CLARKSTON CONSULTING

INSIGHTS

Build an Effective Merger, Acquisition & Divestiture Execution Capability

Are You Ready for Your Company's Next Deal?

After helping many of our clients execute corporate mergers, acquisitions and divestitures (MA&D), perhaps the only consistency we have found is that little, if any, due diligence is done on the involved parties' ability to execute the action. While companies certainly go in with good intentions of conducting proper due diligence, it's often not possible or even practical given the dynamics of the situation. Speed may be required to get the deal done, and confidentiality may require the activity to be held very closely. What may have begun as noble ideas in the boardroom, we see many companies mired in long, post-deal integration initiatives that consume extensive amounts of time and resources from the company.

Today, MA&D deals are accelerating at an even faster pace. The dichotomy of lower valuations in conjunction with strong balance sheets has created an environment ripe for acquisitions as companies seek to make the best use of their available cash. During that same period, leading companies have focused more and more on their core competencies, simplifying their business models by divesting portions of their business not directly related to those core competencies. Last year, there were over 20 major corporate spin-offs, and we expect activity will be even higher this year.

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Are You Ready?

If your CEO came to you today with an acquisition or divestiture to execute, would you be ready? In this dynamic environment for structural corporate change, leading companies have MA&D as a defined part of their operating strategy. Companies that can quickly execute on these acquisitions and divestitures will be the ones who will lead in tomorrow's business climate.

Leading companies will have the ability to quickly execute on corporate restructurings, allowing them to flex their strategies to meet market demand. We will see an environment of "haves" and "have–nots" related to those who are able to successfully execute their strategy and adapt quickly to changes in the marketplace. How do you make sure your company is one of the "haves"?

The first step is to create MA&D as standard practice in your company. Companies have been executing acquisitions and divestitures for many generations so it would seem self-evident that there are lessons that can be applied. Leading companies have resources that are deployed and methodologies that act as their "playbook" in executing MA&D. The key elements are:

Organization – Not all firms are large enough to have dedicated resources for addressing MA&D, but all leading firms have designated people who know their role when these opportunities come up.

Methodology – Leading firms have defined approaches for handling each point in the process. The diagram below depicts the high-level elements to this type of approach that we have helped companies build. Each step of the methodology includes standard templates that ensure that the items most important to a given company are addressed at each step.

Unique Considerations for Each Type of Activity

Leading companies have a keen appreciation for the differences between mergers, acquisitions, and divestitures. Characterizing them together is an oversimplification, because they are all quite different and specific practices need to be applied in each case.

Mergers

A true merger of equals is rare. Typically, one firm will have a larger imprint on the combined firm's management, culture, and strategy. Size is not always an indicator of which company will have the larger imprint. The merger of Applied Biosystems with Invitrogen to create Life Technologies is an example of a smaller firm, Invitrogen, ultimately having a much greater impact on the combined firm. When it is evident to all parties which firm will have the greater impact, the process acts much more like an acquisition.

In true mergers, the cultural environment is much more sensitive, given the expectations on both sides that each company will have a roughly equal impact on the new company. Managing these expectations is critical to moving quickly to accretion. Below are some best practices for approaching mergers successfully:

- **Rebranding** – our clients have found it most beneficial to rebrand into a new company, retaining the commercial value of the brands in their approach to customers, but culturally aligning to a new beacon.
- **Clear communication of strengths** – an understanding of what each party brings to the table, while evident to senior management, is surprisingly not trickled down to the lower levels of the organization. The communication plan must outline how the companies complement each other, particularly when the two firms previously were regarded as competitive.

- **Horizontal vs. vertical integration** – In our experience, the most successful mergers result from similar products or services in different geographies. Other types of horizontal integrations, such as different product offerings in the same geographies, have proven more difficult. Generally, vertical integrations have shown to be more effective as acquisitions.

Acquisitions

A key question on any acquisition is whether the transaction acquires the entire company or merely a portion of the company. For the purposes of this paper, we will discuss acquisitions as acquiring the entire company and leave acquiring part of a company for the divestiture portion later in this paper.

Our clients have found that acquisitions are the easiest of the three to manage. There is clarity about who will take control and typically less disruption to the overall business. All systems, processes, data, and resources become owned by the new parent. Our clients have also found that their customers realize the least amount of disruption in acquisitions.

