Building M&A Integration capabilities

How Serial Acquirers Become Master Acquirers. M&A practices as a key instrument to improve M&A integration

Gates, Stephen; Heimeriks, Koen H.; Zollo, Maurizio

BUILDING M&A INTEGRATION CAPABILITIES: HOW SERIAL ACQUIRERS BECOME MASTER ACQUIRERS

M&A practices as a key instrument to improve M&A integration processes

Stephen Gates
Audencia Nantes

Koen H. Heimeriks*
Copenhagen Business School

Maurizio Zollo
INSEAD

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EXECUTIVE SUMMARY

While firms increasingly rely on mergers and acquisitions as a key growth instrument, many firms have difficulty successfully integrating the target. To counter the disappointing statistics, some firms like IBM and Xerox use M&A practices that capture learnings to improve M&A integrations. Comparing occasional with master acquirers, we find that those that make effective use of such M&A practices increase their chances of success with up to 24%. While there are plenty of reasons for M&A integrations to fail, we derive four key lessons that give master acquirers a leading edge over their occasional counterparts. The findings are based on survey data by 101 firms engaged in 2,447 integrations over the past decade and one dozen expert interviews. The conclusions are based using case examples of master M&A integration practices from six master acquirers IBM, Xerox, Home Depot, Dow Chemical, GE Capital Finance and SC Johnson.

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Correspondence to: Center for Strategic Management and Globalization, Porcelaenshaven 24, DK-2000 Frederiksberg, Denmark, Heimeriks@cbs.dk. The authors appreciate the contribution of The Conference Board for which interview material and data were compiled in preparation of a research report

on this topic.

INTRODUCTION

When it comes to mergers and acquisitions, CEOs would like to believe that the following scenario will also come true for their impending deals:

“When Xerox announced that it would acquire Tektronix, its share price hardly moved either on the day or during the entire first week. However, one year later, a study revealed that the smooth and successful integration of Tektronix added $1 billion in market capitalization. Xerox also gained a strong market share position (number 2) in color engines and print controllers, both of which are now found in many of Xerox’s core products. Finally, a number of Tektronix senior executives moved up into senior leadership positions within the corporation.”

Regrettably, one figure that has persisted over time is the high failure rate of M&A integrations. While M&A profitability is measured differently across the numerous studies, research shows that as little as 20% of all integrations truly create shareholder value. Examples of disastrous integrations abound such as those following the AOL and Time Warner integration in 2001. Hence, firms struggle to reap the benefits of the costly integrations they pursue. Still, it does not stop many to continue to spread the urge to merge. Although the number of newly announced integrations slightly decreased during the beginning of the decennium, it has increased substantially again in many sectors since 2003.

Some companies have much more experience with M&A than others. Recent McKinsey research revealed that as much as 84% of the deals are done by only 19 of the Fortune 500 companies. Such master acquirers benefit from the accumulated experience they have built up which can be important to be successful in subsequent deals. Yet our insights suggest that it is not experience alone that counts. Rather we find is it the investment in post-integration learning that drives superior M&A integration performance. Master acquirers not only repeatedly rely on acquisitions as a way to grow, but also prove very dedicated to codify knowledge arising from previous acquisitions to build M&A integration capabilities.

We investigated *how* the master acquirers have built their M&A capabilities. Using survey data provided by 101 firms that were engaged in 2,447 integrations over the past decade, we compare the frequency of use and effectiveness of four categories of M&A integration practices for master versus occasional acquirers.

Using rich material from in-depth interviews, four key lessons from IBM, Home Depot, Dow Chemical, and Xerox are used to demonstrate how these firms use M&A practices and raise their M&A integration performance by up to 24%.

**** Insert Sidebar 1 about here ****

PRACTICES UNDERLYING M&A CAPABILITIES

While for most companies mergers and acquisitions are onetime events, there are some firms that are very committed to improve their acquisition integration process. These firms are deliberately documenting and sharing their prior experiences. There is an evident interest in understanding how such firms master M&A integration.

Using the results from the 101 companies, we found that they use four different groups of practices that help build M&A integration capabilities: 1) internal and external functions and staffing, 2) quantitative models, 3) tools and 4) documents and manuals (see Table 1 “Description of Categories of M&A Practices”).

