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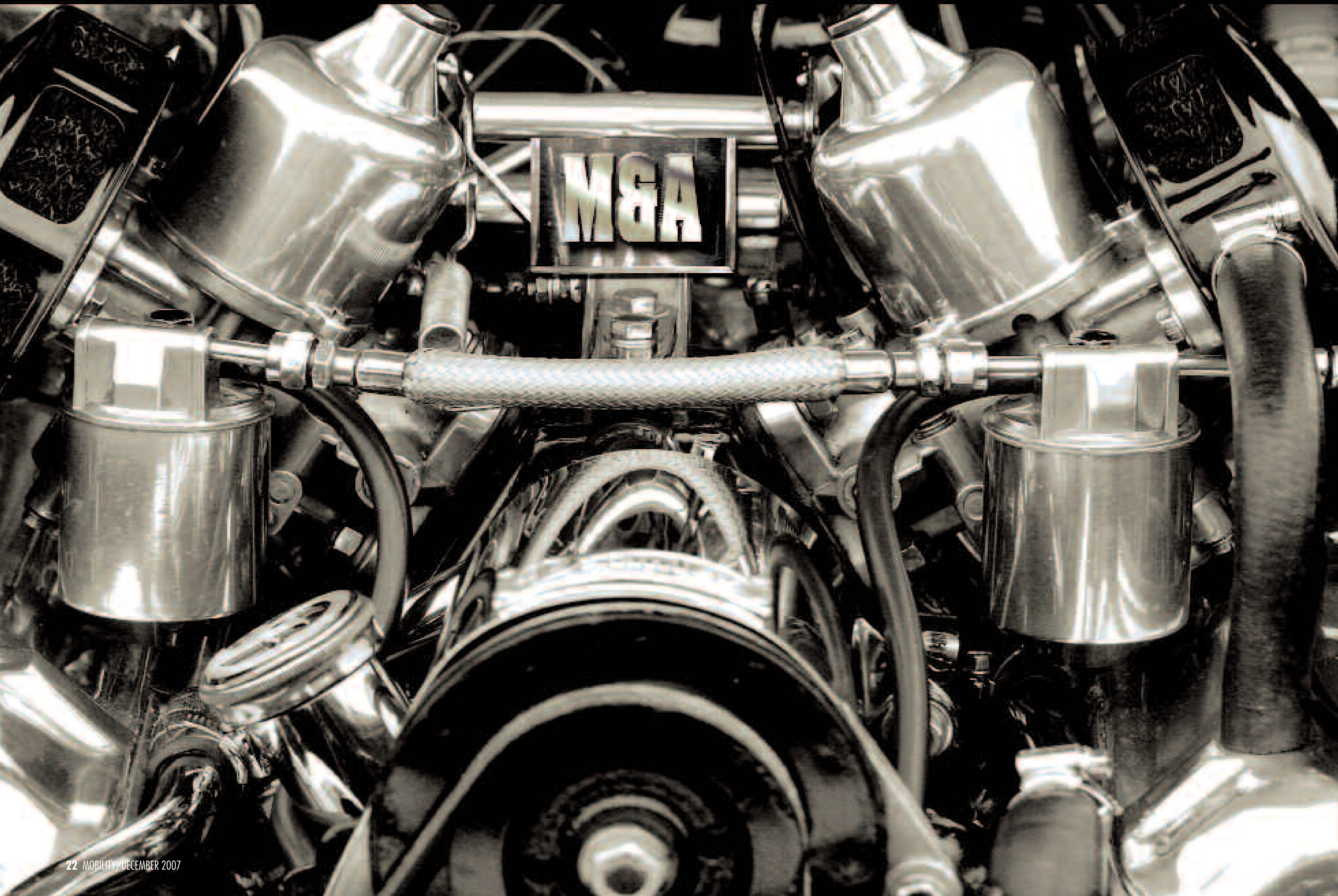
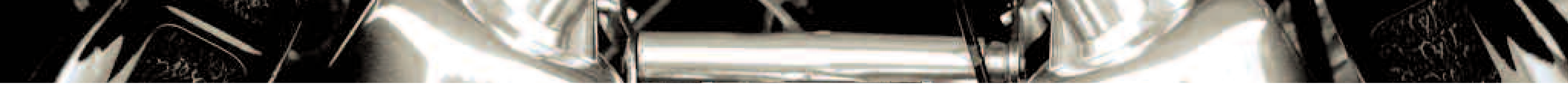
THE INTEGRATION ENGINE

BY GAVIN DUNAWAY



Tools and Processes That Facilitate M&A: *Part 1*

Organizational growth through mergers and acquisitions (M&As) is a popular strategy for companies seeking to expand their business scope; organizations that use M&A to grow incorporate streamlined tools and processes to keep their integration engines running smoothly, merger by merger, acquisition to acquisition. Through conversing with M&A experts and examining survey results of companies that use M&A as a core instrument of growth, Dunaway illuminates the various procedures employed during the phases of M&A from a human resources (HR) vantage.



