

## Mergers and Acquisitions Operational Synergies Perspectives on the Winning Approach

Part 1 of the Miniseries on Mergers and Acquisitions Operational Synergies



# Contents

|              |   |
|--------------|---|
| Introduction | 1 |
| Plan         | 2 |
| Prepare      | 3 |
| Execute      | 4 |
| Conclusion   | 5 |

# Introduction

Managers often cite synergy gains arising from operating improvements to justify mergers. For example, the chairman of ExxonMobil stated that “By year three, the merger is expected to provide recurring positive cash flow of about \$4 billion per year, reflecting the after-tax impact of synergy benefits and optimization of the merged company’s capital investment program.” The combined firm could benefit from economies of scale and scope, and reduction in operating costs or capital investments, thus improving cash flow.”

Why are mergers so often unable to achieve their desired results? While integration is not conceptually difficult, our experience indicates that it requires careful planning followed by an extremely meticulous focus on execution when confronted by the enormity of the effort.

Facing skepticism and intense pressure to perform, managers overseeing the execution of these transactions tend to focus on quick wins. While supply chain efficiencies and operational improvements have a direct impact on the revenue, cost, capital expenditure, and working capital synergies that result from a merger, our experience indicates there are several missed opportunities in all phases of the merger process, from pre-deal planning through post-integration.

Our research indicates three principal reasons why companies fail to achieve mergers and acquisitions (M&A) operational, supply chain, and manufacturing operations synergies.

1. **Planning:** First, companies focus on capturing short-term financial synergies rather than taking a holistic view. By reducing the scope, they often overlook many “hidden” synergies and fail to create high performing supply chains with significant long-term upside that provide sustained value for customers and stakeholders.
2. **Preparation:** Second, during M&A due diligence, companies overlook the overall business and operational “compatibility” of the two companies. Operational synergies are not synchronized with the customer/market needs of the combined entities, often requiring supply chain “rework” or savings “erosion.”
3. **Execution:** Finally, companies drastically underestimate the complexity, resources, communication, and management focus needed to execute a successful integration and realize expected synergies.

We explore each of these three key themes briefly below. For more detail, please look for the additional three articles in our *Mergers and Acquisitions Operational Synergies* series that focuses on each of these themes.

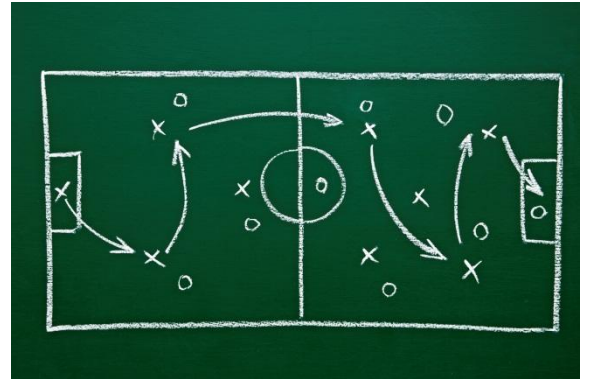
# Plan

## Plan for an integrated supply chain and identify leaders early in the process

The typical acquisition integration process consists of three phases:

1. Strategic buy and close
2. Organize and plan
3. Execute and manage

The linear progression of activities in such a “typical” acquisition, while sufficient in certain cases, is fraught with pitfalls and pain points that can stall or eventually destroy the value of an acquisition that might otherwise have been a success.



Tight timelines in the M&A process may mean supply chain and manufacturing impacts are not fully considered in the overall benefit of the deal. However, this can be mitigated with a more effective approach of establishing the supply chain and manufacturing operations leadership and teams early in the merger planning phase. This allows the team to thoroughly conduct the supply chain due diligence during phase one and set the merging companies to quickly identify and realize synergies across the supply chain.

### Case study: U.S.-based auto and homeowners insurance company

| Background   | Approach  | Value delivered   |
|--|---|---|
| <ul style="list-style-type: none"> <li>• <b>A division of one of the nation’s largest P&amp;C insurance companies, specializing in serving the small business commercial insurance market reached terms to acquire the policy “renewal rights” of a competitor organization’s Small Business Insurance division</b></li> </ul> | <ul style="list-style-type: none"> <li>• Defined a formal integration structure with an Integration Management Office, cross-functional teams, business teams, and a joint steering committee</li> <li>• Developed an integration plan and approach for Merger and Acquisition that included pre-deal due diligence and planning over the first 4-6 weeks, followed by 2-3 months of strategy, planning, and execution of announcement, pre-close and post-close integration activities</li> <li>• Deployed pre-close (Day 1) integration planning team in five focus areas including Integration Management Office (IMO), Workforce, Communications, Synergy and Finance, and Shared Services</li> </ul> | <ul style="list-style-type: none"> <li>• Achieved an issue-free transaction announcement (Day 0) and close (Day 1) for one of the most complex transactions in the client’s history</li> <li>• Provided key insights and led analyses for functional integration initiatives that helped the client achieve key strategic growth goals, and realize operational improvements</li> <li>• Positioned the client for success by effectively transitioning integration knowledge and developing an M&amp;A Integration Playbook CD with processes and guides that can be leveraged on future deals</li> </ul> |

# Prepare

## Adopt a holistic approach and align the operating model to enable the business model

Merger rationale is founded on the principle that one plus one can somehow equal more than two. Although most organizations realize that continuing the status quo will not achieve these arithmetically defiant results, change is easier recognized than done. A successful merger requires the organization to revisit core questions about how it goes to market, what the company is selling, and who the company is selling to, among other things. When approached systematically within the context of new company objectives, this revised go-to-market approach can set the basis for lasting competitive advantage without disrupting business momentum.

