks established?
- **Tax Diligence:** Taxes can present additional opportunities and risks to the buyer. They should consider:
 - What are the tax implications of completing the transaction?
 - What is the best structure to optimize tax attributes in addition to meeting the needs of the buyer?
 - What are the ongoing tax liabilities of the target, and what is the impact on the deal's internal rate of return?

16. Can information be shared between companies before the deal closes?

Capturing the value of a complex merger deal is never easy. To develop a well-thought-out integration plan that captures this value, important information (much of which may be proprietary) needs to be shared before the deal is closed. Unfortunately, regulations in the United States and other jurisdictions do not allow sharing competitively sensitive information prior to deal consummation.

However, more businesses are making very effective use of the period between regulatory filing and the close of the deal to organize and leverage “clean rooms” as a way to bring together data from all parties in a physical or virtual repository. They are then deploying “clean teams” charged with accelerating the

speed and quality of integration planning. These teams have access to all organizational data in ways that are fully compliant with antitrust regulations in the Hart-Scott-Rodino Act of 1976.

When correctly deployed, clean rooms and clean teams can help to reduce transaction costs significantly, quickly identify increased revenue opportunities, realize cost synergies, increase shareholder confidence, and streamline merger processes for employees and systems.

Integration Planning

17. What are key considerations during this phase?

Successful integrations deliver expected synergies and value while controlling risk and minimizing business disruption. Achieving these goals requires extensive cross-functional coordination, robust project management of timelines, interdependencies, and explicit pursuit of tangible benefits. This means that integrating all but the smallest of deals is one of the most complex tasks undertaken by many organizations today.

18. How should we structure the integration team?

Appointing the right team to manage the integration is one of the most important factors in determining the success of the integration. While a successful integration can't correct a poorly conceived deal, an unsuccessful integration can destroy the potential value of even the best strategic acquisition. Structuring the integration team correctly and staffing it appropriately are both essential to a successful integration.

Team structure should be modular, with a central PMO coordinating the activities of multiple function-specific teams. Functional teams should be appointed at the major function level (e.g., finance and accounting, IT, HR, sales and customer service, marketing, and operations/supply chain). There is a balance to be struck in the number of teams: having additional teams can reduce workload on each team, but at the expense of the need for increased coordination, more diffuse responsibility and slower decision-making. Appointing functional teams at the major-function level only is typically the right solution. In select instances, the most complex major functions can appoint sub-teams with additional members to handle isolated issues or particularly difficult areas of integration.

Some organizations consider regional/geographic approaches to integration. While it is important for the PMO and functional teams to incorporate regional considerations, it is often counterproductive to appoint regional integration teams. The only exception is smaller deals that are region-specific, which may be appropriate to integrate on a regional basis (with central oversight and governance).

19. Who should be on the PMO and functional teams?

Shifting gears from finding and executing a deal to integrating an acquisition requires both continuity with the due diligence team and the infusion of operating talent and project management capabilities. This often means maintaining core members of the diligence team, and bringing in new members to drive the integration.

- **Forming the PMO:** This is where there will be a need to both retain members of the due diligence team and incorporate project management consultants (either internal or external).
- **Forming functional teams:** These teams include employees from both organizations, and a dedicated liaison from the PMO. The number of members from each organization will be dependent on the type of integration (e.g., tuck-in versus merger of equals). Additional project management and analytical support may be required for each functional team: the extent of support needed will be driven by the complexity and scope of the functional integration.

20. What is the best governance model for the integration team?

Integrations should be overseen by a cross-functional steering committee that includes senior executives. Especially in the period before closing and the first 30 days of the integration, the steering committee should meet regularly to review progress, provide adequate opportunities to escalate issues for decision-making, and manage cross-functional interdependencies. Steering committee meetings can decrease in frequency once major decisions around integration scope and approach have been made and synergy targets with an associated tracking approach have been decided.

21. How do we define the scope of our integration efforts?

The scope and approach for integration will be dependent on the nature of the acquisition. Acquirers should have a clear business case used to support the acquisition, and that business case will answer questions that determine the scope of integration.

Different deal types demand different integration approaches. Matching the two is an intuitive, straightforward step that sets the tone for the entire integration:

	Relative Size of Target	Integration Approaches
Tuck-In	10 percent or less of acquirer's pre-deal sales/assets/enterprise value	Complete integration
Major Acquisition	10 to 75 percent of acquirer's size	Situational, based on value drivers for deal: can be complete integration, best-of-breed or minimal/portfolio approach
Merger of Equals	75 percent or more of acquirer's size	Best-of-breed or portfolio approach

22. What is the significance of the drivers of value during integration?

The value drivers have a major influence on which areas receive the most resources and contribute the greatest synergies in integration. Primary value drivers typically fall into one of the following categories:

Value Drivers	Integration Areas of Focus (Where Resources Will Be Applied)
• Economies of scale • Operating leverage • New products/services • New regions/markets • New channels	• Consolidation of operations • Elimination of excess capacity • Leveraging combined purchasing volume • Back-office integration and rationalization • Front-office integration • Operational execution • Organizational alignment • Back-office capabilities to support the business

In all scenarios, securing the benefits of the deal through the primary value drivers requires a combination of both controlling risk and capturing synergies.

23. What approach should be taken for integrating back-office functions?

Every acquisition will involve back-office consolidation and rationalization to some extent. Even simple portfolio acquisitions that are not integrated still require planning for consolidated financial and tax reporting. When beginning the integration process, the assumptions made during due diligence and negotiations should be revisited and used to set the tone for back-office integration.

The approach to back-office integration should be driven primarily by post-merger business needs, and also should consider expected cost synergies. Selecting an approach before functional teams begin work can drive efficiency and avoid wasted time: The selected approach can be challenged if functional teams make a strong case for a different approach. However, providing a top-down approach can allow functional teams to progress quickly by avoiding extended debate on integration approaches that don't deliver necessary cost savings.

High-level approaches to back-office integration include:

- **Shared services approach:** If one or both organizations already utilize a shared services environment, all activity can be migrated onto a single shared services platform over time.
- **Minimal integration:** If the acquirer intends to run the target as a separate business, only financial consolidation will be affected. In such situations, outsourcing may still be considered for cost reduction.
- **Complete integration:** In this scenario, duplicate functions are consolidated and the number of processing locations is reduced. Synergies come from economies of scale and reduction in duplicate management layers, even in instances where costs are dependent on transaction volumes.

Back-office integration approaches can vary widely and individual processes are often treated differently (with high-value or high-risk processes seeing more focused integration). Developing a high-level approach before starting detailed functional planning will help set the tone and ensure synergies are appropriately pursued. See the Integration Execution section for more information about integrating specific functional areas.

24. What approach should be taken for integrating IT systems?

The approach to systems integration is both dependent on and a driver of the overall integration approach. While business needs and potential synergies are primary drivers of an integration approach, onetime costs and implementation risks of IT integration must be considered.

The approach to IT integration typically maps to the overall integration approach:

- For complete integration and shared services implementations, all transactions usually are moved to the acquirer's system footprint. This can take the form of either migrating the target onto the acquirer's instance, or transitioning the target onto a new instance that mirrors the acquirer's.
- For minimal integration, the acquirer's systems continue to operate and financial consolidation is performed separately (e.g., in an acquirer's consolidation tool, such as Oracle Hyperion software).
- A "best of breed" approach is typically not cost-effective and increases the risk of business interruption. Under this type of approach, the two entities' systems are reviewed and compared. This theoretically allows selection of the best components of each IT environment. In practice, the costs, time and risk of integrating components from each of the two footprints typically outweigh the expected benefits. Instead, the functionalities most important to the business should dictate which system footprint of the two is selected and implemented across both organizations. See more specific information that follows on some leading practices to consider when integrating IT organizations.