**** Insert Table 1 about here ****

The frequency with which companies are using specific M&A integration practices differs widely, from 93 percent claiming to use a financial evaluation model to 47 percent noting that they carry out M&A integration training, (see Table 2 “Use of M&A Integration Practices” and Appendix “Description of M&A Practices”).

**** Insert Table 2 about here ****

The most frequently used practices are also those that are involved in the earliest and most quantitative phases of the M&A process (due diligence checklist, financial evaluation models, and outside lawyers and financial experts). While not all of the 23 M&A practices are used by all of our respondents (e.g. integration management training is not used by a majority of respondents), master acquirers without exception make extensive use of practices to support their integrations.

An interesting example is General Electric Commercial Finance. This branch provides worldwide financial services and has acquired over 130 companies over the past ten years. While the length of the integration processes may vary, GECF's experience with M&A integration allows it to strictly adhere to each acquisition's set timetable. In order to leverage its experiences, it has used a predefined set of M&A integration performance metrics. Moreover, it uses a number of tools to mitigate the risks posed by cultural and management differences. For instance, an HR integration manual is used to address critical questions during the integration process about employees and company cultures. In 2004, GECF created an online 'deal room' where key learning from its M&A integrations are discussed. Subsequently, these lessons are documented and referenced for access on the firm's intranet. The deal room is also used by integration teams to discuss integration issues during interactive meetings.

WHY M&A PRACTICES MATTER

The use of M&A practices has three main advantages: they help employees share prior experiences, foster transparency in the integration process, and build commitment towards integration success.

Sharing prior experiences. By sharing and documenting experience, employees can learn from each other. Organized "de-briefing" sessions with all the relevant participants in an acquisition allows for a learning feedback loop. What worked well is highlighted and what needs to improve and how can become part of the initial M&A due diligence procedures. At Dow Chemical, the M&A Expertise Center facilitates this feedback loop since the M&A integration team takes the lead not only during the due diligence phase but also during implementation. Moreover, knowledge gained from the due diligence process can be best used during the integration if the M&A integration team leads it.

Fostering transparency in integration process. Formalizing M&A integration practices can render an overwhelming process more transparent. One of the means to meet the inevitable political concerns during a merger or acquisition is to communicate endlessly what are the clear objectives and processes. Having clear practices improves communication. At IBM, a highly-developed system of performance measures not only pilots the integration process better, but also focuses everyone's attention on value-creating activities. It creates a disciplined process to improve performance reporting to the CEO and CFO, which in turns encourages transparency.

Building commitment towards integration process. A well-oiled "integration engine" brings a certain dynamism that encourages commitment to the integration objectives and goals. The initial phases – often confused and full of anxiety – are critical to winning commitment. Especially for the target's management and employees, the integration team's professionalism, demonstrated through their experience and knowledge supported with documented procedures, can help reassure and engage them. At Home Depot, roles and responsibilities are defined for each functional area in the integration process with a generic template, assigning timelines and toll-gates measurements, and creating an on-line integration playbook that can be flexibly applied to different lines of business. All these efforts to standardize processes build commitment towards the integration process.

COMPARING OCCASIONAL AND MASTER ACQUIRERS

To understand what distinguishes occasional from master acquirers, we compared the firms who regarded M&As as a core growth instrument with those that did not. We discovered that master acquirers used not only a greater number of M&A practices (see Table 3 "Use of M&A Integration Practices Comparing Master and Occasional Acquirers"), but were also much more effective in using those M&A practices to be better in M&As (see Table 4 "Effectiveness of M&A Practices Comparing Master and Occasional Acquirers").

**** Insert Table 3 about here ****

**** Insert Table 4 about here ****

So master acquirers not only report using M&A integration practices more often, they also report more effective use of these practices. Of the list of 23 items, occasional acquirers only make more often and more effectively use of external consultants. It seems intuitive that master acquirers with their own internal M&A integration team would rely less on external consultants and find them less effective.