A key strategic question to be answered is to what degree should the acquired company be integrated and how quickly. Companies such as Berkshire Hathaway make it their model to acquire companies and largely leave them alone, not pushing to integrate processes, systems, or organizations, much less cultures. These types of acquisitions are predicated on the stand-alone value of the business. However, the majority of acquisitions are predicated on the value of integration, bringing economies of scale and/or vertical integration to deliver more value to the customer. Below are some of the best practices we have found through our work with clients on acquisitions:

- **Align the integration strategy with the acquisition strategy** – We have found that companies are typically very clear up front why they are making an acquisition. However, this often does not translate to a congruent integration strategy. The acquisition rationale should drive whether, when, and how integration should be executed. We often see companies trying to integrate more aggressively in the spirit of simplicity of an operation. However, if the strategic objective of the business is a possible spin-off later on, or if there is even a remote question on this front, it may not make sense to integrate aggressively, if at all. This may seem obvious, but it is surprising how often we find that integration approaches are out of alignment with the overall strategic objectives. Certainly, if the acquisition rationale is largely to gain economies of scale then integration should be as aggressive as possible.
- **Provide sufficient integration funding and resources** – As integration budgets compete with other investment capital, integration investments don't necessarily deliver immediate returns, so it is important to reflect back on the business case for the acquisition to support the investment in integration. The same prioritization should be applied to human resources and dedicating the necessary people to get through the integration effectively.
- **Have the courage to be honest about tough messages** – People in a company being acquired understand that economies of scale will be sought. Still, we often see management talking softly around tough questions. We have seen companies be most successful in retaining the right people when they communicate in plain terms about the likely ramifications. This demonstrates respect to those receiving the message and garners respect as well. The best resources at the acquired company often view the acquisition as an opportunity to gain exposure to a larger company and increased opportunities for career growth.
- **Establish retention plans for key resources and evaluation criteria to identify these resources** – We find the scope of resources engaged in typical retainer agreements to be surprisingly limited. Acquiring companies also often overestimate their own ability to take over the responsibilities from these resources. Leading companies build objective evaluation criteria for identifying key resources based on function, business impact (particularly to customers), and skills. For those moving on, formal transition plan needs to be put in place to ensure you're getting what is needed from them.

Divestitures

Our clients and our experience consistently demonstrate that divestitures are the most difficult to execute. They require careful consideration on carving out people, physical assets, systems, data within those systems, networks, contractual relationships, intellectual property, and a host of other items. We have even worked with clients who had to split a floor of an office, literally putting up a wall in the middle of the physical space. Further complicating these situations are transitional services agreements (TSAs) that are put in place between the two companies about what services the former parent will continue to provide for the divesting entity and for what time period. TSA's can be very complicated contracts, can have hefty financial penalties for delays, and are often drawn up by people with little understanding of what is required to execute the elements.

- **Greater analysis of systems impact during due diligence** – We have found that executives often do not have a strong enough appreciation for the difference between acquiring an entire company versus acquiring a portion of one from a systems perspective. Splitting data, accounts receivables and payables, unique system customizations, and the like is a much larger undertaking than acquiring an entire system or set of systems. The most successful companies have spent much more time during the due diligence process in evaluating this. Divestiture opportunities where the divested portion is largely independent from a systems perspective can be executed much more easily. Divestiture opportunities that involve tightly integrated portions of a business need to be thoroughly thought through with expectations set up front on the complexity.
- **Invest time in drafting a thorough TSA** – Entering into a TSA, both sides are amicable and want to do whatever possible to execute the spin-off as quickly and efficiently as possible. However, in many cases we have found that companies move quickly into TSA creation, creating a TSA that is at a fairly high-level and that has been created with limited consultation of those who would need to execute each point of the TSA. We have found the result to be optimistic estimations for the time and effort involved. Spending additional time up front pays in multiples later on, and both sides stand to benefit.
- **Stay focused on the customer** – Even with the most thorough planning, significant decisions and negotiations will need to be made throughout the divestiture process. It is important to keep these decisions focused on the customer and providing as little impact as possible to the customer's experience. This same philosophy needs to be communicated repeatedly to all levels of the organization, particularly those who directly interact with the customer. The most successful companies have proactively established communications with customers, such as a hot line or an email inbox, which can be used whenever they have questions or feedback about the divestiture process.

Clarkston Consulting has helped build these elements as a core competency for our clients. This Insights Paper is the first in a series of subsequent papers that will further discuss each step in building your MA&D methodology.

Continue the Conversation

Read more about Mark's perspective on building an effective MA&D execution capability on his blog at ***www.clarkstonconsulting.com/blog***

Conclusion

In this paper, we briefly touched upon what we have found to be the most important points to successfully executing mergers, acquisitions, and divestitures. At Clarkston Consulting, we know these can be done effectively. We've helped our customers do it. Bringing in the right experience to guide this process is critical to successful planning and execution. What will you do to make sure your company is part of the "haves"?

About the Author

Mark Ginestro, former partner, has more than 17 years of experience and has become a trusted advisor to many of our clients and one of the firm's most highly sought after voices for counsel. Through his work over the years with both life sciences and consumer products firms, he has gained experience delivering business results in the areas of strategy, business process improvement, change management, regulatory compliance, and supply chain.

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About Clarkston Consulting

Clarkston Consulting is a different kind of management and technology consulting firm. We deliver a unique experience for market leaders within the Consumer Products and Life Sciences industries. Considering professionalism, expertise, and value as prerequisites, we take service a step further through our unyielding commitment to the success of people as individuals, both our clients and our employees. By combining integrity, adaptability, and a whatever-it-takes attitude, we have achieved an extremely high rate of referral and repeat business and a 10-year average client satisfaction rating of 97%.

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