25. How should integration plans be structured?

Studies have shown that deals with robust integration plans backed by explicit principles and policies for the integration period deliver greater shareholder value. The drivers behind this are typically detailed Day 1 and 100-day plans that provide the framework for a rapid integration process that pursues synergies/transformational opportunities on an expected timeline.

26. What are the key components of a Day 1 Plan?

The structure and content of a Day 1 Plan are driven by the plan's dual purpose: to provide clear guidance on what must happen immediately after closing and to serve as a control mechanism to ensure activities are executed. For this reason, a Day 1 Plan typically takes the form of an extended list of essential tasks organized by responsible function, combined with the rules for how key processes and systems will continue to operate while integration progresses. Preparing a Day 1 Plan is a valuable exercise beyond just the end product, because it requires the organizations to identify a) key decisions that must be made before closing and b) process gaps that need to be addressed.

There is a robust body of literature around Day 1 Plans, and examples are readily available. An effective plan should be usable (i.e., sortable and viewable) by multiple dimensions:

- By function
- By site/country/region
- By business unit (if applicable)
- The term “Day 1 Plan” is a misnomer, as these plans actually cover numerous activities leading up to a successful first day as a combined company. When done well, Day 1 planning makes it clear to employees, customers and investors that the merged company has the situation in hand and will continue to execute effectively during integration. When Day 1 planning is neglected or done poorly, companies can rapidly lose their most valued customers and employees.

27. What are the key components of a 100-day plan?

These plans can be frustrating to the newly initiated, because they can be detailed and lengthy. Integration is a unique situation where focusing solely on material items or leaving seemingly insignificant tasks to chance can have major negative consequences. So, by definition, 100-day plans must provide details of tasks across all functions that must take place to keep the integration moving. While many integration tasks are simple when considered individually, making continual progress across almost every part of the organization in parallel is what makes integration difficult and detailed planning necessary.

Similar to Day 1 Plans, there is an extensive body of literature around 100-day plans. For most integrations, these plans will be organized primarily by function, with tasks broken out by location/site. Key steps in a 100-day plan include:

- Implement short-term changes that either have immediate financial impact or are important to continued operations. Examples include migrating to common policies and procedures in both front- and back-office functions.
- Test and refine major assumptions about the integration approach and value drivers made during the due diligence phase. Develop the implementation approach (and, where appropriate, detailed plans) for achieving the desired future-state operating model over time.
- Implement organizational changes when possible. Such changes can be executed immediately in certain functional areas, while others must be phased in over time (to coincide with achieving the future-state operating model).

28. How detailed should Day 1 and 100-day plans be?

A high-level approach to integration planning simply is not adequate. Typical project management principles of matching the level of rigor to the level of risk or opportunity should not be applied. Because of the number of concurrent functional work streams and the extent of interdependencies, integration planning must be executed at a very detailed level.

29. What is the role of a Transition Service Agreement (TSA)?

TSAs are legal documents that govern services and/or goods provided by the seller after a deal closes. They specify the key terms under which each service or good will be provided including:

- Length of time for which services or goods will be provided
- Pricing
- Expected volumes (which may be subject to caps or volume-based pricing)
- Service level and staffing level
- Performance metrics (e.g., response time, error rates)

TSAs are commonly used when the target is a carve-out of a larger corporation or part of an operating group of companies. They also can be used in instances where the target has essential vendor contracts that do not allow change in control. Whenever the acquirer does not acquire full rights to an essential service, process or system, a TSA will be needed.

30. What functions/systems are commonly subject to TSAs?

Back-office functions are the most common area where TSAs are employed. When the target operates on a shared systems environment (i.e., the seller's other businesses outside of the acquisition will continue using the systems) and the target cannot be migrated to the acquirer's systems immediately, a TSA will be required. This is often done for finance and accounting functions in carve-out situations.

Although less common, manufacturing and distribution functions also can be temporarily contracted with the seller. For example, supply and tolling agreements are common in certain pharmaceutical deals.

31. How long should TSAs last?

It is in the best interests of both buyer and seller to keep the term of the TSA to the minimum reasonable length. This will keep the buyer focused on quickly integrating the acquisition, and help both organizations achieve their desired post-deal operating models. However, the acquirer must negotiate a TSA that allows sufficient time for a controlled migration from the seller's services and systems, including historical data migration. A rule of thumb is that TSAs should be six months in length, with options to extend the period by three months and six months (usually at a higher price).

TSAs of less than three months and more than one year are much less common. However, they may be necessary in unique situations such as highly customized information systems.

Integration Execution

Studies have shown the importance of integration execution to the success of deals. As noted earlier in this document, securing the benefits of the deal through the primary value drivers requires a combination of both controlling risk and capturing synergies.

32. Managing risk: What are the key types of risk in most integrations?

Merger integration entails all the risks commonly encountered by a business, plus the additional risks specific to bringing two organizations together. Every deal is unique, but the biggest risks to achieving the expected results are typically:

- Loss of customers or order volume to competitors
- Business interruption (e.g., due to inability to ship orders or production disruptions)
- Loss of key personnel
- Underachievement on savings projections

Each of these risks is real and should be considered carefully alongside the potential benefits of a deal. Recognizing the risks, identifying the levers that influence them, and estimating the probability of occurrence are important steps to managing integration risks.

33. How can the risk of losing customers and/or orders to competitors during integration be controlled?

Certain deals involve negative synergies due to expected customer losses following consolidation. Such losses can be estimated and included in financial modeling during due diligence. However, there is the additional risk of unexpected customer loss to competitors during integration. When poor integration negatively impacts customer service levels, significant value can be destroyed through lost orders.

Customers are always at risk in competitive environments. After mergers are announced, customers are more likely to focus on any disruptions in service and act on them. The following risk factors should be monitored during integration:

Risk Factors	Tactics to Manage Risk
• Poor communication with customers • Changes in ordering processes or pricing not well understood • Changes in vendor name/contact information/item numbers not processed	• Clearly defined Day 1 communication to customers, including a) proactive visits/calls to key accounts; b) mail and email communication to customer purchasing/accounts payable groups • Active monitoring and elevation of customer complaints during first 100 days • Active monitoring of key account volumes
• Changes in sales and customer service models	• Active solicitation of feedback (e.g., via survey) after changes to sales force structure/customer service models • Deep analysis of lost proposals or customers after changes to sales and customer service model, including customer interviews
• Billing errors (especially pricing)	• Integration of billing systems must be recognized and managed as one of the highest risk areas in systems integration, with extensive testing before implementation • Establish task force to collect all post-integration billing errors centrally, along with associated root cause analysis and reporting
• Shipment delays (refer to business interruption risk in the response to Question 32)	• Identify products, plants and production nodes with elevated risk of disruption during integration. Proactively consider safety stocks and alternate distribution paths to handle associated disruptions • Establish interim processes to elevate delays and missed orders rapidly, with associated metrics for addressing delays

34. What can be done to reduce the risk of losing essential talent?

During integration, companies risk losing key employees from both the acquirer and target. Executive recruiters (and competitors) will target talent during times of transition, including mergers. Companies must work to keep employees and simultaneously prepare for the loss of key talent.

Acquirers can take multiple, proactive steps to retain talent:

- **Move quickly.** Good decisions made quickly are often better than perfect decisions made slowly. Executives can be selected before closing or immediately thereafter. Managers then can be selected by executives, considering targets and the future-state operating model.
- **Pick winners (and losers).** Uncertainty around roles and reporting lines is one of the most commonly cited frustrations leading to attrition after mergers. Making clear personnel decisions and communicating them definitively can reduce the risk of losing top performers who become frustrated with uncertainty.
- **Use retention bonuses.** This can help to keep people on board during difficult transitional months. Retention programs add to integration costs, but can be more cost-effective than recruiting new personnel.
- **Communicate.** In situations where staff reductions are expected, all employees should be informed promptly of the timing, severance package, and process for selecting redundant employees.