Master acquirers outperform their less effective counterparts substantially: depending on the size of the acquisition they have a performance which is up to 24% higher. The performance differences differ depending on the size of the acquisition: as the size of the target grows larger, so the likelihood of failure rises, especially for acquirers with little experience or knowledge codification. Therefore, large deals (i.e. >US$ 1bn in sales) are more successfully managed (24% higher) by master acquirers than occasional acquirers. The differential in success rate between master and occasional acquirers in smaller deals (i.e. <US$ 100m in sales) is lower (7% higher). On average, the odds of success in M&A integrations are 13% higher for master acquirers than for occasional acquirers.

Depending on size of the acquisition, master acquirers do not just simply perform better because of their past experience, but because they are committed to making more effective use of their M&A practices. The next section illustrates how by distilling four lessons learned from five master acquirers. IBM, Caterpillar, Dow Chemical, Home Depot and Xerox explain how they implement and make effective use of their M&A integration practices.

BUILDING M&A INTEGRATION: FOUR LESSONS FROM FIVE MASTER ACQUIRERS

Lesson 1 Specific Performance Metrics Drive M&A Integration Success

Mona Miyashita, Managing Director, IBM Corporate Development (M&A Integration), strongly believes that performance metrics are key to successful M&A integration. In general, the process of setting up and validating meaningful metrics requires focus and a wide-ranging discussion about the strategic rationale for the acquisition. Business case assumptions translate into value drivers which then form the basis for meaningful performance metrics (e.g., revenue, cost/expense synergies, new customers, etc.). These performance metrics can be validated in due diligence to determine the risks associated with the business case.

The integration team can organize so-called 'value driver work stream teams' that are responsible for delivering the associated performance metrics (e.g. new sales opportunities with acquired company’s clients, retention of target company’s business partners, selling acquired company’s offerings through IBM sales channels, synergy cost and expense through the merger, etc.). In addition, the leading indicators required to execute specific metrics can serve as “headlights” during the performance tracking process, providing early warnings and signs of future performance and permitting time for course corrections if necessary.

One of the key lessons learned from IBM’s M&A integration experience involves broadening the role of functional work streams. While it is important for functional integration experts (who are often “black belts” in their area of expertise) to manage the nuts-and-bolts integration tasks, it is equally critical that they concentrate their functional expertise on executing the value drivers for a specific acquisition. Stretch performance metrics for functional work streams should be considered. These measures can provide needed support for transformation and strategic goals (such as change management and cultural integration) and help meet more tactical milestones.

The process of developing and monitoring performance metrics also allows future integrations to benefit from the wisdom acquired through previous M&As. According to Miyashita, analyzing what could have been improved (and how) in previous acquisitions leads to earlier readiness for similar requirements and their related leading indicators. Leading indicators, for example, often arise from insights gained from completed acquisition integrations. Designing leading indicators for the performance metrics helps prepare work streams to be ready for a fast start on “day one”.

For Miyashita, the effective use of acquisition integration performance metrics is ultimately dependent on how well the acquisition performance process is aligned with company management systems. At IBM, the CEO and CFO regularly evaluate every acquisition’s progress using a robust quarterly review process for eight quarters. This visibility creates accountability and motivates managers to focus on meeting their commitments. Another advantage of this process is the opportunity to make positive changes to IBM’s base processes. When performance metrics are used as an integral approach in the end-to-end acquisition process (from due diligence to reporting back to the CEO and CFO), they help improve focus, drive execution, and increase the chances of a successful integration.

Lesson 2 Standardizing M&A Integration Procedures

Every year, Home Depot’s M&A group and relevant functions target a dollar amount for acquisitions to complete. In 2005, these projections led the company to pursue 21 acquisitions. Due to this level of M&A activity, the company has made documenting and standardizing processes for its many acquisitions a critical activity.

John Hartmann, director, strategic business development, manages the process and execution of integrating acquisitions at Home Depot. Over the past two years, Hartmann’s role has expanded to include regulating the process of M&A integration, selecting and training business integrators, educating business leaders for M&A integration, and overseeing the quarterly integration review process. His group has also created an “e-room” that makes collaborative tools and templates available online to help pilot current integrations and prepare employees for future acquisitions.

