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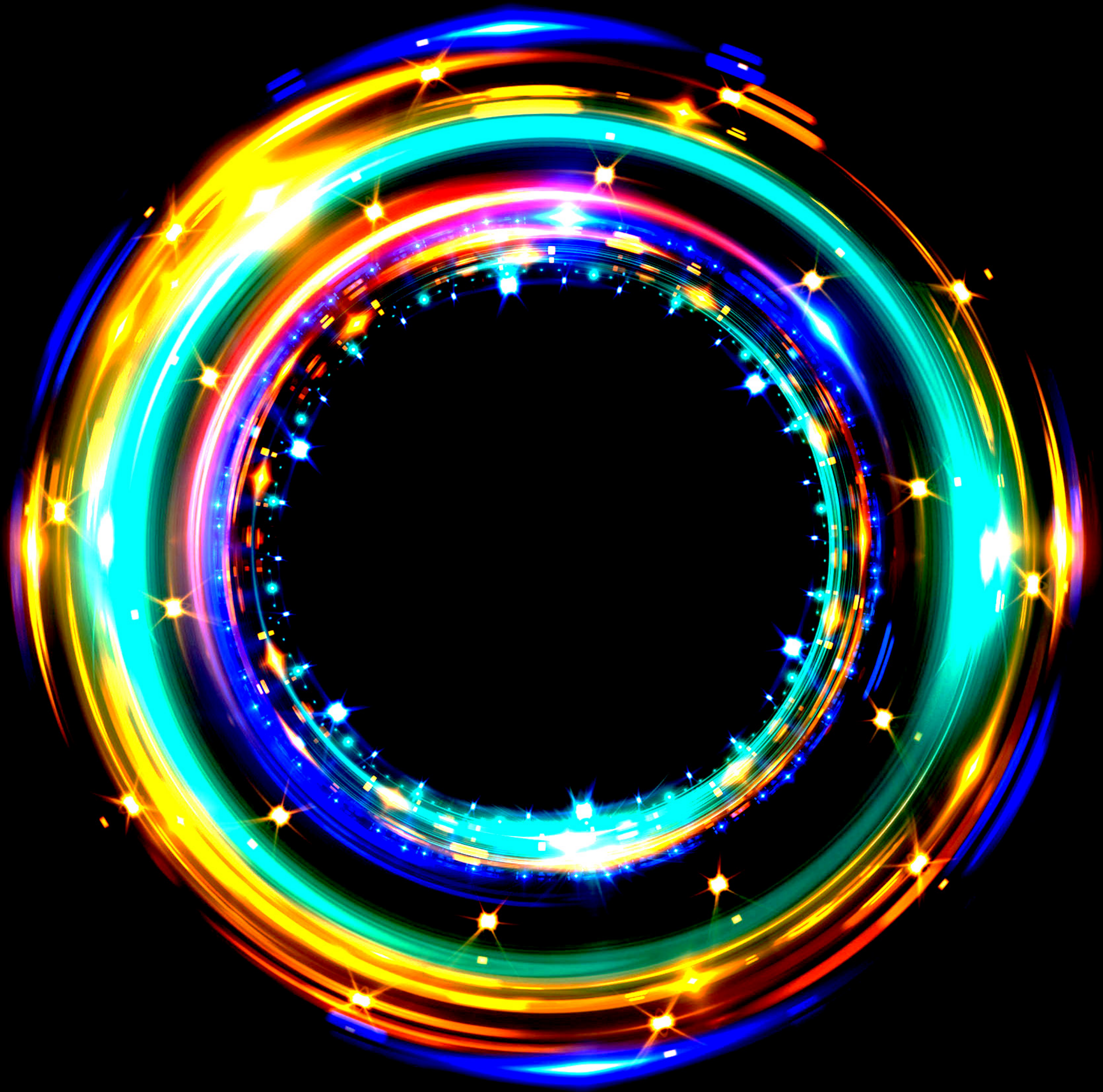

The catalyst

Transforming while transacting

M&A

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Introduction

An acquirer entering into a significant M&A transaction has many decisions to make, ranging from what brands to keep to what systems to adopt. In our view, one option they should strongly consider is whether or not to use the transaction to drive a transformation agenda. Rather than proceeding in incremental steps on a narrow deal thesis, there is often a bigger opportunity to reinvent the business or rethink the operating model. In the face of digital disruption, rapid technology innovation, and accelerating industry convergence, M&A transactions can serve as a window of opportunity to capture transformational value.