35. How can companies prepare for and deal with the loss of key employees?

Companies should expect some attrition of key employees, in spite of all efforts to avoid it. Steps to manage this risk include:

- For critical posts, have succession plans (not just the Day 1 organization chart).
- In the HR work stream, include a plan and team assigned to “save” key talent when resignations are announced. The team should have access to tactics such as onetime monetary incentives and direct meetings/calls with senior executives.
- Build functional integration teams to avoid single points of failure. In resource-constrained situations, this is commonly accomplished via the inclusion of consulting resources on functional work stream teams.

36. Capturing synergies: How can realistic synergy targets be set?

Deals often under-deliver on expected synergies, and missteps in integration are commonly identified as the culprit. Achieving desired synergies requires more than just allocating targets and backing into the number of needed headcount reductions.

Synergy targets need to be rooted in solid business plans. We recommend that acquirers expand the high-level estimates developed during due diligence into more formal business cases. This can be done during the period between announcement and close. Business cases then provide the linkage between identifying value drivers during due diligence and taking action to deliver on their potential during integration.

Each business case starts with high-level synergy targets and value drivers identified during due diligence. One-time costs are added, and estimated timing for reaching run-rate savings is refined. Assumptions are pressure-tested and updated: This is the stage at which approaches to securing savings (and revenue synergies) are solidified. It is also when targets can be assigned to functional areas, business units or sites.

37. How deep in the organization should synergy targets be pushed for PMO monitoring?

Measurement often drives achievement, and the adage holds true in integration. Formally measuring synergies for one to three years after the deal closes is commonly considered leading practice. The hardest parts of driving achievement through metrics are:

- Setting baseline costs and appropriately measuring achievement of synergies over time.
- Assigning targets at the right level in the organization.
- While much has been written about measuring synergies, there has been limited focus on how deep in the organization these targets should be assigned. This important lever of achieving results is too often overlooked and handled on an ad hoc basis.
- PMOs commonly err on the side of driving targets too deep into an organization. In the pursuit of accountability (and hard-dollar estimates for use in populating templates), functional teams are required to estimate savings based on bottom-up, site-specific plans. This can cause functional teams to pursue tactical, siloed approaches to cutting costs, and to miss bigger opportunities.
- Holding targets at a higher level such as business unit or region, or even simply the functional level, can provide line managers with the flexibility and incentive to develop creative solutions that deliver savings.

Conversely, when targets aren't pushed to at least the functional level, functional integration teams often flounder and have trouble delivering savings without the pressure of stretch targets from executive management.

Project Management

All M&A transactions require robust, disciplined project management. Extensive interdependencies, aggressive timelines and the need to deliver clear improvements with measurable results all drive the need for project management's ability to handle complexity and drive forward progress.

In the section on integration planning, a number of topics were covered on project planning, team structure and choosing the project team. This lays the groundwork for project management. Executing over the first 100 days, the first year and the first two years of integration requires a disciplined, thoughtful approach to project management. Finding the right PMO and putting functional teams in place is an essential first step, followed by the tough but rewarding work of managing project plans and executing on them.

38. What are best practices for developing and maintaining integration project plans?

Should functional teams and cross-functional sub-teams be held to standards/templates for project planning?

Building, maintaining and managing project plans becomes exponentially harder as they are cascaded out into functional teams and topic-specific sub-teams:

- The PMO and functional teams will include members with strong project management skills (which can be supplemented by outside consultants, if necessary). However, sub-teams may have limited skills in formal project management.
- Rolling detailed plans up into a consolidated high-level plan is time-consuming and taps scarce resources. The problem is compounded when every plan is prepared differently.
- Resource management across work streams is difficult at best and, in some cases, simply not possible.

Following are recommendations for dealing with issues in managing multiple integration plans:

- Skilled project management resources are required at both the PMO and functional team levels. These staff members should be dedicated, not engaged part-time. Integration project management is simply too time-consuming a task to handle in addition to the responsibilities of a "day job," especially in the early stages of integration.

- Project planning and monitoring will require integration among the PMO, functional teams and issue-specific/cross-functional sub-teams. This is best facilitated by using a common project planning language, with emphasis on form over substance. Invest time in communicating this language, including project team training and support materials.
- Standardized templates are unpopular but necessary in some cases. Functional teams will have to provide high-level project planning information to the PMO for consolidation, including timing of milestones and major actions; onetime costs; headcount impacts; and projected savings. The PMO should keep the format concise and straightforward.

For functional work streams, we have seen two approaches that work:

Approach	Pros	Cons
PMO provides a common tool and templates that must be used for all work streams, and consolidates detailed plans	• Provides PMO with high visibility to detail • Interdependencies are explicitly identified and managed in the project plan • Allows resources to move across work streams • Allows PMO to drive progress centrally and more effectively	• Consolidation is time-consuming • Functional teams can be frustrated by PMO requests for edits • Can lead to focus on process, not results • More time and effort to train teams
Functional work streams select their own tools for detailed project management, and report summary information to PMO in standard templates	• Rapid kickoff because work streams use familiar tools • Detailed decisions and management performed closer to those with functional knowledge	• Less central control, more dependent on capabilities and driving of work streams • Work streams do double-work (detailed plans plus PMO's high-level plans) • Interdependencies must be tracked separately

Either approach can be made to work effectively. Organizations should select an approach that considers their culture, work style (including what approach worked on prior integration projects), internal capabilities, and level of consulting support.

39. What project management software (if any) should we use?

The PMO should coordinate the use of standardized project management software. Its use can vary among the PMO, functional teams and sub-teams. Project management software is almost always used at the PMO level (e.g., Microsoft Project or other project management software already used by the acquirer), and is also commonly used at the functional team level. Microsoft Excel can be used to capture basic data for sub-teams and sometimes is employed at the functional level, especially for smaller integrations.

Organizations that already use Microsoft SharePoint extensively may find a benefit from using it as a platform to assist with integration project management. However, this is only recommended for companies with extensive experience using SharePoint for task lists and workflow management (not just file sharing).

40. How often should the PMO's master project plan be updated?

The master project plan should be updated for significant changes every week through the first 100 days. The PMO should solicit information on significant changes from each of the functional teams, and incorporate those details into the master plan. A more comprehensive review and update can be done every two to four weeks. Because of the time involved, comprehensive updates should not be done weekly; this will unnecessarily divert resources from making progress.

After the first 100 days, the master plan can be updated less frequently. The timing of when the master plan can be abandoned (in favor of managing directly via the functional plans or even initiative-specific plans) will vary widely with the scope of integration activities undertaken.

41. How often should functional team plans be updated?

Functional team plans (as well as initiative-specific plans) should be maintained on a weekly basis. While this process can consume significant time and resources, it is important for maintaining momentum and actively identifying issues.

Change Management

42. Why do many integration efforts fail to reach the desired synergies?

A top reason why many M&A transactions fail to deliver on targeted values is lack of a “future-state vision” conceived at the executive level that can be communicated clearly to, and understood and acted upon by, department managers and front-line employees. It also is common for leadership to fail to recognize the complexity of the environment (e.g., different cultures and languages, multiple locations and organizational levels) that the merger will impact, and/or the complexity of the information that must be communicated to various audiences.

Without a clear vision or effective communication about the impact of change, together with the setting of actionable goals for the adoption of new policies and processes, securing employee buy-in for this type of significant change initiative will be difficult, if not impossible. If employees cannot see the need for change, or understand their value and impact on the change process, they are not likely to accept it – and may even go out of their way to resist it.

