Global integration success - A China perspective
By Harvey Xiao & Keat Lee
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Executive summary

In a world of increasingly larger cross-border M&A integrations, China often sits at the center of attention due to scale, potential, and operational complexity. To achieve integration success within China, and globally requires deliberate collaboration with the global team, selective identification of in-country stakeholders, a disciplined reporting and governance cadence, and emphasis on employee morale.
Introduction

In an environment of growing M&A activity, China is often the center of attention due to its scale of impact and complexity.

Consistently high and steadily increasing M&A activity in recent years
China M&A deals grew rapidly at 4x the global CAGR, and now account for >15% of total global deal value.

Rising global M&A activity translates to significant implications for our clients in China. The increase in not only volume, but also value of M&A transactions means that deals are becoming increasingly complex and likely include cross-border integration activities. This complexity is further emphasized by issues commonly seen in China such as cultural differences, operating model discrepancies, regulatory environment complexities and varying perspectives toward shared services. More so than ever, China sits at the center of the M&A story — either as the country of deal origination or as a target growth region.
Global integration success - A China perspective

<table>
<thead>
<tr>
<th>Top 10 Global M&amp;A Transactions in 2016</th>
<th>Target Acquiror</th>
<th>Deal Value ($bn)</th>
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<tbody>
<tr>
<td>Time Warner AT&amp;T</td>
<td>107.9</td>
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<td>Monsanto Bayer</td>
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<td>Reynolds American (57.8%) British American Tobacco – BAT</td>
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<td>Energy Transfer Partners Sunoco Logistics Partners</td>
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Sources: Dealogic M&A Review Jan 2017

However, while China continues to grow in importance, it rarely serves as the headquarters in complex global integrations, but rather acts as a regional integration center. China integration scope and timelines in global projects are often driven by a global integration team. This is often due to the scarcity of experienced, global-minded talent. However, global clients often lack experience understanding the unique complexities of China. This lack of experience, compounded by cultural and communication challenges results in a lack of trust between global and local China integration teams. Based on our experience serving several recent global M&A deals, we found that it is crucial for the China team to actively provide input and influence global integration decisions while building a strong rapport with global team members.

Successful integration projects in China require a strong foundation consisting of:

- Comprehensive understanding and alignment on scope
- Clearly defined integration team structure and escalation paths
- Disciplined cadence of integration activities, meetings, and workshops
- Implementation of appropriate proof of concept / trial runs for complex processes
- Proactive identification of synergy opportunities to realize quick-wins to boost profits and morale

This rationally structured approach not only breeds success in China integration, but also caters to the attainment of the project’s global integration goals.
Scope

Clearly defined integration scope and parameters with proper alignment among stakeholders are critical for global integration success.

Prior to forming appropriate integration teams and defining activity cadences, it's critical that the global and country integration leads are aligned in terms of high-level integration scope as well as work stream level decision rights. Making sure all stakeholders are aware of overall integration strategy and timeline along with whether key function level decisions will be made at a country or global level eliminates unnecessary confusion and frustration down the line. While seemingly a trivial point, it is one that is often not given enough emphasis in the frantic and often disorganized early days of planning a global integration.

During a recent global engagement, we worked together with our clients to design a multi-phased integration approach due to operational complexities and required system lead times. In this merger of two similar sized global companies, three intermediate phases were identified on the path toward full integration. Each phase was defined by a series of people, process, infrastructure, and IT milestones that brought the merging companies closer to operating globally as one. This multi-phased strategy is increasingly common in complex global integrations.

Due to reliance on global systems, ties with global operations, and multiple other dependencies, it was necessary for stakeholders within countries to be clear on scope and timeline for each intermediate phase. This clear understanding and alignment at the country level was required to make sure functions within each country would be operationally ready for the global system, process, and other changes represented by each phase of the program.
This level of alignment and clarity is also required at the function level to understand work stream level responsibilities and decision rights. Each functional lead needs to understand which integration related decisions need to be made at the country level as well as the timeline and impact of decisions and process changes that trickle down from the global team. Typically, shared-service related functions such as IT, legal, marketing etc. have centralized planning while operations, HR, finance, sales etc. have greater country-level scope given their greater country specific considerations.