Aditya Birla Management, Mumbai, India, is a "serial acquirer." Prior to 1996, the conglomerate had grown primarily through investment in Greenfield operations, but Aditya Birla Management Management was investigating different avenues of expansion. Members of senior management attended a series of seminars illuminating the potential of mergers and acquisitions (M&As) where they discovered the philosophies behind valuing businesses and devoured tales of successful integrations.

In 1999, Aditya Birla Management began a series of acquisitions that continue to this day. Now, the management company oversees businesses in a wide variety of industries—T to T, everything from textiles to telecommunication, said Dr. Santrupt Misra, director of human resources (HR) and information technology (IT) for Aditya Birla Management—across an expansive geography, including Asia, Australia, Europe, and North America. While it is well known that a large percentage (anywhere between 60 and 75 percent) of M&As fail to live up to expectations or founder, Aditya Birla Management has experienced success using M&A, in part, through the streamlined procedures it has developed. The company has created an integration engine.

Misra stated two main reasons organizations partake in M&A: incidental, as in an opportunity presented itself, and strategic—M&A is an integral part of a company's plan for growth. Companies that use the latter reasoning are considered serial acquirers. These companies employ tools and capabilities to aid in the process of melding the acquirer and the target company—also known as integration.

Quantitative tools, such as due diligence checklists, are considered the most effective means of streamlining the integration process, according to the Conference Board report, "Strategic Mergers and Acquisitions: Creating Tools and Capabilities for Successful Integration." In addition, the makeup of the integration team is critical to M&A success; how to assemble an effective integration team is knowledge that serial acquirers must have down pat.

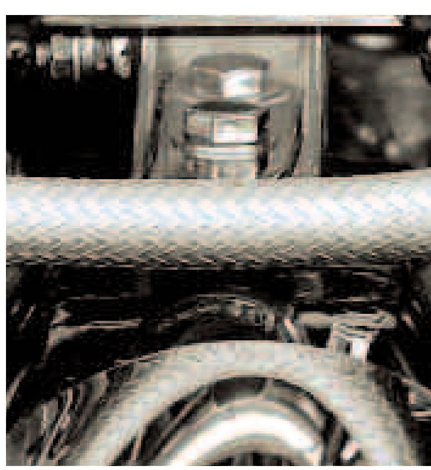
In particular, people-related issues can cause M&A to stall out—HR challenges are an oft-cited reason for M&A failure to meet objectives. Corporate cultures can collide in M&A leaving casualties galore—top talent may flee and retention might sputter. Productivity may decline because employee responsibilities are unclear.

HR plays a key role in M&A because the department is responsible for more than just the integration of its own department. HR professionals become pilots during an M&A, charged with finding a flight plan with the least amount of turbulence for the passengers—the human capital. This entails that the department is heavily involved in the tools and processes that facilitate M&A success.

"HR is not just integrating HR specifics—compensation, benefits, payroll, and so on—HR also is facilitating the integration of the whole merger or acquisition," said David Eaton, president and founder of Aperian Global, Boston, MA, who has been conducting a global M&A best practices study focused on the five phases of M&A—scoping, due diligence, the deal, integration, and sustainability (see sidebar on page 26)—and human integration challenges in particular. "HR wears two very important hats, one being more strategic, the other more tactical."

Tools and processes are essential to every phase of the merger, from due diligence to actual integration to ensuring post-integration sustainability. Relocation is itself a tool, and the relocation department is an essential part of the M&A integration process, particularly in cross-border M&A.

M&A integration planning is not just for those organizations that eat, sleep, and breathe acquisitions; it is helpful for companies pondering whether M&As will be their method for furthering operations. Integration best practices allow an M&A to be sped along and be less of a strain for all involved. Any expanding company can build an integration engine to assist in its future development.



M&A Procedures

According to Misra, strong M&A procedures serve three chief purposes for HR:

1. To identify people-related risk factors ahead of time.
2. To identify integration challenges and their magnitude.
3. To minimize the possibility of surprises post-acquisition.