To communicate to their teams about change and help enable sustained knowledge transfer throughout the change implementation process, managers need to be equipped with the appropriate tools, processes and training. But strategic communication and training programs often are not developed or are introduced too late. The result is poor alignment of managers and employees with the future-state vision and transformation objectives.

43. What role can HR play in the change management effort?

The failure to bring HR into the change process early is another reason why many integration efforts fail to achieve the desired synergies. HR not only can help communicate the future-state vision to employees and address workers’ questions and concerns, but can also influence the organization’s ability to retain talent both during and after the implementation of change. However, a recent global study on post-transaction retention noted that HR “may not be aware of or brought into the deal process until well into due diligence, by which time its ability to influence the ‘who’ and ‘how’ of retention may be minimal.”⁴

In addition, not involving HR in the change process early can prevent organizations from assessing the level of “change readiness” for specific employee groups; thus, companies miss the opportunity to identify and address potential “people roadblocks” to success. It is also often the case that organizations unsuccessful in their change and transformation initiatives fail to monitor the implementation process effectively or measure change success, including how well employees are adapting to change.

⁴ *Retaining Talent After a Transaction: Lessons Learned From Organizations That Do It Well*, Towers Watson, Oct. 2012: www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2012/10/retaining-talent-after-a-transaction-lessons-from-organizations-that-do-it-well.

44. How can organizations better enable their employees to manage through a merger or acquisition?

To improve an organization's ability to achieve its targeted goals for any transaction, they should take time to develop and execute a customized change management program that focuses on education and awareness efforts designed to help employees navigate the changes that occur in these transactions. A strategic change management program can help to:

- **Increase speed of adoption of combined or transformed processes and systems** – Communications about change tend to focus on expected outcomes (e.g., a new system will be deployed by X date to X group of employees). But the actual speed of change adoption is influenced by employees' awareness of the need for the change, whether they have unanswered questions or outstanding concerns, and whether they decide to participate fully in the change.
- **Drive ultimate utilization** – Communications and training will impact an employee's level of understanding or attitude toward "opting in" or "opting out" of using a new process or accepting a new policy. Employees need to believe in the change, understand the change, and have adequate knowledge to help implement the change successfully.
- **Ensure proficiency** – How effective employees are when tasked with implementing change is tied directly to the cumulative improvement of each and every employee who will be doing his or her job differently because of the change.

"It is noteworthy that all survey respondents – regardless of their position or company size – identified the same top-two priorities regarding their personal skills: leadership within the organization and change management."

– 2014 Finance Priorities Survey: Negotiating a Challenging Business Landscape With Slippery Slopes and Uncertain Terrain, Protiviti. Available at www.protiviti.com/FinanceSurvey.

45. What are some change management leading practices?

While not all-inclusive, following are some other leading practices for better enabling change:

- **Assess readiness for change (current state)** – Organizations need to assess their current state, which includes measuring the level of employees' change readiness and determining if the purpose for change is understood clearly by all stakeholders.
- **Assess leadership capacity and stakeholder commitment** – It is essential for leaders and other stakeholders to have the credibility, reputation and skill to support the change effort.
- **Develop a change strategy and architecture** – Organizations should develop an explicit strategy and structure that define both the nature and sequence of communications, activities and resources required to facilitate the change process.
- **Develop a clear communication strategy** – Awareness around key goals should be built and progress toward attaining those goals should be communicated. Collective ownership of change and success should be emphasized and encouraged.
- **Increase individual and team capacity** – Organizations should take steps to increase the ability of both individuals and teams to act on the business vision (i.e., the future-state vision conceived at the corporate level) and to operate effectively in the new environment.
- **Assess culture and change alignment** – Leadership must assess alignment of the current culture with the change process and build new cultural values and behaviors to support the business.

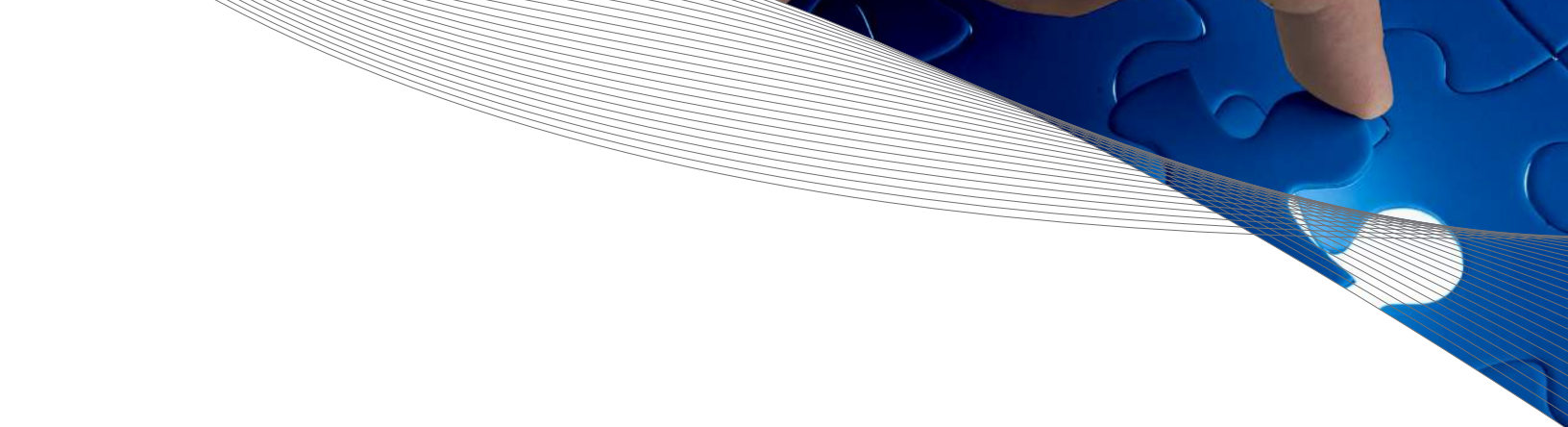
- **Organizational design and performance management** – This includes the development of systems for training employees, and measuring and rewarding their success.
- **Training** – Training is central to continuous “people support” throughout change and transformation initiatives. Customized, effective training can help employees navigate all types of change, from system upgrades to policy updates to new information flow processes.

46. How important is effective communication and what are some leading practices in this area?

M&A transactions need the full support of employees to be successful, which is why the importance of strategic communication programs with broad reach and deep impact cannot be overstated. In large-scale integration efforts, especially, customized communication programs that clearly outline the speed and urgency of change, and answer for employees the “What’s in it for me?” question, can help foster workforce engagement and the adoption of new processes and policies.

Some best practices for creating an effective communication strategy that helps support a change effort include:

- Developing a formal communication process and program, including lexicon and branding guidelines, with help from communication leaders such as HR and operations managers
- Assessing the best methodology to conduct rapid employee education and awareness of the change vision (i.e., future-state vision set at the executive level)
- Creating support materials, including a “communication map” that outlines defined communication methods, messages and events
- Establishing metrics for communication feedback and effectiveness
- Developing customized, front-line engagement communication and training tools to help facilitate knowledge transfer and behavioral shifts during the integration effort



Key Functional Integration Areas

Finance

47. What are some of the unique issues related to integrating finance organizations?

When two companies merge, integrating their finance functions is a major and time-sensitive imperative. Variations in financial standards and procedures can prevent the merged entity's finance function from effective daily operations, impacting both internal and external stakeholders who will demand consolidated financial statements, earnings and projections as soon as possible.

Treatment of common customers and vendors from the two companies in the finance processes and systems will be an important consideration for the finance organization to ensure that transactions are recorded properly (i.e., to prevent duplicate or misapplied items) for the newly combined company.

