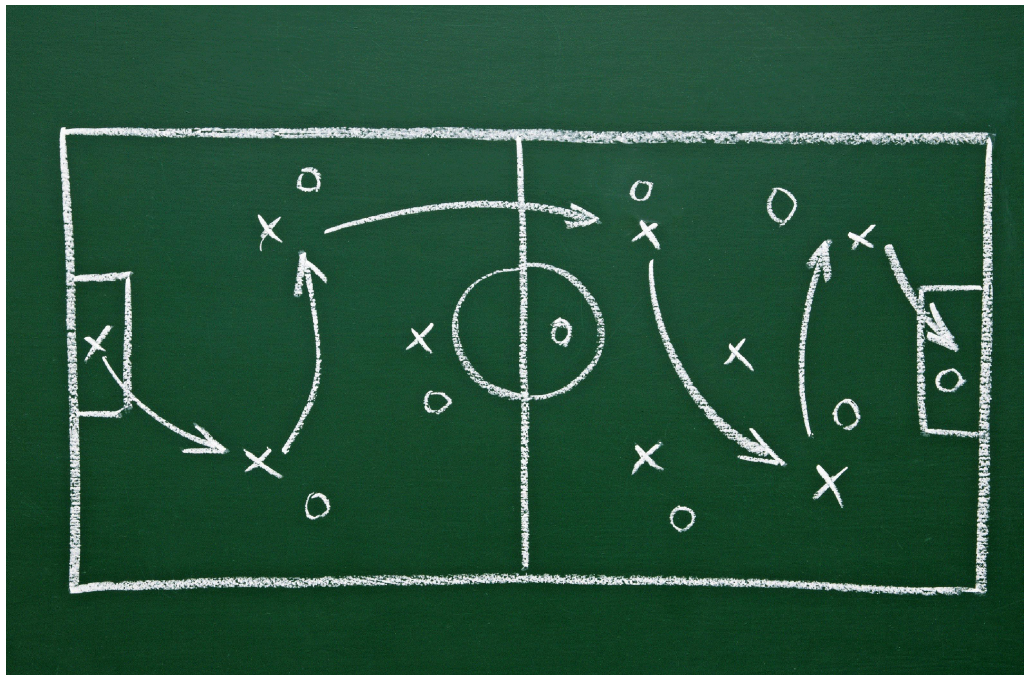


“Planning” to Capture Mergers and Acquisitions Operational Synergies Perspectives on the Winning Approach

Part 2 of the Miniseries on Mergers and Acquisitions Operational Synergies



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Introduction

Research indicates three principal reasons why organizations miss synergy targets related to M&A, supply chain, and manufacturing operations. In the first paper of this series, we highlighted that a company understanding the importance of “Plan, Prepare and Execute” is in a good position to maximize value from integration.

By incorporating a supply chain perspective while “Planning” for integration, organizations can significantly increase the likelihood of achieving operational goals and realizing synergies. Organizations can achieve this by including supply chain executives from across the supply chain during the “Planning” stages of integration. Supply chain executives are able to identify M&A operational synergies early in the integration process and help ensure goals are set to maximize synergies from across all operations.

However, during the planning stage, many companies fail to optimize the scope and do not include a supply chain, manufacturing, and operations perspective causing them to potentially miss the associated long-term upside. Once the right senior management, including supply chain executives along with other key operational leaders, is identified to drive integration, it is important they collectively translate the “strategic rationale for the acquisition” into the integration strategy of how the two entities will function together. From here, senior management should define the interim- and end state vision while keeping the “strategic rationale for the acquisition” in mind.

While developing the integration strategy, organizations should also evaluate their approach to achieving operational synergies based on the characteristics of the acquisition. (e.g., operations integration for an acquired target with revenues less than 5% of acquirer will vary significantly when compared to an integration of a large size company with revenues greater than 10% of acquirer.)

In order to plan for “Integrated” supply chain synergies, operational leaders along with various other stakeholders should take a comprehensive operations perspective for the entire integration process while planning for the different phases. In addition, during the subsequent phases of integration as the leaders begin the process of “Preparing” for the merger of the supply chain operations, a team-based control structure should be established to link integration strategy and leadership with task-level actions to coordinate issue, action, and dependency management across the organization.

Key “Planning” Factors

1. Early Identification and Involvement of Right Leadership

M&A transactions offer significant opportunities to achieve revenue and cost synergies as well as drive efficiencies across the supply chain. However, according to a Deloitte Consulting LLP (“Deloitte”) study, 50%–80% of all M&A deals fail to live up to expectations. In 70% of deals, synergies are not achieved and only 23% earn their cost of capital. In the first six months, productivity drops by 50%. After one year, 47% of the new company’s executives have left. The vast majority of companies fail to achieve synergies due to poor integration “Planning” leading to lower than expected synergies, value capture delays, supply chain disruptions, rising operating costs, and decreasing efficiencies. There is a direct correlation between effective integration “Planning” and desired integration outcomes - higher value, faster outcomes, and less risk.