Supply chain and manufacturing organizations are intentionally aligned to serve a specific business model. Therefore, if the business models of the merging entities are not aligned, supply chain and manufacturing operations are likely to be misaligned as well.



### Case study: U.S.-based manufacturing company

| Background  | Approach   | Value delivered  |
|---|--|--|
| <ul style="list-style-type: none"> <li>• A manufacturer of aftermarket automotive parts with revenue of \$1B merged with another automotive aftermarket parts manufacturer with revenue of \$1.2B.</li> <li>• The combined entity has limited fact basis on the competitive positioning of the integrated product/service portfolio, hindering the combined entity's ability to leverage scale.</li> <li>• The combined entity needs to rapidly develop the "go to market" strategy to further drive profitable growth with its "large" customers.</li> </ul> | <ul style="list-style-type: none"> <li>• Conducted a business unit overview, reviewing financial results, strategic objectives, and account level detail</li> <li>• Conducted discovery sessions to understand each unit's market strategy, clients, and sales processes</li> <li>• Solicited customer insights, defined customer and target market segments, and defined segment value propositions</li> <li>• Prioritized opportunities into a portfolio of options based on impact, complexity, and timing of benefits and developed an implementation roadmap to realize the benefits</li> </ul> | <ul style="list-style-type: none"> <li>• Developed an integrated strategic initiative roadmap to achieve high-priority initiatives necessary in ensuring the success of the combined product portfolio</li> <li>• Performed early assessment of the four key areas of the sales value chain distribution, strategy, operations, and people to understand the key elements that drive these areas and provide recommendations on improvement opportunities</li> <li>• Developed specific, actionable and positive return on investment breakthrough strategies for the large customers</li> <li>• Identified process improvement opportunities to more quickly identify cross-selling opportunities and reduction in barriers to cross-business unit collaboration</li> </ul> |

# Execute

## Define not just the end state, but also the steps to get there

Integrating the supply chain and manufacturing operations functions across merged entities is complex due to the wide scope and long duration of the process. Synergy gains are possible to be achieved after day one (post-close). Day two supply chain integration planning activities typically run as a separate program geared towards realizing the ultimate goals of the merger or acquisition.

Day two activities are more complex and hence require more time. The main reasons for this are:

- Lack of free-flow information between merging entities
- Interdependencies between functions
- Mitigating the broader impact on customers and supply chain partners

The activities for day two are typically longer term and require much more effort. These often involve synergy capture opportunities such as plant optimization, systems implementation (Enterprise Resource Planning (ERP) or other supply chain systems), or transition services

agreements (TSA) exists. A successful day two should require that core supply chain project activities are ably supported by necessary cross-functional teams.



If these integration activities are not undertaken shortly after day one, then it is unlikely the supply chain integration will be addressed in a systematic manner at a future date. The combined company may then live with an inefficient, costly, and relatively ineffective supply chain for years to come until other triggers force changes to the supply chain.

### Case study: Global aerospace systems company

| Background   | Approach   | Value delivered   |
|--|--|---|
| <ul style="list-style-type: none"> <li>• <b>A manufacturer of control systems for aircrafts, homes, and commercial buildings with revenue of \$8B merged with an equipment manufacturer of products ranging from aircraft engines and collision with revenues more than \$15B.</b></li> <li>• <b>The merger created a Fortune 50 company bringing together deep management talent along with diverse, successful, and complementary businesses.</b></li> <li>• <b>Transaction value: \$15B.</b></li> </ul> | <ul style="list-style-type: none"> <li>• Increased scale and business diversity to drive consistent earnings</li> <li>• Accelerated earnings growth</li> <li>• Identified significant sales and cost synergies in aerospace business</li> <li>• Supported client's leadership in the development of a global merger integration approach linked to the combined company's overall business strategy</li> <li>• Providing program management oversight for over 130 integration transition teams</li> <li>• Led day one planning and preparation</li> </ul> | <ul style="list-style-type: none"> <li>• Synergy achievement exceeded initial estimates by 20 percent</li> <li>• Merger integration completed in an accelerated timeframe</li> <li>• Well-defined implementation plans for every functional area allowed management to use limited resources against the right priorities</li> <li>• Established successful governance and decision-making processes</li> </ul> |

# Conclusion

Deloitte's experience suggests that companies can greatly improve their chances for a positive outcome by putting more emphasis on supply chain integration planning, operational analysis, and execution. A major contributor to achieving post-merger integration synergies is the way the combining entities manage supply chain issues throughout the genesis, structuring, and consummation of the deal. Most supply chain integrations typically extract short-term financial synergies efficiently, but fall short of creating high-performing supply chains. Supply chain integration should be planned or implemented only after having a clear definition and understanding of the business strategy for the new company and aligning the operating model with the business strategy.

Though imperatives for lasting success with supply chain integrations in M&A are few, achieving them is a challenge. Companies should focus on the supply chain early, identify the leadership and team, adopt a holistic approach, and execute well. The focus should be on enabling business and operations strategies and building a supply chain organization driven by a performance-based culture and a self-assessing DNA. By taking a complete look at all the relevant sources of value and risk, the chances of a successful acquisition increase significantly. In addition, before merging supply chains, companies should closely consider the optimal timing for making changes that will bring the least amount of disruption.

When done right, supply chain mergers not only help companies avoid critical service disruptions, but can also turn the supply chain into a competitive advantage.

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