Additionally, a majority of the potential gains from a merger cannot be achieved without committed support from finance, which will put a strain on its resources and needs to be accounted for in developing integration plans.

48. What key risks should finance executives consider in the planning of the integration?

Many companies recognize this challenge and give substantial attention to financial integration soon after announcing the deal. However, this urgency creates its own problems. Under time pressure, finance professionals will feel rushed to combine disparate numbers and harmonize divergent processes. If they do not yet have a clear vision of the new company's future state, they may implement manual temporary workarounds, such as preparing manual reconciliations of customer accounts, which require incremental work effort, cost and risk to finance. By focusing only on interim integration work and not considering the future state in parallel, many companies risk that the manual interim state will one day become the future state.

Maintaining disparate and manually integrated systems limits opportunity for future standardization and cost reduction, thereby preventing promised synergy capture. Only through proper investment in process and system automation, such as integrating financial and management reporting processes and tools, can the cost of finance be reduced, service levels to the business optimized, and finance function synergies realized. Companies that implement temporary manual solutions to integrate for Day 1 and then design the future state risk significant rework and throw-away of interim solutions.

Executives could achieve better results in the long run if they took time up front to consider the transformational goals for finance:

- What should the combined finance organization structure look like?
- Which operations, processes and systems should be adopted?
- What financial advantages do they expect the merger to produce?
- What benefits can business units expect from finance?
- What finance-related milestones are essential and practical for Day 1 of the new company?

49. What are some key Day 1 planning items on which to focus?

Among the Day 1 “must haves” are several legal items the company should have an understanding of in order to operate as a combined company. These include changes to the names of legal entities; new signature approvals; and combined external reporting and key internal financial reporting.

However, the level of harmonization and automation for some of these items may depend on the time taken to integrate before Day 1. Thus, integration team members may have some latitude on the sophistication of their solutions.

In addition to Day 1 “must haves,” the treasury function requires a solid cash position and visibility into the daily cash position, ensuring legacy accounts have been transitioned and that existing accounts have adequate cash positions to enable daily clearing and anticipated cash withdrawals. This is often overlooked as part of the integration planning effort but is vital to maintaining the correct levels of cash management within the organization.

50. Beyond Day 1 to 100, what are the key considerations from a finance organization perspective that need to be addressed to enhance the transition?

A finance program office should be in place from Day 90 through the final stabilization. This program will lead the finance sub-teams to manage operational continuity, execute prioritized near-term (Day 100) activities, and identify synergies – all while keeping key customers, employees and investors informed of the integration strategy and plans. Key considerations include:

Finance integration:

- Define integration team reporting relationships (both direct-line and dotted-line reporting).
- Establish and execute reporting and issue management processes.
- Deploy standard planning tools and templates.
- Define key integration milestones and overall roadmap.
- Define communication channels between transition teams.
- Define team participation “boundaries” and information sharing for both parties, including use of “clean teams.”

Finance sub-team integration:

- Prepare business and functional-level integration plans for Day 1 operational continuity.
- Define Day 100 priorities, projects and supporting work plans based on “as-is” and “to-be” assessments.
- Execute integration “quick wins” and Day 1 and Day 100 plans to achieve operational requirements and synergies.
- Identify key issues and prepare contingency plans to manage and respond.

Finance change management:

- Detail and execute a communication plan for all stakeholders.
- Establish retention agreements for key individuals.
- Define strategies to address key cultural differences.
- Create Q&A mechanisms to address issues and rumors.

51. What should the finance organization plan for beyond Day 100?

The finance program office should maintain sub-process and functional team priorities, as well as resource allocation with long-term initiatives needed to drive organizational, process and systems change. Clear repeatable processes to track the achievement of synergies should be defined. Finally, plans and long-term positions to transition to “business as usual” leadership should be established. Beyond Day 100 key finance considerations include:

Finance integration management:

- Define, plan and resource long-term finance integration and optimization projects.
- Refine key integration milestones and overall roadmap.
- Manage transition of resources and reporting to “business as usual” structure.

Finance functional integration:

- Optimize key finance policies, processes and finance systems (e.g., financial reporting standards, planning and budgeting roll-up and forecasting templates).
- Implement leading practices for key finance processes and information systems that were not able to be changed during the initial integration effort.
- Eliminate remaining redundancies in processes and systems.
- Develop platforms to scale for future organic and/or acquisition growth.
- Revise synergy targets and estimated run-rates based on progress of first 100 days and what “steady stable” will look like (i.e., conversion of integration scorecard to “run the business” scorecard).
- Refine go-forward synergy tracking and reporting process based on transition to business as usual.

Finance change management:

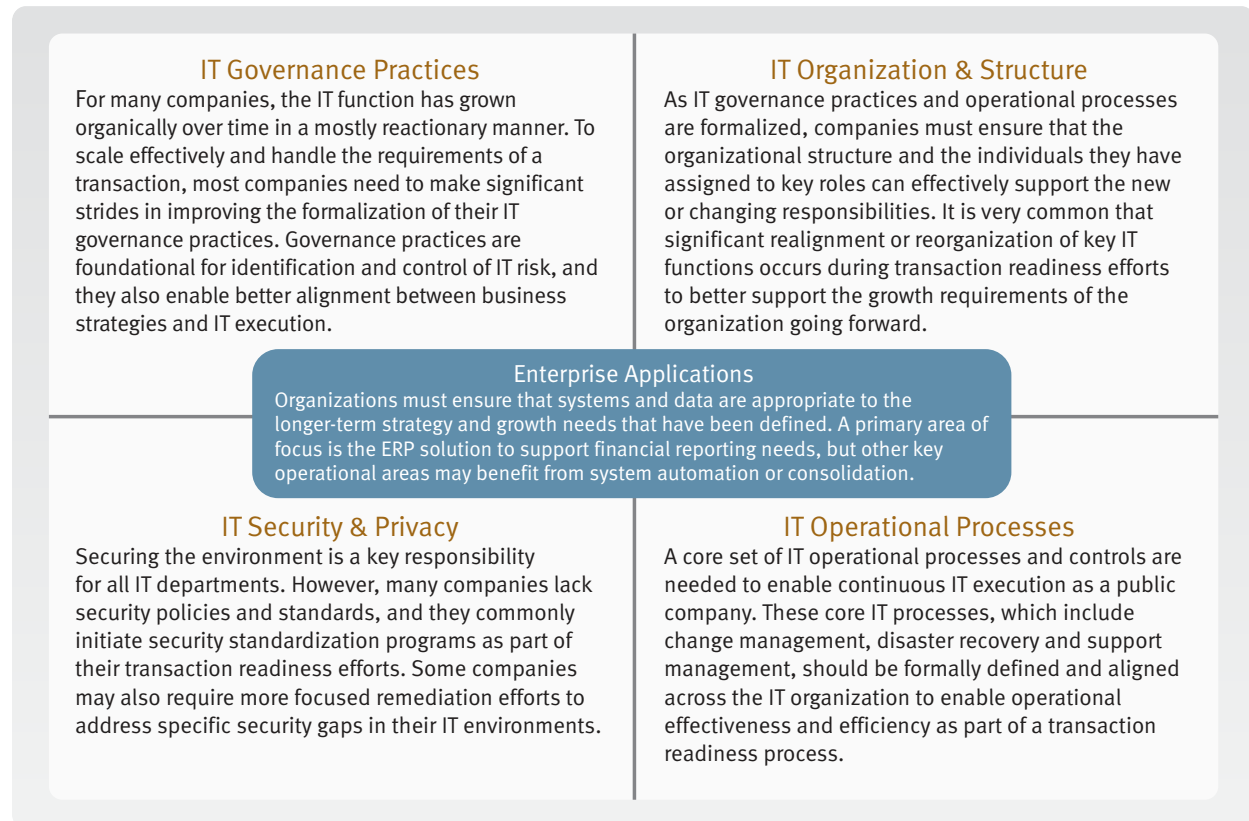
- Revise training procedures based on the new process enhancements and policy modifications.
- Conduct job and workplace skills training (per finance function and sub-process).
- Implement revised finance change management plans.
- Continue to manage cultural issues of new organization infrastructure.
- Monitor progress toward cultural goals.