Checklists and Offices

Tools and processes can be modified depending on strategic intent, size of the target company, industry focus, or geographical location, all of which can be volatile variables. In "Strategic Mergers and Acquisitions," the Conference Board examines tools and capabilities that companies pursuing continual growth through M&A employ to support their integration processes. In a survey of M&A directors, 38 percent said their companies use M&A as a core instrument of growth to a good or great extent.

The due diligence checklist was the highest rated and most widely-used tool—98 percent of respondents reported using checklists and 82 percent regarded them as good or excellent.

Due diligence checklists are critical for a merger, Eaton said. "Consistency matters across acquisitions. By having templates and checklists, it encourages not only a continuous improvement process, but also a scalable one."

However, just because a process has a standardized procedure does not mean deviations are unacceptable. There always will be unique aspects to the storyline of a merger, Eaton said. "If you are starting from a baseline in consistency, then you can constantly be in improvement mode and build on your successes one at a time, across multiple transactions."

Misra added that while due diligence checklists were practical guideposts, they cannot be substitutes for business understanding and intrinsic judgment. The checklists may be crutches, but they will snap if leaned on too much; rather, the contents should be seen as principles instead of prescriptions for the "right way."

"Integration has a social, cultural, and emotional process that requires constant intuitive assessment," Misra said. "It, therefore, cannot be easily fitted into a straitjacket, copy-book formula."

The similarly themed HR integration manual, used by 66 percent of responding companies, warranted a 7 percent excellent performance rating and a 57 percent moderate or below rating. The Conference Board noted that a due diligence checklist is an early stage device, while the HR integration manual comes into play later in the merger. In general, quantitative devices used in the early phases of the acquisition were found to be far more effective than later-stage tools used in HR integration.

Another tool that garnered high marks in the Conference Board report—and used by more than three-quarters of the respondents—was an M&A department or an integration management office (IMO), which received an excellent performance rating from 36 percent of respondents and a good rating from 48 percent.

Eaton has found in his research that most companies with successful, sustained M&A growth have dedicated IMOs that join the process early in the due diligence phase. Within these offices are representatives from multiple functions; HR is particularly critical, factoring prominently in the due diligence, integration, and sustainability phases. These offices will begin drawing integration plans shortly after the letter of intent is signed, and functional leaders from both organizations should be involved in the IMO activity.

However, Misra disagreed about the necessity of an M&A department or an IMO; maintaining institutionalized processes and evolved M&A capabilities for reorganization should be higher in prescience. If M&A is central to growth strategy, upkeep of the M&A procedures should be an organization-wide task.

"An M&A department per se confines the M&A capability of that department thereby to a few people," he said. But if the M&A opportunities are coming to the organization at a staggering rate, installing an IMO

Metrics and Feedback

According to the Conference Board, 67 percent of M&A directors used performance metrics to assist during integration, and 57 percent rated their level of performance good or excellent; however, 43 percent said they performed moderately or below average. Establishing performance metrics requires a wide-ranging discussion about the strategic rationale behind the acquisition. These metrics then can be validated during due diligence.

Five-Step Program—M&A Stages

The number of stages involved in M&A is up for debate—some say four, while others claim five. Eaton details a thorough, five-step process.

1. *Scoping.* In this stage, an organization evaluates the role M&A will play in its growth/globalization strategy. Subsequently, the organization develops a set of protocols for determining potential target companies.
2. *Due Diligence.* Once an organization selects a target, data gathering begins. Many M&A integration tools first appear in this stage. Aspects of business and national culture are examined for acquiescence with the acquirer culture. After a letter of intent is signed, the due diligence kicks into high gear and the data gathered is validated. These are culturally loaded events (conversations and the like) and culled data needs to be filtered carefully.
3. *Deal Phase.* Dynamics of Culture (corporate/national) play a significant role in final negotiations and can affect post-integration success. Agreement can be reached on management structure, communication/decision-making, and other group norms.
4. *Integration.* The offices merge, putting the planning developed in the previous stages into action. A "third culture" is built that drives successful human integration.
5. *Sustainability.* The integration is evaluated and adjustments are made to ensure the merger or acquisition will stay intact well into the future.

may be a best practice. "If one is repeatedly doing 40 to 50 M&As a year, it may be useful to have a dedicated group of people to look after M&As, as pulling out people time and again when running a business is a tough task."

Metrics and Feedback

Aditya Birla Management employs a performance matrix for acquisition goals that is configured during the deal phase. Along with business goals, employee retention is an essential metric for judging the success of M&A. Metrics may be based on statistics culled from previous M&As, such as retention of top talent or assets.