In our experience, the alignment between operations and commercial functions is especially important for two main reasons: First, decision rights for commercial related integration activities are often made at the global level whereas operations planning is often done at the country level. Second, stakeholders from commercial and operations teams often have conflicting incentives. Through integration activities, commercial leaders look toward opportunities for growth while protecting customer experience, whereas operations leaders often seek to capture efficiency synergies and cost-reductions from combining operations. Managing these conflicting pressures and facilitating alignment between operations and commercial functions early on are critical to avoiding an over-emphasis on operational efficiency at the expense of customer experience.
Global team

China can drive or influence global integration projects and priorities through a dedicated global task force

As mentioned earlier, several aspects of a global integration are typically decided at a global level. The output of these decisions drive several aspects of scope and timelines within countries. Given the importance of these global activities along with the growing importance of China in recent integration projects, it is important that China provides influential input into global integration decisions. In one of our recent engagements, input from the China team regarding the complicated labor and tax regulations within the country helped the global team structure intermediate integration phases in a manner that minimized risk to China operations.

In addition to defining global timelines, global resources are often needed to facilitate rollout of integration related changes. From experience, these activities can range from IT / system related updates to distribution of new equipment to training of employees on new processes. Depending on country level requirements and environment, it can be beneficial to have these global resources earlier or later. For example, we recently worked with a country Integration Management Office (IMO) team to lobby the global IT team to prioritize China in distribution of a new software that allows for facility integration. In this case, the China team could realize significant savings from ability to integrate its facilities. Presenting these synergies to the global team helped influence the sequence of IT distribution.

In an effort to have a continuous voice in global integration decisions as well as a dedicated channel of communication between global and country teams, we recommend permanent resources from larger countries to join the global planning committee. In recent engagements, we typically placed two resources from China to provide input and perspective to the global IMO. It works best when these resources are Subject Matter Experts (SMEs) in their respective fields. When IT is a large portion of the global shared services, as it typically is, we advocate that one of these resources have both strong knowledge and influence with the China IT team.
Another major responsibility of these country SME resources is to provide status updates as well as potential risks and obstacles to the global IMO. Overlooked risks and issues from China can have major implications to an integration program. Following the established global IMO cadence, representatives from the China team should highlight key milestones and escalate issues as appropriate so that the global IMO can make effective integration decisions and adjustments as required.
China IMO

A tailored China IMO structure is essential to establishing accurate dependency-linked milestones and to effectively driving integration progress.

Like the global IMO, the China integration team also relies on an effective program structure and disciplined cadence to help define and execute against its integration activities. Once the scope of the global and country-level integration responsibilities is clear, the China integration leader / sponsor should kick off the country level integration with the relevant functional stakeholders. Typically, each globally recognized function, such as HR, Marketing, and Finance will serve as a work stream in the integration effort. China’s integration lead will work with each work stream lead to guide them in establishing an appropriately detailed set of milestones that represent the integration effort.

One important step for the China integration lead is to determine whether additional work streams should be included at the country level. In China, typical areas of complication include regulatory, tax, commercial, and labor considerations. We have typically advised our clients to include these work streams separately or in combination to the globally recognized functions (e.g. HR, Marketing, Finance etc.) based on the potential impact issues in these areas can cause.

Each Function Represented by Separate Work Streams
Dedicated leads within each work stream drive integration activities

Ops function divides into 3 work streams

#1 Work Stream
Sub-Work Stream

#2 Work Stream
Sub-Work Stream

#3 Work Stream
Sub-Work Stream

Sources: Deloitte Analysis
Note: Illustrative purposes only – does not reflect actual data
Once appropriate milestones are established and reviewed for appropriate detail, the China IMO is responsible for facilitating the identification of dependencies each work stream has with one another as well as with global teams. Only when these dependencies are appropriately marked and aligned can an accurate illustration of integration timeline be established. In addition, appropriately sequencing these milestones based on dependencies will allow for easy assessment of impact across work streams when a milestone needs to be modified.