Transformation is never a given. In fact, there is an all-too-common practice to approach transaction implementation in two steps. Step one focuses on combining the organizations (or splitting them out in the event of a divestiture or spin-off) and on stabilizing the business. Step two is transformation—the phase where the organization tries to reimagine, optimize, and rightsize the business and its operations and systems to drive growth and profitability.

This two-step approach is tried and tested—but has drawbacks. It prolongs the timeline and can suboptimize the value realization potential. It can create competing agendas, and governance structures limit one another. In fact, having two separate steps often leads to fatigue, using up the original deal energy and excitement and leaving many parts of the organization wholly unchanged and far from optimized, despite the best of intentions.

Deloitte research helps confirm the concern that existing integration practices do not consistently deliver success. Some 46 percent of respondents in our *2020 M&A Trends* report indicate that less than half of their deals over the past two years have generated the expected value. Respondents continue to rank effective integration as one of the most important factors for deal success.

Transforming while transacting

Leading organizations and forward-thinking executives are now embracing a different approach, one in which transformation is pursued simultaneously with a transaction. In effect, companies "transforming while transacting" are using the aperture of a M&A deal to redefine themselves. Taking advantage of the opportunity, they are implementing new business and operating models for a combined or separated entity, and in doing so, driving significant revenue growth and sustainable margin improvement.

Organizations that embrace the transforming-while-transacting paradigm begin thinking about and planning for transformation early in the life cycle of the deal—as early as when the strategy is being set and the investment thesis defined. Due diligence can then be used to validate the investment thesis, with a focus on the stand-alone value drivers, potential synergy benefits and potential benefits from applying transformation levers across the organization, and potential risks and mitigants. As organizations develop their end-state vision, they explore alternative models and approaches to applying transformation levers. In some cases, they define pilots to test the use of new technologies and capabilities. Finally, these organizations define, prioritize, and sequence key initiatives within the transformation roadmap to achieve the desired, risk-balanced acceleration of value realization.

What does success look like? Transforming while transacting can result in an integrated organization with expanded market access and product offerings; an organization newly positioned to deliver

significant revenue growth through a revamped commercial model and improved customer experience; an organization that can deliver operating income expansion through simplified technology architectures and a more efficient and automated back office—or a combination of all three.

In a divestiture or separation, transforming while transacting may allow an organization to better achieve the strategic objectives for both the seller and buyer of a carved-out entity, focusing more clearly on customer engagement, simplification of the go-to-market model, or improvement of operational efficiencies. Reshaping the business and operating models and transforming the IT infrastructure as a part of the separation process may reduce complexity, virtually eliminate transitional service agreements, and minimize stranded costs.

Case in point

Two large public hospitality companies wanted to use their merger as a catalyst to become more digitally enabled and more innovative. To drive actionable growth, long-term sustainability, $150 million to $200 million in cost synergies, and additional revenue synergies, the company sought to develop new capabilities in advanced analytics, robotics, and cognitive technologies. Leadership viewed transforming while transacting as an opportunity to redefine the overall vision and began the transformation planning during diligence.

Transformation activity centered around three areas: growth strategy and innovation, operating model and organization design, and value capture. A visioning lab attended by executives from both companies created alignment on future direction for the combined organization. It identified critical strategic capabilities, provided a current-state capability assessment, defined the future operating model, and built a readiness plan for day one after the transaction closed.

Planning the transformation before the transaction helped enable $200 million in incremental EBITDA benefit and led to a three-year roadmap to develop industry-leading capabilities and technologies. The transformation levers applied here included organization design, capability development, operating model design, and digital disruption adoption.

These opportunities are within reach today. The transforming-while-transacting paradigm can drive faster, more significant, and more sustainable value creation. In this report, informed by Deloitte's experience advising clients on more than 10,000 transactions, we intend to explain both the promise and the practical considerations that surround this approach to M&A. We will specifically address four fundamental questions to help any company entering into a sizeable transaction to assess the transforming-while-transacting potential:

- **What** are the advantages and disadvantages of transforming during a transaction?
- **When** does it make sense to consider transforming while transacting?
- **When** during a transaction is the right time to start a transformation?
- **What** transformation levers are available while transacting?

What are the advantages and disadvantages?