Information Technology (IT)

52. What are some of the unique issues related to integrating IT organizations?

Because technology has become so pervasive, IT touches virtually all aspects of a company's operations, and many of these functions are mission-critical. IT is the common denominator among all corporate departments, and insufficient technology support in the wake of a merger virtually guarantees that potential synergies within affected departments will fail to materialize.

A comprehensive approach is needed to address the key areas of IT consideration, including:



Aligned IT capabilities enable enterprise strategy and application functionality.

- **Enterprise applications and data:** Core information systems need to support the requirements of the combined organization, including aligning processes and controls and consolidating and eliminating redundant functionality and platforms.
- **IT governance:** Establishing the proper set of policies, practices and functions to enable ongoing control of IT risks and alignment between business strategies and IT execution.
- **IT organization and structure:** Reorganization of key IT functions and responsibilities is typically required to better support the mission, vision and strategy of the combined organization going forward.
- **IT operational processes:** Core processes need to be aligned and integrated across the IT organization to enable operational effectiveness and efficiency post-merger (e.g., change management, disaster recovery, help desk, performance monitoring).

- **Information security and privacy:** Policies, standards and responsibilities for ensuring appropriate handling and protection of company data need to be clearly and consistently defined across the combined organization.
- **IT infrastructure:** Platforms, hardware and network components supporting the enterprise applications and IT operations need to be integrated and standardized, potentially including data center consolidation and migration efforts (e.g., to a larger combined facility).

“In one out of four organizations, management has limited or no understanding of what constitutes ‘sensitive’ data and information, and needs to do a much better job of communicating to their organizations about differentiating between public and sensitive data.”

– *Knowing How – and Where – Your Confidential Data Is Classified and Managed: A Survey on the Current State of IT Security and Privacy Policies and Practices*, Protiviti. Available at www.protiviti.com/ITSecuritySurvey.

53. How does a chief information officer (CIO) manage competing priorities?

While ensuring that IT delivers required value during merger integration, CIOs must balance three competing priorities in the process. First, they are tasked with simply “keeping the lights on” or continuing the business-as-usual functions for employees during a time of corporate stress, and in the face of technological risks inherent in a large-scale change in systems. At the same time, they also must combine the IT departments of merging entities (including software, hardware and staffing resources), often with the goal of reducing costs. Finally, CIOs must balance these steps with the larger goals of providing IT support for the integration of other company functions – such as HR, finance and operations, in which the potential synergies are often far greater – and establishing an end-state enterprise architecture to support the new company’s future growth.

54. What is the best approach to managing the integration process?

Step One: Gather requirements and assess gaps in capabilities.

The first step in merger integration should happen during the due diligence phase, when IT must develop an initial understanding of all technological requirements created by the merger. This starts by evaluating requirements within the IT department itself. CIOs need to develop a comprehensive understanding of the IT resources on both sides of the deal to determine how the two entities can fit together, where any possible synergies can be found, and where integration risks might lie. This requires a census of IT infrastructure and a plan for rationalizing resources and eliminating redundancies in the department. Areas of analysis include:

- Hardware, software and network systems
- Enterprise applications and data (e.g., enterprise resource planning (ERP) and/or customer relationship management systems)
- Corporate programs for specific lines of business, products, services and vendor platforms

Step Two: Prioritize initiatives.

Given that IT resources are likely to be stretched thin during merger integration, technology leaders must take a systematic approach to ensure these resources are deployed in the most effective way. When IT is looped into the process of integration planning early, they can work in conjunction with business teams to decide how best to prioritize projects.

These priorities should be considered across three dimensions:

- Business impact, including regulatory compliance, risk management, and possible rationalization of services or product lines
- Ease of implementation, including technical complexity, resource demands (personnel and technological), and the degree to which certain projects are interdependent with others
- Expected business benefit, including potential cost savings and growth in revenue and/or market share

Step Three: Develop an integrated implementation road map.

Once CIOs have identified integration priorities for both the IT department and new corporate structure, they can translate this list into a road map that includes subprojects, detailed timelines and contingency plans. The map likely will uncover overlaps across the prioritized initiatives and key gaps in the IT capabilities needed to carry them out. A robust map should include a plan to address those imbalances. Furthermore, it should include key conditions and success factors for each step.

A detailed implementation plan requires overcoming several challenges. First, IT departments must balance multiple types of projects and initiatives from the three primary objectives discussed earlier: continuing business-as-usual operations to maintain stability during integration; rationalizing enterprise applications, data, infrastructure and staffing resources of the combined entity; and supporting business projects that require adjustments to IT platforms.

Second, these departments must identify and address sequencing issues. Several initiatives may have related interdependencies that mandate a specific order of execution, potentially including broader business integration efforts being led outside of the IT organization. The implementation road map should be updated to include these scheduling requirements, and the IT plans should be closely aligned with the overall change management efforts.

55. What key risks should IT leadership consider in the planning of the integration?

A common pitfall in merger integration planning is to place too much emphasis on the IT department itself – specifically, short-term cost savings from integrating IT resources – and not enough on the IT requirements or new business capabilities needed to bring the company's other functions together or to support future growth. This occurs when executives from IT and the main business are not in alignment during the strategic framework, analysis and design stages. However, when IT and business units are working closely together, CIOs can assemble a comprehensive list of all initiatives and objectives related to IT support for the merger.

56. How do organizations manage all competing IT initiatives?

A key reason why strong governance is so crucial for merger integration is timing. Merger integration efforts typically occur over a sustained period, during which circumstances can evolve and many elements of the original plan can change. A solid governance structure that encompasses IT and business will help ensure these changes are addressed in a consistent manner across the combined firm, rather than in silos.

Several best practices can improve the likelihood of a successful governance structure:

- The IT implementation leadership team must be identified early in the merger process to reduce uncertainty in the organization and set clear lines of responsibility. Chief among these responsibilities are defining potential initiatives and marshaling the IT resources needed to support them.
- Cultural issues are usually significant in determining the success of mergers and thus need to be addressed head on. Differences manifest themselves not only between the corporate cultures on either side of a deal, but also between IT and business functions in the same organization. The ability to understand and manage behaviors, while acknowledging complementary strengths and skill sets, is critical to merger integration.

- Consistent criteria are needed to decide how resources – including money, talent and business processes – are to be allocated among competing priorities.
- Mergers are inherently stressful for the IT organization, but clear and frequent communication can help alleviate this problem. In particular, senior IT management should establish and enforce principles that set the tone for integration, including articulating the overall vision behind the deal. At the same time, a transparent process for making decisions, along with straightforward communication of those decisions through all levels of the organization, will help ensure employees understand the rationale behind difficult choices and act quickly in support of them. Often, this requires candidly discussing the trade-offs and potential risks to business operations, service levels, and other aspects of the company, alongside a frank discussion of how those trade-offs are necessary for the organization's long-term success.

Supply Chain/Procurement

57. What are the key issues in integrating the procurement function?

Procurement typically generates the greatest short-term savings during a merger and is therefore often a visible and critical element in delivering value to most deals. While procurement has the same organizational design issues as other units, it also must quickly mobilize its efforts to realize short-term savings targets.