Milestones with Dependencies Appropriately Mapped and Sequenced

Upon completion of an established work plan with dependency-linked milestones, the role of the country IMO shifts from activity planning to status tracking and issue identification / resolution. Specifically, status tracking is an area that is often underappreciated and insufficiently emphasized due to its seeming simplicity. Effective status tracking requires comprehensive appreciation of milestones with each work stream and consistent discipline. Through frequent (usually weekly) meetings with each work stream lead, the China IMO will remain up-to-date with the happenings within each pillar of the integration. Over time, this structure will train an intuition to ask the appropriate questions and choose the relevant issues / updates to escalate up to overall country or global level meetings. This structure allows for swift, informed decision making that is key to preventing costly delays.
In addition to work stream meetings, a cross-functional meeting cadence is critical to avoid each function working in a silo. This platform, chaired by the IMO, gives each work stream lead time to provide a brief integration update to their peers. More importantly, escalation issues previously identified during work stream level meetings can be presented and discussed. Often times, milestones adjustments or cross-functional support can be granted within this session. Even if not immediately addressed, this platform allows for follow-up conversations with appropriate stakeholders to be scheduled. The combination of selecting the appropriate stakeholders, implementing an effective reporting cadence, and enforcing a disciplined IMO cadence provides the foundation for successful country integration.

**Weekly Cross-Functional Meeting**
Each functional lead provides integration update and escalates key issues. Special topics requiring cross-functional attention are presented and discussed

<table>
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<tr>
<th></th>
<th>Executive Summary / Overall Timeline</th>
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<tr>
<td>1</td>
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<td>2</td>
<td>Special Topic</td>
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<tr>
<td>3</td>
<td>Special Topic</td>
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<td>60 mins</td>
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</table>

Sources: Deloitte Analysis
Note: Illustrative purposes only – does not reflect actual data
Proof of concept phase

Period to test operational complexities in environment with limited impact to verify readiness of systems and processes required to realize longer-term integration benefits

As alluded to previously, integrations in China face several unique challenges. Complex regulations around operating permits, tax districts, and labor laws among other areas present significant risks and challenges to a global integration agenda. An approach we’ve guided clients through to mitigate these risks in China is to leverage a proof of concept phase. The idea is to select a small, but operationally complex portion of the Chinese business to integrate first in an effort to test people, systems, and processes. Proof of concept candidates can include smaller business units, product lines, or operating locations.

Proof of Concept Phase Tests Complex Regulatory & Operational Processes
Regulatory, HR, and operational processes often need to be piloted prior to full integration

China Regulations
Customs Rules – First ever integrated process in China – enable Customs supervision by conducting trials upon receipt of approvals
Regulatory environment - Need to gauge government reaction to integrated processes due to complexities

Compensation & Band Concerns
Variable Pay Design – Mechanisms / rules differ between both sides
Compensation & Band, System Testing – Employee reactions to integrated Compensation & Band will be observed for future phases. Variable pay system will be tested

Market / Operations
Integration – Allow ability to test / learn from integration activities
Market & Customer Reaction – Proof of Concept phase allows us to observe customer reaction and minimize impact in future integration phases

Identify and mitigate regulatory issues in Proof of Concept environment
Proactive actions to minimize customer & employee impacts from integration

Sources: Deloitte Analysis
Note: Illustrative purposes only – does not reflect actual data
In a recent engagement, we helped our client identify 5 smaller cities with complex operations to include in their proof of concept phase. Even though these cities represented less than 5% of our client’s China revenue, they represented a complex series of operational and regulatory changes. We structured the integration timeline to integrate these 5 cities 4 months ahead of the general integration date. This extra time allowed our client to adjust certain operational assumptions and resolve several process issues in a relatively insignificant environment. The lessons learned during this period were extremely useful to achieving a smooth general integration months later. In most integrations, having a low risk trial run period with a representative business segment is a worthwhile investment.