Transforming while transacting can help accelerate a company's ability to change its business and operating model, readying the combined organization to more effectively compete. It can increase the likelihood of deal success as well, whether an organization is integrating an acquisition or divesting a unit. Transforming while transacting can create opportunities in the following ways:

- It expands value-creation potential and boosts the chances of achieving the deal value that was expected when the transaction was initiated.
- It accelerates returns for the business and readies it for future success.
- It takes advantage of a window when attention from management and the organization is high, when effective governance is in place, and when there is organizational acceptance that things are going to change.

In our annual *M&A Trends* survey, respondents not only highlighted their concerns about failure to achieve expected deal value, but also identified gaps in integration execution and inability to achieve cost synergies as two critical reasons for deal failure. Sales not materializing was another top reason for why deals may come up short (figure 1).

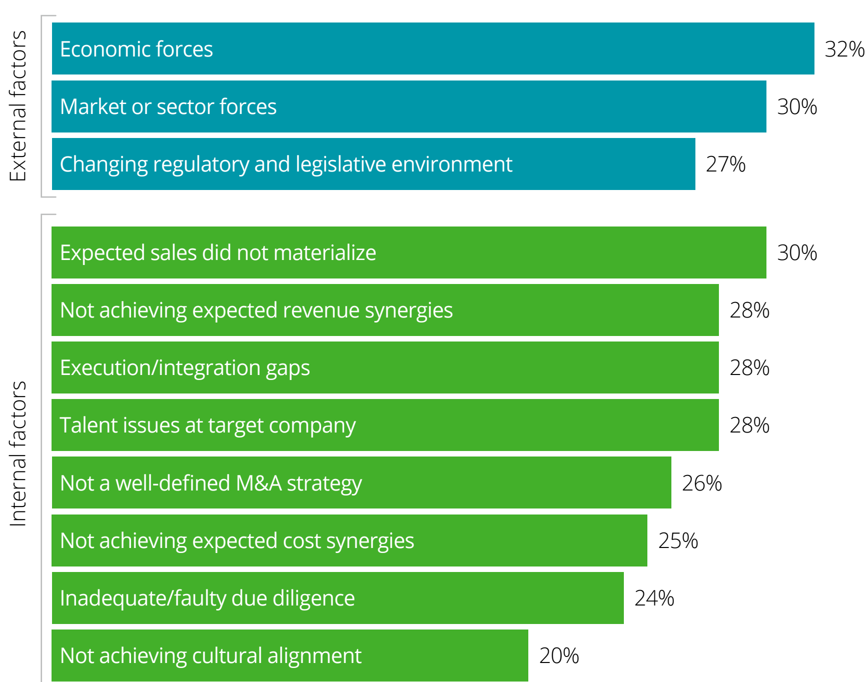
Transformation increases the number of levers available for value capture and expands the potential impact of the transaction. It opens the aperture to help executives and business leaders find new value creation pathways that their competition may not see.

Companies with a clear view of how to transform can build toward a future with a more competitive business model, making one leap instead of multiple execution steps that may be costly and slower. For example, a company with clear strategic intent to move to a cloud-based solution can bring both sides of a business combination into the cloud during the integration phase, rather than first melding two on-premises systems and then moving to the cloud.

Finally—and this may be the most compelling reason—every significant transaction creates a window during which the focus on change is sharp, governance is in place, and openness to change is accepted. With the right vision, amid these circumstances, a transformation can serve as a significant unifying force for the newly combined organization.

Transforming-while-transacting decisions are not without risk. These risks may include timeline delays and the possible failure of business or operational model changes. These risks are exacerbated when planning and/or execution is rushed. These risks can be mitigated by having strategic clarity at the outset and effective prioritization of transformational initiatives.

Figure 1. Top reasons why M&A transactions have not generated expected value



Source: Deloitte, *The state of the deal: M&A Trends Report 2020*, January 2020.

When does transforming while transacting make sense?

Companies should not pursue transformation during every transaction. Transforming while transacting is appropriate where there is an opportunity to create value, a need to reshape and advance capabilities and operations, and an appropriate window to effect change. In such circumstances, companies should strongly consider how to best take advantage of the transformational opportunity—and make it count.

Financial considerations or performance commitments to the board or to investors may come into play when deciding whether transforming while transacting is appropriate. The size of the organization matters, and so too do the performance commitments that have been made to investors and analysts. The degree of change and disruption an organization can handle may also need to be weighed. Some companies are better equipped to handle change, although this can be difficult to measure.

When should transformation occur?