As part of their effort to institute standard processes, Hartmann’s group has also developed a generic integration template to collect information from each function. This data is then used to define the roles and responsibilities for each functional area (e.g., IT, human resources, legal, communication, risk management, finance, credit services, corporate compliance, government relations, public relations, and safety). All functions are then assigned timelines and “toll gate” measurements (i.e., approvals for each part of the process that are needed to advance to the next level of approval). These templates and “toll gate” measurements vary depending on Home Depot’s three lines of business - The Home Depot (Retail), HD Supply (Wholesale), and Services (Installation) - and the special characteristics of each acquisition. In addition to forming the basis for a playbook that functions as a detailed guide to the integration process, these tools can also be used in weekly phone calls to business and integration leaders and other functional specialists.

Depending on its size, an acquisition may pass through three or four quarterly acquisition integration reviews that focus on exceptional items outside of the target metrics set for the acquisition plan. While financial metrics remain an important part of these meetings with the CEO and the CFO, additional measures have been created around functional integration activities (such as IT, human resources, safety, legal, etc.). Starting about a month prior to the quarterly review meeting, the

M&A integration team preps each business leader on how he or she should present progress for his or her part of a particular integration. Members of the team also act as fact-finders, determining what is not going well so that remedial action can be taken.

Lesson 3 M&A Professionals Bundle and Disperse Best Practices

Dow Chemical established the M&A Expertise Center (the Center) in 2002 after its successful acquisition integration of Union Carbide in 2001. Randy Croyle, director of the Center, believes his team can facilitate the implementation of a wide range of activities by managing the “white spaces” that every company has between its various businesses, geographies, and functions. The Center’s operational abilities allow it to manage time-critical elements that are just as useful for closing down a plant as they are for integrating a major acquisition.

While ownership of an acquisition resides with the business division executive responsible for managing it, staff from the Center work with the lead executive to define the integration leader’s roles and responsibilities. After developing this profile, the two sides then collaborate to select the most appropriate person for the position of integration leader. Once such a leader is appointed, he or she works with Center staff to assemble implementation teams.

The Center also assists the business leader in establishing overall objectives for the acquisition and determining the value drivers (e.g., headcount reduction, purchasing synergies, new product launches, etc.) behind the synergies that will justify its price. As a result, part of the Center’s role is to challenge business managers’ assumptions. This may mean pushing executives to make their synergy projections more realistic, or, on the other hand, advising leaders to move more quickly and make more aggressive projections. Center employees are active during the due diligence phase as well, ensuring that important information gathered over the course of that phase is not lost during implementation.

The M&A Expertise Center integration team is now “swimming upstream” to incorporate their knowledge earlier in the process by supporting the deal negotiation teams. Randy Croyle explains implementation issues to deal negotiators who may change their positioning or valuation of the target firm as a result.

Dow's "After Action Review" process, which is patterned on the U.S. military's, is an important part of building knowledge about how the company integrates its acquisitions. The first step in any such review is establishing its scope (e.g., whether it should it focus only on due diligence or also zero in on the sales or marketing aspects of the integration). As soon as this focus is set, an open-ended survey is sent to key individuals involved in the acquisition integration, and one-on-one interviews are conducted to hear the unvarnished analyses of what worked well and what did not. Key knowledge points gleaned from this process are summarized and incorporated into M&A integration procedures for use next time. In one acquisition, for example, the approach to lowering costs was to reduce personnel across all functional areas in the target company. An analysis of the results of the after action review, however, showed that it would have been better to reduce customer-facing personnel more slowly than back-office personnel.

The archive of lessons learned continues to grow and provides examples for specific activities such as customer service, purchasing, or engineering. Information from the archive has been used to create over 100 templates to help pilot the integration process. The Center integration team also strives to incorporate the knowledge they have gained into the process in other ways. By explaining implementation issues to deal negotiators early in the process, Croyle can help them determine whether they need to alter their positioning or their valuation of the target firm.

Lesson 4 Piloting an Integration with Management Tools and Metrics

John Vester, then Vice President of Strategy and Business Development, Xerox developed nine M&A integration management tools to pilot the integration of Tektronix. Certain tools, such as those for readiness preparation, closing work plan, monitoring employee website comment board, were only used by the integration team members. As the integration got underway, more of the tools facilitated synergy tracking, senior management work plans, briefings, and reporting to executives on the overall status of the integration.