**Proof of Concept Selection**
Selected pilot region covered 5 cities representing ~5% of revenue. Separate customer relations teams maintained during POC period

| Proof of Concept phase includes: 5 smaller cities |
|---|---|
| **Customer impact** | **Employee impact** |
| 5% of China revenue | 8% of total employees |
| Dedicated teams in work streams to serve customers to minimize impact | Operations only – no other functions |
| | Further guarantees customer experience |
| | Creates seamless transition |

Sources: Deloitte Analysis
Note: Illustrative purposes only – does not reflect actual data
Quick wins

Often not complex to achieve but critical to building morale among integration and leadership teams and instilling confidence with stakeholders and investors

Synergy opportunities and quick wins are frequently mentioned by management but often poorly executed. A structured plan with clearly articulated individual accountability is necessary for synergy realization. In the drive to reach aggressive milestones and fire-fight an array of issues, opportunities for to demonstrate quick integration synergies are passed over. However, these quick wins are important for several reasons. From a China perception perspective, demonstrating some P&L or operational wins from integration activities, however small, show well to the global team as well as to the market. The willingness to capture these synergies along the way exhibits a dedication to integration efforts and proves favorable when asking for global resources or funding.

Also, even small synergies can serve as major morale boosters to both sides of an integration team. In every integration, there exists more than a fair share of naysayers and skeptics. Quick wins are a great way to combat negative opinions and gain momentum. In addition to the operational or monetary benefits, quick wins give stakeholders topics to highlight during internal and external events without disturbing integration activities or dependencies.

In a mature market, people redundancies are often the largest component of integration synergies. However, with the growth potential in China, redundancies are typically not part of the integration plan. Several other areas within a business likely contain quick win opportunities from integration such as sourcing / procurement and facility utilization improvement. From a procurement perspective, the combined purchasing power of the integrated organization often allows for greater bargaining and larger discount rates. From a facility perspective, it’s often possible to combine workspaces or other assets without combining processes or systems.

Beyond cost savings, integration projects in China often are candidates for quick revenue synergies through:

- Cross selling
- Product bundling
- Value-added services through value chain extension
The combined capabilities of integrating firms allow increased revenue opportunities that didn't exist prior to joining operations. While each individual quick win may be relatively small, the combined number is often significant. Also, the morale and perception boosting effects are alone worth the time and effort required to achieve them.

**Quick Wins / Synergy Analysis**

From a procurement perspective

- **Purpose**: Review service levels and costs between both companies in specific areas, and identify potential synergies and quick wins.

- **Scope**: To follow company A or company B?

- **Approach**:
  - Cost
  - Service
  - Volumes

- **Timeline**:
  - Jan 03, 2017: Align with stakeholders
  - Jan 13, 2017: Analyze on cost and service comparison
  - Jan 25, 2017: Complete 1st draft
  - Feb 15, 2017: Present in cross functional meeting
  - Mar 1, 2017: Complete 2nd draft

Sources: Deloitte Analysis
Note: Illustrative purposes only – does not reflect actual data

**Synergy consolidation from multiple sources can add to significant savings, resulting in increased profitability**

Sources: Deloitte Analysis
Note: Illustrative purposes only – does not reflect actual data
Conclusion

In recent years, more and more companies rely on global mergers & acquisitions to expand their scope and bring more value to stakeholders. Within these M&A integration activities, China is often the center of attention due to its undeniable opportunities regardless of whether it serves as the origination country. However, unique regulatory and operational challenges in the country make for a difficult integration environment. Through meaningful collaboration with the global team, appropriate selection of local stakeholders, and disciplined planning, governance and reporting cadence, the integration team can build the foundation for a successful engagement. This structure along with a proactive emphasis on testing assumptions and motivating employee morale combine for an effective integration approach.
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