58. What is the best approach to managing this type of multipronged effort?

The best approach is to follow a phased strategic sourcing plan that focuses first on key organizational and operational issues, such as team leadership, initial organization design, potential benefits and ease of implementation. It is critical to understand where external purchases can be consolidated. Typically, companies start by looking at indirect goods and services, but sizeable savings can often be found on the direct side (e.g., raw materials for companies that manufacture similar items) as well. Developing an up-front understanding of spend by category, business unit and location in the merged entity will enable an organization to identify where cost savings and/or service-level improvement opportunities exist. Gathering and normalizing spend data are critical. There then should be an immediate focus on capturing procurement synergies, which usually entails a multistep process of understanding the total cost of ownership of the current suppliers, evaluating viable alternative suppliers, developing category-specific sourcing strategies, identifying potential savings (while maintaining or improving service levels), and negotiating new agreements where applicable. Lastly, developing tracking tools to ensure compliance with the new agreements will capture the ultimate value of the merger in the longer term.

59. How should teams best organize to achieve these objectives?

A coordinated effort to focus on organizational design, savings capture and Day 1 coordination can help keep responsibilities straight and teams focused on key priorities. Organizations that succeed in this area usually develop cross-functional teams who understand the technical constraints that may exist in certain strategic categories. For example, at a high level it may seem that common goods and services are procured; however, slight but strategically important nuances might exist that need to be factored into projected savings. A category that may seem relatively easy may in fact need to be delayed due to internal constraints.

60. Isn't most of an organization's data around its vendors and supply chain proprietary and confidential?

Yes, and as discussed above, a “clean room” approach, with some use of nondisclosure agreements, can be put in place that allows teams to collect and use confidential information without violating laws, or placing organizations at a disadvantage if the deal fails to close.

61. Where do savings typically come from in the procurement/supply chain functions?

Usually, the area that generates the greatest long-term savings is adopting sourcing best practices. The best way to achieve these savings is to use a well-structured sourcing methodology that pursues opportunities in waves, starting with the easiest and most rewarding areas first. For indirect, highly commoditized categories (e.g., office supplies), sourcing strategies may include volume concentration and/or consolidating the number of suppliers. For less straightforward categories, successful companies measure total cost of ownership (TCO), allowing them to complete a best price evaluation and award business to their most valued suppliers. Finally, if volume concentration and best price evaluation prove challenging, savings can come from product specification improvement, joint process improvement and demand management.

62. Are there other sources of value within supply chain/procurement?

While strategic sourcing is a logical place to start, companies can also look at areas such as procurement process improvement. For example, a detailed data-driven review may uncover opportunities to re-engineer, standardize or automate processes that the two companies performed differently or in an ad hoc way before. An opportunity exists to remove bottlenecks, develop consistent standards, and ensure roles and responsibilities are well understood. As a result, a more productive merged entity can often shed headcount within the supply chain and procurement functions. Other sources of value beyond just supply chain and procurement include selling, general and administrative (SG&A) cost reduction, product rationalization, and manufacturing overhead reduction.

Marketing and Sales

63. What types of issues can impact the marketing and sales organization during an M&A transaction?

Mergers generate anxiety inside and outside the companies involved in the deal, and competitors happily exploit such fears in order to recruit star salespeople and poach customers. Leading companies embrace the opportunity to build a new sales organization that is more than the sum of its parts.

Key steps are essential to facilitating successful integration of sales operations:

- Understanding the importance of sharing information about the integration process with customers and the sales force tops the list. Many companies take the opposite approach and are surprised when post-merger revenue fails to meet expectations.
- The combined sales team must quickly maintain existing key accounts, and also win new prominent accounts, to build momentum and internal confidence in the merger.
- The executives running the integration effort must recognize the need to identify and retain essential support people, as well as sales representatives.
- Senior managers should review the merged portfolio of customers and make tough calls about who warrants new investments, and who might be shed or given less attention.

64. What are leading practices to address some of these key issues?

- **Strong, clear, timely communications** – Some companies choose not to involve their customers in merger-related activities such as changes in organizational structures and roles, customer engagement rules, and customer support. But most customers are willing and even eager to help a merging organization reshape itself. They prefer to participate in – rather than learn after the fact – changes that may impact them.

Leading companies take a broad view of their relationships with customers, discussing not only the details of the sales relationship, but also such issues as contracting, delivery and support. Involving and communicating openly with key customers can help make them feel their needs and expectations are being addressed and that they are a part of the merger success.

- **Involvement of salespeople in the integration process** – Because most sales representatives must stay focused on revenue targets and compensation in order to succeed, many companies seek to protect them during this process so they can concentrate on customers and continue to make sales.

However, most salespeople are hungry for information. Uncertainty about the organization's structure and customer assignments can slow sales as the salespeople spend time discussing the issues and planning for the worst. Sales representatives need reassurance about internal issues, such as how they will be compensated and who will cover which accounts. Otherwise, high performers may defect to competitors.

- **Best-practice acquirers who track progress carefully** – Best-practice acquirers monitor the sales integration process closely, following lagging indicators, like revenue, as well as leading indicators, such as how much training on new products is happening, how long deals take to close, how often prices or contracts must be altered, how much sales shrink, and how many customers previously served by both merging companies are won or lost.
- **Sales momentum build-up** – Best-practice integrators know that the first 100 days after a merger closes are critical to demonstrating the deal's value and tangible benefits to the sales force, customers and investors. These companies focus on winning a few critical large transactions early as proof-of-concept cases, using the full weight of the top team, product development, salespeople and technical support.

Sales of products identified as “quick wins” – those most easily sold initially to customers of both merging companies – provide an immediate, focused experience for the sales force. At the outset, sales performance incentives should target such transactions.

The timing of IT integration can often put a deal's early sales momentum at risk. Leading integrators accept the reality that momentum may require temporary plug-and-play solutions for IT and finance. These workarounds ensure sales representatives can make forecasts, enter joint orders, gain pricing approval, manage exceptions and orders that need to be expedited, and troubleshoot issues in sales crediting and compensation.

- **Looking beyond sales representatives** – Retaining top sales force talent is critical, and it's easy to use revenue statistics to decide who stays and who goes in any integration effort. Yet all organizations employ certain people whose contributions are less easily measured, but who are nevertheless the “glue” of a high-performing sales team.

Best-practice integrators identify these people and their place in the organization's internal network and target them for retention early. These employees may be sales support staff in functional areas like IT and finance, for example. An incomplete process for categorizing employees risks losing the value of this network.

- **Consideration of the sequence for unveiling the integrated sales unit and selecting staff for retention** – Reorganizing the front-line sales staff and back-office support simultaneously can disrupt customer service significantly. Deferring changes in support functions until account coverage and related matters have been resolved may help ensure uninterrupted customer service.
- **Review of the customer portfolio** – Most sales organizations in a merger focus on retaining all customers, regardless of expense. That's natural, given the heightened awareness of competitors' actions and the desire to show the company is meeting revenue expectations. But mergers provide an opportunity to refocus on the most important and promising customers and to allocate resources to meet their needs more fully.

While altering long-standing customer relationships is never easy, best-practice integrators use the merger process to evaluate a portfolio critically. To ensure they focus on the most profitable accounts, they examine the true cost of serving customers – support activities and sales representatives' time. They explore options for reallocating account resources, which may mean reducing coverage for customers receiving top-tier service because of historical relationships rather than profitability. And these integrators are willing to have difficult conversations with customers – discussing contracts, terms and conditions, pricing, and anything else that affects account profitability.

Internal Audit/Risk and Compliance Functions

65. How can internal audit assist an organization during the M&A process?

As noted earlier, M&A transactions have a mixed track record in achieving the targeted financial returns due to the numerous risks outlined in this document. As boards are taking a more active risk oversight role in these deals, they will need assistance to evaluate the risks independently and understand if management is providing the appropriate risk management planning and execution for these transactions.