Readiness preparation and a closing working plan, the first management tools, were instrumental in creating the decision log, which was critical to managing a successful integration.

Discipline in integration management arises from putting decisions within appropriate parameters. For the Tektronix integration, these included:

- Decision number (prioritized by deadline date)
- Decision description
- Closing date requirement (yes/no)
- Function
- Areas impacted
- Geographies impacted
- Dependencies
- Date decision needed
- Priority (A, B, C ranking)
- Value measure
- Date first identified
- Days open
- Who’s working
- Status
- Actions already taken
- Implications if unresolved

By tracking all decisions, including those that were behind schedule, integration managers could see whether decision makers were moving fast enough and, if not, use the results to influence the pace of the process. The log also helped the integration manager identify the consequence of not making a decision on time.

Since no single tool was good for everything, the acquisition process required a variety of approaches. In his experience, John Vester has found that a management tool performs well for about three months. He also emphasized that the 80/20 rule prevailed throughout (i.e., it was better to focus energy and time on the big decisions with 80 percent impact than on issues with smaller impact) and that he made sure that tracking tools and metrics interacted at least at the level of information. Discipline in integration management arose from creating a critical decision log and focusing on the issues with highest impact.

SUMMARY

Master acquirers distill their experience into knowledge that can be reused for future acquisitions. The four lesson from five masters show that accumulating experience cannot replace a dedicated effort to learn from integration experience. Even if a company is not a serial acquirer, it can still document its knowledge and make full use of it when another acquisition comes along. At SC Johnson, since a large acquisition occurs only every two or three years, there is no permanent M&A integration team. When corporate needs to mobilize many resources for a large acquisition, it pulls together a sizable integration team specific to the acquisition. Nevertheless, Lee McCullum, Executive Vice President and Chief Financial Officer, emphasized that the integration team is called together after the announcement to review the documentation from four of SC Johnson's major acquisitions and ensure that they understand the learnings that have been captured. Over the past 15 years, the company has carefully documented the results and lessons from its M&A integrations, and benefits from its own knowledge to improve its acquisition integrations. Raising the odds of success substantially, these efforts have proved worthwhile for SC Johnson as well as for our other master acquirers.

SIDEBAR 1 Research Design and Methodology

In 2006, The Conference Board launched a two-stage research project on M&A integration practices among master acquirers. The project was composed of two types of research: first, an investigation through questionnaires, and second, interviews with integration specialists at experienced acquirers. The project aimed to answer the following questions: Which M&A integration practices do master acquirers (and occasional) use most? How do master (and occasional) acquirers rate the effectiveness of their M&A integration practices? Which M&A integration practices do master (and occasional) acquirers rate as most effective? Do master outperform occasional acquirers in their M&A integrations?

Survey
A list of 23 M&A integration practices was drawn up from past research and confirmed in discussions with consultants. This list was included in the questionnaire, in the terms used by acquisition specialists.

In 2006, 400 surveys were sent worldwide to members of The Conference Board’s* merger and acquisition, business development and corporate strategy membership networks. Of these, 101 surveys were received for a response rate slightly over 25 percent. The 101 respondent firms were engaged in 2,447 integrations over the past decade. For some figures, we used a subset of 75 respondents due to missing data. Of the 75, 27 did not or only slightly view mergers and acquisitions as a key growth instrument; we call these 'occasional acquirers'. The remaining 48 firms all to a good or great extent relied on M&A as a key growth instrument; those we call 'master acquirers'.

Of the respondents, 65 percent are headquartered in North America; 35 percent in Europe. The sample consists of many large companies: 59 percent had sales over $ 5 billion. Respondent companies were widely distributed across industry sectors: 43 percent from manufacturing; 29 percent from services; 12 percent from financial services; and 11 percent from energy and utilities among others.

