How to maximise value creation during the M&A process?

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It is commonly acknowledged that mergers and acquisitions can be effective tools in the execution of a corporate strategy seeking to maximise value for shareholders.

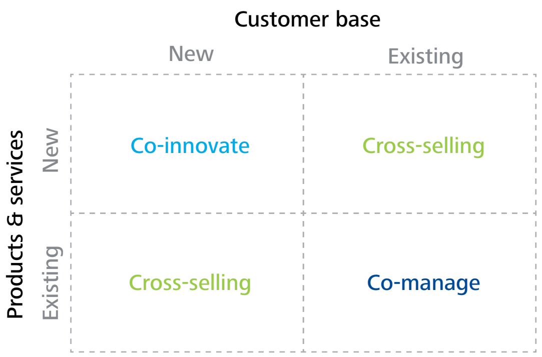
That being said, this route is not without pitfalls and careful thought must be given to the planning of both the execution and the post-deal integration phases.

The integration risks are often not fully understood or fully scoped at the time the deal is signed. Similarly, integration risks are rarely seen as a high priority at that stage.

From the point of view of the acquirer's shareholders, a transaction can lead to value creation through three main avenues:

- Target is acquired at a lower price than its intrinsic value
- Improvement of the target's operating and financial performance on a stand-alone basis post-acquisition
- Realisation of synergies between the acquirer and the target, assuming that the value associated with these synergies is not transferred by the buyer to the seller via the transaction price

This article will focus on the third source of value creation, namely the value generated through the realisation of synergies between the two parties.



What are the different types of synergies?

Synergies occur when the value and performance of two companies exceed the sum of the separate individual parts.

Broadly defined, synergies can be placed into two categories:

1. Operational synergies

These synergies are generated via improvements in the sales or production cycle of the combined entity which could not be made on a stand-alone basis.

Operational synergies can be considered depe nding on where their impact can be found on the income statement. To simplify, depending on where their impact is shown, synergies can either be revenue or cost synergies.

a) Revenues synergies

Top-line synergies support the revenue generation of the combined group and can be classified in three broad categories as described below:

- A co-manage strategy can be implemented when two competitors merge in a given segment, thereby gaining a greater market share and pricing power vis-à-vis an existing client base buying existing products
- A cross-selling strategy can be adopted when the acquirer is able sell its products to the target's client base and vice-versa
- When the synergies relate to the new product/service and customer base, we talk about co-innovation. This principle increases top-line synergies through the use of each company's resources to create new services and look for a new customer base. It is also important in co-innovation to review and adapt the product value chain to better address client needs

b) Cost synergies
Cost synergies are generated whenever the combined revenues of the merged entities can be supported by a cost base that is lower than the sum of the cost bases of both entities. This reduction in cost base can result from better purchasing terms leading to lower cost of goods sold, reduction in headcount, improved utilisation ratio of existing infrastructure, etc.

In addition, combining different managerial skills can also lead to operational synergies which can become apparent either at the revenue or cost level.

The origin of synergies will vary greatly from industry to industry and will often shape the nature of a transaction. By definition, industries that are more mature will tend to consolidate for cost-related synergies, while less mature industries still experiencing growth will often see transactions that seek to implement revenue-related synergies. For obvious reasons, the most promising transactions are those where both revenue and cost synergies can be expected.

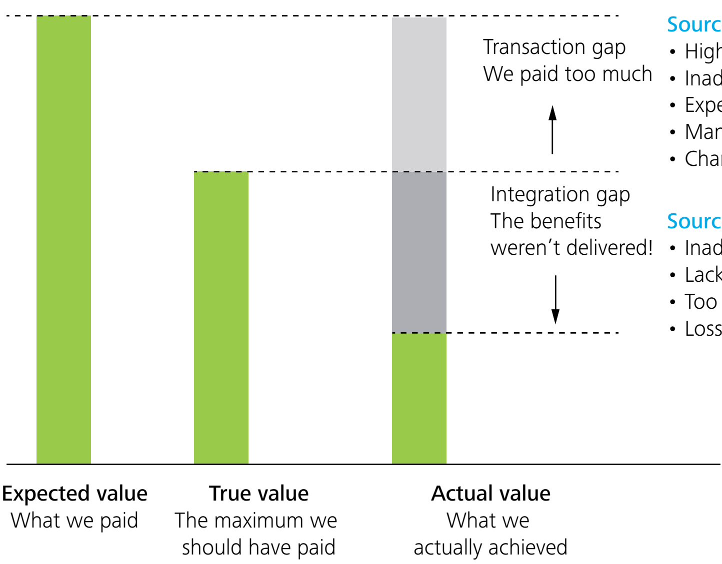
2. Financial and investment-related synergies
While not as widely advertised as operational synergies, financial synergies can also be a significant source of value creation.