When deals are then presented to the board, directors need to understand the inherent risks. Most importantly, they need to understand, and agree, why the deal is being done in the context of strategic fit and incremental value-add. The internal audit function should seek to become involved as early as possible in the M&A process and provide value-added assistance by conducting a risk assessment, including assessing the corporate strategy process, especially as it relates to growth by acquisition. Once an acquisition strategy has been determined, an audit review can add great value if its findings are geared toward preparing the company for diversification.

A risk-based approach by internal audit during M&A projects can focus on identifying risks and helping organizations determine what events or circumstances could create an obstacle to meeting targeted synergies. Management can set the main objectives of the merger or acquisition, and internal audit can assess the process of setting these strategic objectives, the monitoring process, and the level of risk mitigation.

66. How can internal audit add value during due diligence?

Internal audit can ensure that the due diligence process has covered all key issues related to the financial, operational, and regulatory and compliance areas. Due diligence is often accomplished within a limited time frame, and top management often doesn't consider major control issues or deficiencies associated with the target company. Internal audit can ensure these areas are addressed during the due diligence process.

For example, the target company in a merger or acquisition may have significantly different systems and processes than the acquiring organization. Effective documentation and assessment of the possible risk and control issues conducted at a pre-acquisition stage can reduce the cost of integrating these systems and processes in the newly formed company. This review also can be useful for future audits and help to save time during the post-acquisition audit stage.

67. Can internal audit be involved in integration planning and execution?

During this phase, the main objective is for the two organizations to integrate smoothly into one firm, accomplishing the planned level of synergy. Integration can be very risky for many of the reasons noted earlier.

Internal audit can help mitigate risks by:

- Playing advisory roles to functions carrying out the integration. There are various changes in the internal environment of the new firm, and management and employees may often be distracted. Because of their level of process expertise and knowledge of the control environment, auditors can help other functions such as finance, information systems, and HR overcome possible obstacles during this stage.
- Internal audit should assess and follow up on the major issues and weaknesses identified during the due diligence stage.

68. What is a post-acquisition audit?

A post-acquisition audit should be the final stage of any M&A project. As an independent party, internal audit should lead a review that focuses on value synergies achieved against targets set, and the associated root causes that resulted in exceeding or falling short of transaction expectations.

Important to the success of this stage is internal audit's level of involvement during the previous stages. Lack of involvement in earlier stages can lead to difficulties and time-consuming activities to gain an understanding of the newly built organization's key risks and processes as well as to affect the documentation of key controls and development of the audit plan.

A greater level of involvement during the earlier stages can lead to deeper knowledge of the newly acquired company and the difficulties faced at the previous stages. This means that audit planning can be designed in detail and focused on key areas. This involvement also could result in cost and time savings.

By being involved during earlier stages, internal audit can prepare a lessons-learned document about the M&A process. Toward the end of the project, there is an opportunity to reflect back and document significant lessons learned. Major or minor issues that arose can be summarized and used to address obstacles during the M&A project and set a smoother course for future transactions. This documentation also can include the most significant observations and comments from the various stages of the process as well as recommendations relating to project management, scoping, risk assessment, documentation of internal controls, and deficiencies evaluations.

69. What typically keeps internal audit from being more involved in M&A efforts?

Internal audit should be up to the challenge of participating in M&A projects and expanding their role in the organization. However, they first may need to overcome various issues such as a negative perception by management about their new role. Management sometimes views internal audit as mere fact-checkers and not a source of important new information. However, internal audit knows they can effectively contribute to an M&A project because of their deep knowledge of processes and controls.

Often, with limited allocation of audit resources from the audit committee, internal audit will need to free up resources needed to work on M&A transactions by concentrating their audit planning on higher-probability, higher-impact risks and reducing low-probability and low-impact risks from annual plans and audits.

Internal audit also will need to be careful about managing their independence and objectivity in any role other than providing assurance in line with The Institute of Internal Auditors' Standards. But they can provide invaluable support to senior management and act as key advisers throughout the M&A process.

Conclusion

Mergers and acquisitions are some of the most powerful and versatile growth tools employed by companies of all sizes and in all industries. A well-timed and well-managed purchase or merger can boost both the short-term as well as long-term outlook for many organizations.

But as noted above, there are many risks that can cause a significant loss of shareholder value if a transaction is not conceived and executed carefully and strategically. This guide is intended to answer the most frequently asked questions we hear from our clients – from identifying and valuing the right targets, to planning and managing the integration, all the way through the post-acquisition audit.

About Protiviti Inc.

Protiviti (www.protiviti.com) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit, and has served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. Protiviti and our independently owned Member Firms serve clients through a network of more than 70 locations in over 20 countries. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

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About Our Merger and Acquisition Solutions Capabilities

“There were many moving parts and two companies coming together that needed the experience and help you provided. I was personally very grateful for your ability to define the business need AND truly understand how to drive the deliverables to completion. I was impressed with your professionalism and overall ‘can do’ attitude.”

– Product Lead and Senior Vice President

Merging two or more organizations is a complex transaction filled with risk. The best deals follow a structured and disciplined approach with clear strategic objectives, comprehensive due diligence, detailed integration plans, and a focus on creating and capturing value. Although such planned approaches may sound simple, history shows many failed M&A attempts that have resulted in significant impacts to shareholder value.

Our structure allows us to respond quickly to your needs on a global basis with cross-disciplined teams that bring broad perspectives and deep expertise capable of leading the transaction PMO and diving deep into a variety of business and regulatory issues. With our structure, we are uniquely able to deploy a flexible delivery model that adapts to the constantly changing fixed and variable resourcing needs of each transaction.

We have assisted some of the world’s largest organizations with some of the biggest transactions in history, providing services across a range of operations and assets. We focus on key risk areas like no other partner you will work with, with proven project management tools and techniques that help fully capture the targeted results of your deal.

Contacts

Jim Ryan

Global Leader – Mergers and Acquisitions
+1.314.656.1745
jim.ryan@protiviti.com

Thomas Andreesen

+1.312.476.6318
thomas.andreesen@protiviti.com

Andrew Clinton

+44.20.7024.7570
andrew.clinton@protiviti.co.uk

Kimberly Dickerson

+1.312.476.6409
kimberly.dickerson@protiviti.com

Charles Goldstein

+1.410.454.6830
charles.goldstein@protiviti.com

David Haufler

+1.704.916.6599
david.haufler@protiviti.com

Steve Hobbs

+1.415.402.6913
steve.hobbs@protiviti.com

Christopher Low

+86.185.0165.4499
christopher.low@protiviti.com

Trey MacDonald

+1.404.926.4330
trey.macdonald@protiviti.com

Barry Rieger

+1.410.454.6862
barry.rieger@protiviti.com

Ryan Senter

+1.469.374.2425
ryan.senter@protiviti.com

Charles Soranno

+1.732.326.4518
charles.soranno@protiviti.com

Adam Weber

+1.410.454.6817
adam.weber@protiviti.com

Anneke Wieling

+31.20.346.0400
anneke.wieling@protiviti.nl

Relevant Publications from Protiviti

- *Fast-Track Your Merger Integration – Strategic Use of Clean Rooms and Clean Teams*
- *The Value of a PMO in Delivering Strategic Initiatives*
- *Divesting Businesses – Navigating All of Your Moving Parts*
- *Mergers and Acquisitions in the Biotechnology Industry*
- *Working Capital Adjustments: A Post-Game Challenge*
- *Mergers, Acquisitions and Divestitures – Realizing Expected Value*
- *Financial Due Diligence – Kicking the Tires on Your New Acquisition*
- *Protiviti assists a financial services technical architecture team to manage workload more efficiently*
- *Guide to Public Company Readiness: Frequently Asked Questions, 2nd Edition*

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