Interviews
In addition, we interviewed 12 merger and acquisition integration directors from different firms. While some of these firms proved very successful in their acquisitions, some were consistently less successful. Doing this allowed us to compare practices between successful and less successful firms. In particular, the in-depth interviews provided deep insight into how firms differ

in the use of M&A integration practices. More importantly, it led to four important lessons derived from firms renowned for their repeated success in M&A integrations. From these interviews, IBM, Home Depot, Dow Chemical, Xerox, and GE Commercial Finance provided the examples cited in this article.

Table 1 Description of Categories of M&A Integration Practices

M&A practices	Description
Internal and external functions and staffing	Personnel functions in and outside the organization that manage the various M&A integration phases by providing M&A expertise
Quantitative models	Packages and models to allow for comparison between acquirer and acquiree and careful management of integration process
Tools	Instruments and algorithms that help manage M&A integration through provision of guidelines and deliberate sharing of experience
Documents and manuals	Codified material to support specific parts of the M&A integration process to nurture consistency and professionalism throughout the integration process

Source: Partially based on Zollo and Singh (2004).

Table 2 Use of M&A Integration Practices

I. Internal and external functions and staffing

External lawyers and financial experts	89.1 %
Internal M&A department	75.2 %
Internal on-going M&A team	66.3 %
External consultants	55.4 %

II. Quantitative models

Financial evaluation	93.1 %
Project management	71.3 %
Staffing models	57.4 %
Product mapping	54.5 %
Self-training packages	51.5 %

III. Tools

Joint planning sessions	80.2 %
Formal sessions between managers involved in M&A integration	76.2 %
Standards target selection approach	71.3 %
Use of performance metrics	68.3 %
Systematic integration evaluation	59.4 %
Acquisition integration database	56.4 %
M&A integration trainings	46.5 %

IV. Documents & manuals

Due diligence checklist	98.0 %
HR integration manual	65.3 %
Due diligence manual	55.4 %
Systems conversion manual	55.4 %
Product training manual	52.5 %
System training manual	51.5 %
Affiliation/integration manual	48.5 %

N=101

Table 3 Use of M&A Integration Practices Comparing Master and Occasional Acquirers