The options are straightforward: Start planning and executing the transformation in advance of the transaction; during the transaction; or post-transaction. The right timing should be informed by purchase price, speed of transaction close, whether the takeover is hostile, whether there's a need for transitional service agreements, and the extent to which the organizations rely on digital capabilities (figure 2).

When a deal is imminent and transformation has not been a part of the planning, then post-transaction may be the necessary choice. In this situation, planning for transformation and planning for integration (or separation) should be run in parallel and tightly coordinated. Transformation objectives, scope, and strategy will need to be defined; use cases (and sometimes proofs of concept) constructed; and cost-benefits analyses completed, and cash flow analysis is essential. Synergies and value capture plans may need to be modified to take advantage of the benefits resulting from transformation. Board approval, budget, and funding need to be addressed.

Figure 2. When transformation takes place in relation to the transaction

	Transformation timing		
Attributes	Pre-transaction	During (in parallel)	Post-transaction
High purchase price?	X	X	
Limited time before the transaction?			X
Hostile takeover?			X
Significant transitional service agreements?	X	X	
Heavy reliance on digital tools?	X	X	
Rapid and sizeable value commitments	X	X	
Equal- or larger-size target		X	X
Highly complex technology architecture		X	X

Source: Deloitte framework

Case in point

A multinational IT company recently sought to transform itself as it spun off some of its existing businesses. The transaction was intended to refocus the organization on its core business of selling enterprise bespoke and hybrid technology solutions. To be successful, the company needed to invest in technologies to differentiate their enterprise server and storage business while building core network, service, and consulting capabilities. This was a strategic shift from a legacy hardware manufacturing business. The company also needed to shift customer focus from consumers to businesses and enable flexibility and agility to quickly respond to changing demands.

Given the complexity of the transaction, the organization decided to begin its transformation planning post-separation. Quickly after the deal closed, the company gathered and analyzed the data needed to support business decisions and develop standardized processes to simplify its operations, rightsize its technology infrastructure, and implement a single and scalable enterprise resource planning system.

If possible, the best time to start a transformation process comes before a deal is even signed. Starting early can help foster an expanded view of value creation opportunities and possible transformational outcomes and benefits. In fact, predeal transformation can provide a soft landing to an integration or separation. Priority should be given to revenue and customer-facing processes and the operational support for these processes across supply chain, IT, and finance. If you recall, earlier in the paper, research shows that sales not materializing is a key reason for deals failing to achieve value. Applying the prioritization above allows for sales organizations and people to do what they do best: sell and close deals. The less they need to worry about disruption from the transaction and can maintain focus on the customer and the customer experience, the better they perform.

What transformation levers are available?

While transformations can take many forms and derive a variety of outcomes, all transformations are composed of the same finite set of levers (figure 3). Consider these the building blocks—the foundational processes and structures that can be examined and changed when an organization transforms itself.

How many and which levers will be employed will be unique to every organization or situation and, indeed, how extensive the reach is may vary as well; levers can span every part of the organization—within and across functions, business units, geographies, or markets, affecting gross margin down to operating margin.

Process reengineering is the redesign of how work is executed to achieve intended outcomes with greater efficiency, lower cost, and improved effectiveness. Reengineering can simplify, standardize, or automate processes. It may involve the optimization of controls, harmonization of policies, or simplification of compliance.

Organization design is the effort to define the best organizational structure to deliver on an intended strategy. Evaluating and redefining leadership structure; aligning reporting hierarchies to strategic objectives; optimizing spans and layers; clarifying role definitions; goals, and incentives—all of these can have a huge impact on the output of an organization.