These synergies will arise in several situations, such as:

- When the combined entity's cost of funding is more attractive than the weighted-average cost of each entity's capital on a stand-alone basis
- When the combination leads to better overall capital allocation (e.g. merger of a company with excess capital with a company offering significant investment opportunities)
- When the combination leads to a lower tax base overall (e.g. one company with losses carried forward merging with another with a significant taxable base)
- When the combination leads to the avoidance of redundant investments

What are the challenges associated with implementing synergies?
The first challenge posed by synergies is their initial quantification. While cost synergies and some financial synergies can to some extent be fairly accurately quantified, the number achieved can differ considerably from the initial assessment. The challenge is even more significant when it comes to revenue-related synergies, as their actual size depends on several factors including the reaction both from the potential market and from the competition.

The second challenge relates to the inability to unleash the inherent potential of a merger. While the initial quantification might have been accurate, management will be faced with a significant challenge if a post-merger integration plan has not been precisely put in place during the closing stages of the transaction process.



Source of transaction gap:
- High competitive auction
- Inadequate due diligence work
- Expected synergies overstimated
- Management eagerness to do a deal
- Change in the environment

Source of integration gap:
- Inadequate planning
- Lack of programme leadership
- Too much time spent on organisation politics
- Loss of focus on everyday operations

Some principles to maximise the realisation of synergies

While there is no magic recipe in this field, some basic principles can be followed to facilitate the integration process between two companies and maximise the probability of seeing the expected synergies materialise.

1. **Thorough prior due diligence**
   Operating and financial synergies should be carefully identified, quantified and validated by both management teams during the transaction. This stream should be a critical part of the due diligence process and sourced by people equipped with a suitable skill set as well as offering an independent view of the size and likelihood of realisation.

2. **An opportunity to be creative**
   A significant transaction can be an opportunity to re-think the overall operating model. While some measures might have been considered unfeasible on a stand-alone basis, the benefits arising from the transaction could provide an opportunity to reassess some of them. For example, the possibility of outsourcing a shared services centre could be investigated for some part of the business to limit the investment and focus on the core business.

3. **Formalise and empower**
   Integration objectives should be clearly stated from the start of the life of the combined entity. This can be done via a 'first 100 day plan' for instance, which should also include the identification and recognition of cultural differences. In addition, such measures should be championed by strong leaders within both organisations. By allocating some of your best resources to run this programme, you will empower your staff, facilitate the change process and maximise the probability of getting value earlier in the process.

4. **Be equipped**
   The nomination of an integration director or an integration core team can be of effective support to the leaders in charge of delivering the synergies. Their task will be to ensure the consistency of the integration plan as a whole, as well as promoting alignment at the senior level in both organisations. This core team will put a formal programme management structure in place, which will implement a robust planning and programme management process.

5. **Communicate, communicate, communicate!**
   The importance of effective and frequent communication to facilitate change and maximise buy-in cannot be underestimated. Much of the communication plan needs to be defined pre-deal. Hearts and minds are won and lost within the first few weeks of transaction completion.

6. **Progressing at the right pace**
   While moving quickly to facilitate the integration of two organisations can sometimes be the right way to proceed, careful thought should be given to: (i) ensuring all the necessary information has been shared between the parties before moving towards the integration phase, (ii) leaving sufficient time for a structural solution to be put in place rather than a quick fix which will soon have to be revisited, (iii) providing sufficient lead-time to ensure proper buy-in from all the parties involved.

Conclusion

Many M&A transactions fail to realise the synergies that are often highlighted when a transaction is first announced. After a company has developed its M&A strategy and executed the deal, the bottom line comes down to successful integration. Management's ability to integrate two organisations into an effective and streamlined operation is where transactions ultimately succeed—or fail—to deliver the much-anticipated synergies. A successful integration begins with a plan that will enable those synergies to start taking effect on day one.

While some of the principles mentioned above are nothing but common sense, they may get lost in the day-to-day reality of the challenges that mergers can bring about.

Defining an implementation programme as well as a governance framework during the closing stages of a transaction negotiation are two simple, yet critical steps that senior management should consider in order to maximise the probability of seeing synergies materialise.