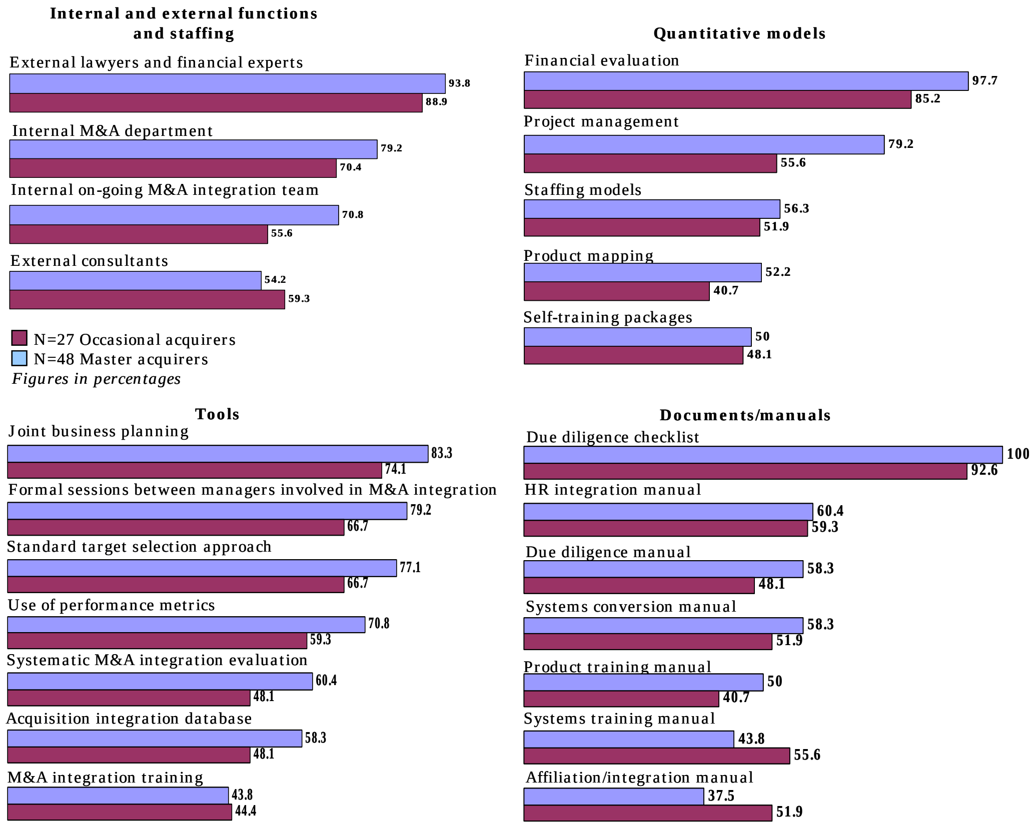
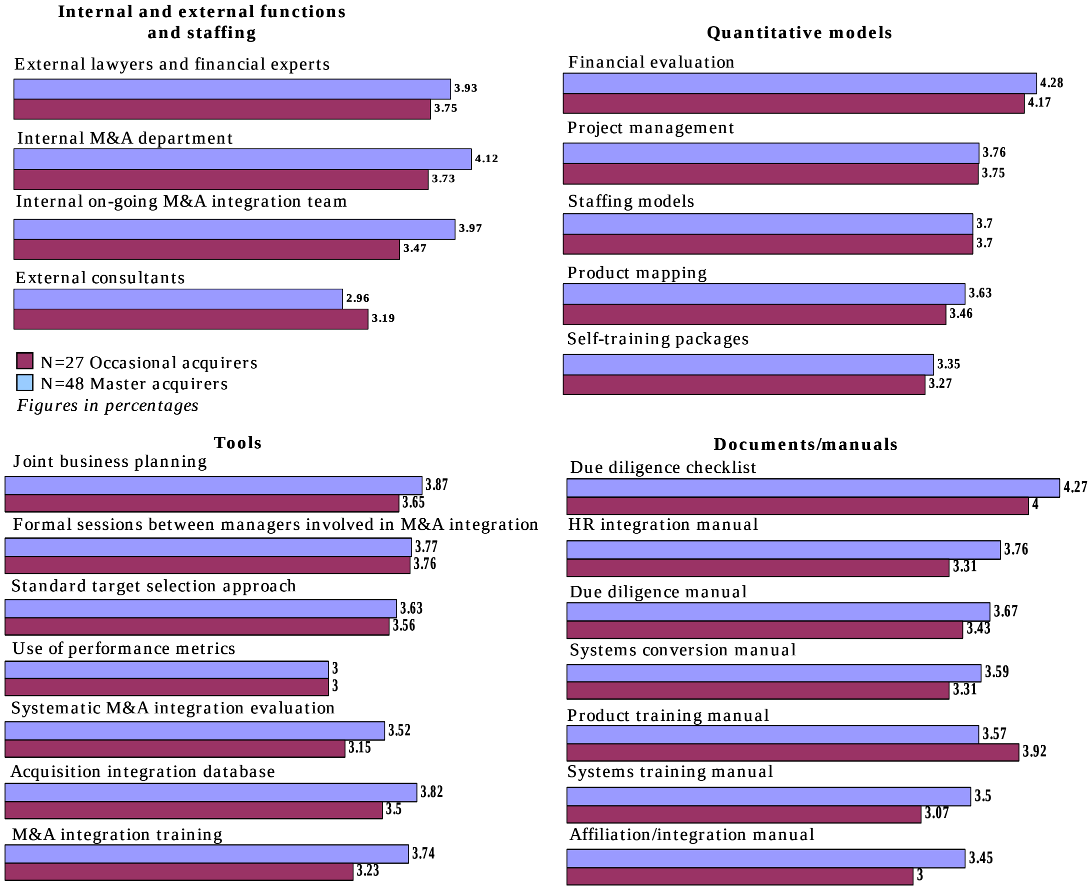


Table 4 Effectiveness of M&A Practices Comparing Master and Occasional Acquirers



Endnote

*The Conference Board is a not-for-profit independent business research and membership organization that creates and disseminates knowledge about management and the marketplace to help businesses strengthen their performance and better serve society. Working as a global, independent membership organization in the public interest, it conducts research, convenes conferences, makes forecasts, assesses trends, publishes information and analysis, and brings executives together to learn from one another.

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