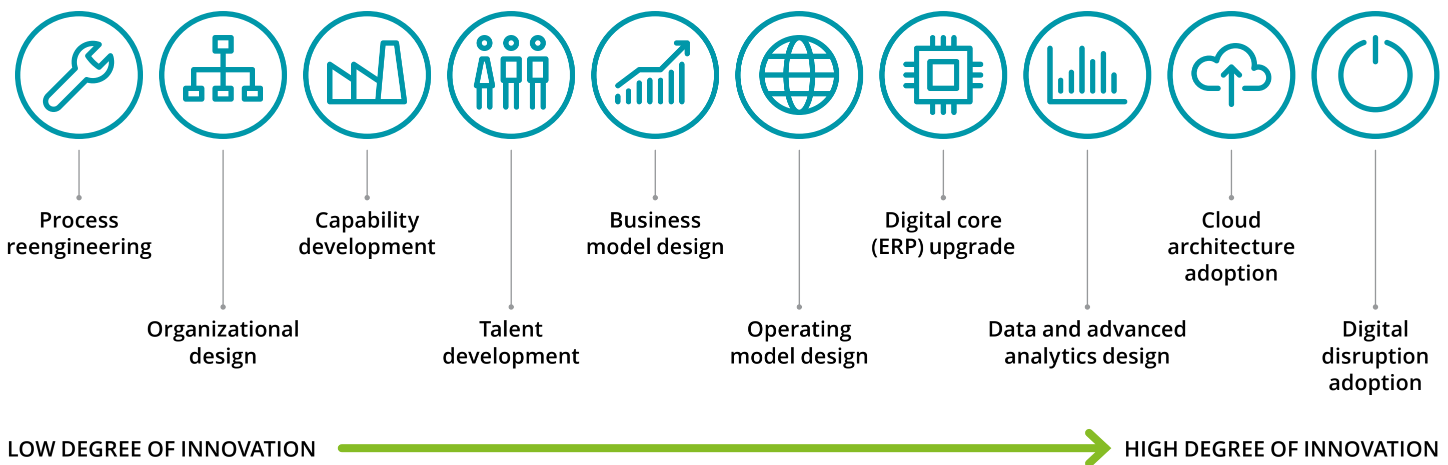
Capability development focuses on the enhancement of the existing features of the revenue model and simplifying operations. A company may also strive for improved profitability analysis, better market entry and capture abilities, refined go-to-market motions, and enhanced data analytics capabilities.

Talent development focuses on redefining an organization's models and processes for career progression, performance evaluation, compensation, and incentives. Overall, this lever is about nurturing a culture that will achieve the greatest potential from a company's human capital.

Business model design relates to how a company creates value—its product and service offerings, value proposition, and revenue model. The goal is to reshape a business to make it easier and faster to provide products and services to customers across global markets and across multiple buying motions. Alignment of the product portfolio, supply chain, and finance will all be in service of that goal.

Operating model design focuses on changing how a company operates across the four operating motions of develop, sell, deliver, and support. Key areas for transformation include geographic footprint, legal entity structure, service delivery model design, use of outsourcing or offshoring, and evaluation of external spend—all with an eye to how best to support the business model.

Figure 3. Transformation levers and degree of innovation



Deloitte framework

Digital core upgrade is the shift from legacy systems to next-generation, digital-ready, cloud-capable enterprise resource planning (ERP) systems. A point to consider here is the scale and magnitude of the effort. While ERP upgrades are foundational to enabling the development of critical capabilities and the adoption of digital disruption, transformation involves a more thorough evaluation of core digital systems.

Data design is focused on enhancing the availability and use of structured and unstructured data to enhance decision-making, produce insights, and connect internal and external performance indicators. Advanced analytics include alignment to external and internal key performance indicators, data science and mining, data visualization, insight development, and predictive analytics.

Cloud architecture adoption sets the stage for an organization to realize the value from cost-efficient software-as-a-service offerings. Cloud architecture is not one-size-fits-all, and not every application must be on the cloud. A critical input for this lever is the organization's overall architecture, infrastructure, and cybersecurity strategy.

Digital disruption adoption is all around us, from robotic process automation to cognitive technologies to artificial intelligence to blockchain. Embracing these digital capabilities can fundamentally change process execution, increase automation, and serve up timely, on-demand insights. They fundamentally change the nature of the work we do, how we work, and the workplace itself.

A transformation agenda is a collective set of one or more of these levers; however, to be effective, levers must be appropriately sequenced, woven, and coordinated within the context of the transaction. In concert, these initiatives enable organizations to reinvent their business and operating model and realize expanded value as part of a transaction.

Conclusion

M&A continues to serve as a critical enabler of growth and value—by accessing new markets, developing new products and services, and developing new or enhancing existing capabilities, companies can capture new opportunities, as well as targeted revenue and cost synergies.

However, in today's dynamic economy, converging landscape, and heightened pace of technological evolution, M&A can and should serve to achieve more. As and when appropriate, M&A should be the catalyst that enables your company to rethink key aspects of its business and operating model and transform both to achieve even greater value.

By effectively utilizing their window of opportunity, applying a more progressive agenda, and creating relentless focus, companies can transform themselves—augmenting their competitive edge and redefining the market opportunity they can capture while maximizing value creation and accelerating time to value.

As you pursue your next deal, consider whether this could be your catalyst, your golden opportunity to transform while you transact.

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