Eaton also cited corporate reputation and its effect on recruiting as a useful metric. A newly merged organization will want to be considered an "employer of choice," and a positive post-integration work environment is key.

"Employees are one of your loudest marketing message centers," Eaton said. "When recruiters are asking employees questions, they hopefully will respond, 'We are so much stronger because of our merger'." Recruiting efforts may stall if employees respond negatively or are wary about the merger or acquisition.

Tools that fared poorly in the survey included the use of consultants to manage integration processes, which 55 percent of respondents had used—of that group, 70 percent rated the performance moderate or below. However, Misra said, depending on the circumstances of the M&A, consultants may be needed; factors such as M&A experience within an organization and the complexity of the transaction may prompt the need for external help. In addition, in cross-border M&A or when entering into a new business sector, expert outside opinion may be a boon to the process.

The documentation of an acquisition is important for assisting future M&A integration teams and developing procedures. "Debriefing" sessions with integration players is one way to gather relevant information. Establishing a feedback loop will encourage dialog about the effectiveness of processes.

"Standardized practices are nothing but distilled knowledge and experience from previous M&As," Misra said. "We keep on refining these tools and processes with every new acquisition. Despite the best planning, one can still have surprises in an M&A, but pre-planning always helps in better due diligence as well as integration."

Assembling the Integration Team

In general, the earlier in the acquisition the integration team is involved, the smoother the integration. This requires that the team be assembled early in the due diligence phase; organizations that use IMOs or M&A integration offices may cull their teams from that center. Sixty-five percent of respondents in the Conference Board study used ongoing integration teams.

According to Misra, the integration team leader must display the most formidable qualities of leadership: the ability to quickly analyze a situation, a sense of fairness and equality, empathy, and top-notch communication skills both at the group level and in one-on-one interactions. While possessing strong organizational skills, he or she also should report directly to the CEO, CFO, or business division director—this increases the likelihood of the team to requisition the best talent.

If the leader must go through numerous sources (or higher-ups) to answer target company questions, that company will think the team leader has little authority, and subsequently increase the level of wariness within the target organization. In particular, target employees may grow uneasy about communication and the internal power structure of the acquiring company. In addition, if the integration leader lacks the ability to answer questions, it will slow down the whole process.

In a Conference Board webcast, Nicolas Albizzatti, expert associate principal with McKinsey & Company, Chicago, IL, noted that one *Fortune* 500 company actually assigns the integration leader to head up the due diligence phase, as well, so information transfer is guaranteed between the two stages.

The size of the target organization will determine size of the integration team. If it is a large target, a sizable crew will have to be established; if the team members are not a part of the ongoing M&A office, HR must determine who will cover their normal work.

Team members should encompass foremost knowledge of their various functions, while embodying business expertise. Prior M&A experience is advantageous, while a deep comprehension of human issues is a necessity.

The integration team also may include high-potential talent who will be able to retain lessons and develop tools for future acquisitions. The Conference Board reported that serial acquirers preferred generalist rather than specialist team members; generalists tend to take a holistic view of the integration process, while specialists are locked in a "silo" vantage.

Also, in "Strategic Mergers and Acquisitions," John Vester, principal, transaction advisory services for Ernst & Young, New York, NY, suggests one can never have too many HR people on the bench in M&A.

The nature of the takeover—hostile, negotiated, or friendly—plays a large role in preparation for integration, and may affect the makeup of the integration team. In a hostile takeover, the members of the integration team (the first responders) will make the first and greatest impression. The types of inquiries they initially make will paint a picture in target employees' minds of how the integration will proceed.

If the integration team asks mainly financial questions, target employees may think all the business cares about is profit and the bottom line. If the integration team requests meticulous detail on every miniscule aspect, the target employers may get the sense the acquirer is nitpicky and full of micromanagers.

When home improvement chain B&Q, Eastleigh, United Kingdom, acquired the Chinese offices of competitor OBI, Wermelskirchen, Germany, the situation was fraught with tension, explained Andrew Farrow, executive vice president, B&Q China, who was integration management director during the merger. The OBI employees felt "sold out" by the head office and were nervous about whether they would keep their jobs. It was up to the integration team to quell that uneasiness, and make a first impression that would welcome OBI into the B&Q team.

This highlights possibly the most difficult task of the integration team; if it is not assembled with premier people, the whole merger or acquisition could be in jeopardy.

Next month in part two, *Mobility* examines tools and processes involved in merging cultures—both corporate and national—as well as the roles of relocation planning and communication. ■

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