To effectively “Plan” for supply chain integration it is vital to identify and involve key executives from across the supply chain (Develop, Analyze, Source, Make, Deliver) early in the planning stage, generally pre-deal announcement. These supply chain executives play a crucial role in driving the initial supply chain assessment of the two organizations to identify major sources of synergies, roadblocks, and risks that may impede the company from realizing that value.

A comprehensive operations perspective can effectively be brought into the M&A integration process when there is collaborative involvement of supply chain leadership with the rest of the executive team. The executive team focuses on defining the business strategy of the combined companies and the supply chain executives concentrate on defining the operating model based on the defined business strategy. The supply chain leadership will be better able to establish the necessary integration team leads and develop a clearly scoped workplan to realize their operational goals. (We will discuss this in more detail in our next article.)

Supply chain leaders working alongside the executive team will be able to set operational goals that are aligned with the future state business strategy. When the right team is brought together with the appropriate cross-functional touch points, the likelihood of capturing synergies significantly increases. Recognizing that the supply chain plays a critical role in the success of any integration is fundamental to realizing the projected synergies.

2. Developing Integration Strategy and Interim-state and End-state Vision

A merger presents the opportunity for management to rethink the company’s business model and define key strategic questions, such as: What markets?, What products?, and What geographies?. The answers to these key strategic questions determine the interim- and end-state supply chain visions and the degree of integration required by each business unit and function.

Integration strategies deployed by organizations are largely dependent on the scale of acquisition (i.e., size of the acquisition to acquirer) and degree of integration desired. While some organizations may choose to operate an acquired target as a portfolio company, others may prefer to integrate selected processes to either build a new structure or absorb the target. The chart below highlights, four common types of integration strategies: Transformation, Bolt on, Consolidation, and Tuck in based on the scale of acquisition and degree of integration.

Different types of integration strategies

Scale of Acquisition (Size of target to acquirer)	>10%	Transformation <ul style="list-style-type: none"> New organization structure is determined that affects the existing processes and value chain of individual organizations. Much longer-term integration needs to be executed. 	Consolidation <ul style="list-style-type: none"> Large-scale nature of the acquisition requires more bandwidth from top management and resources to execute the integration. There are potential ramifications on all aspects of value chain.
	<0.1%	Bolt on <ul style="list-style-type: none"> Acquired company is purchased but continues to operate as a portfolio company with independent processes and structure This is possibly due to the overall corporate strategy, nature of products and/or services provided, brand image, etc. 	Tuck in <ul style="list-style-type: none"> Key assets of the target are absorbed into acquirer's current operation requiring limited integration. Select processes are absorbed while other discarded depending on expected value.
		Portfolio company	Assimilation
Degree of Integration			

Once the integration strategy as well as the interim-state and end-state visions are defined, a comprehensive workplan should follow, which not only looks at integration projects but also all existing supply chain initiatives underway. A project portfolio assessment of all supply chain projects will more easily allow supply chain leadership and corporate development managers to understand areas of efficiency improvement, which are on the critical path to integration success.

It is imperative corporate leaders understand and evaluate the changes to the supply chain upfront. These can affect the cost of integration and potentially delay accrual of sought benefits. From understanding the desired integration strategy, the executive team, including supply chain leadership, will likely be able to develop the interim-state and end-state visions, which will provide the functional teams the business goals to be achieved.

3. Comprehensive Perspective of Operations

Though operational synergies are often a key feature of the value proposition during deal evaluation, the path to achieve those synergies and corresponding feasibility are not included in the preliminary stages of the M&A cycle. To make matters worse, managers were commonly asked to integrate supply chains quickly and cheaply. This gave little time for the supply chain leads to properly plan and prepare in the race to execute and capture savings. Focus was only on cost-reduction synergies and the required controls.

M&A effectiveness is greatly enhanced when a comprehensive operations perspective is brought in. Deal makers need to understand how the potential merger will affect all aspects of the operations. A timely appreciation and inclusion can go a long way to capture the much wanted synergies.

Six major processes of supply chain need to be borne in mind as organizations “Plan” to “Prepare” for “Execution”. Lack of preparation for each of these processes, if not addressed appropriately, can derail the integration and its ability to reach the set targets. The table below illustrates potential reasons of integration failure across the processes that need to be addressed, thereby necessitating an operations perspective.

Develop	Significant differences in design processes affecting design time efficiency Varying approaches to product portfolio evaluation and resource allocation optimization Production planning and supply chain readiness
Analyze	Outdated forecasting techniques that can affect joint integrated business planning Ability to reduce production of slow moving inventory Assumptions around potential reduction of inventory levels affecting customer service
Source	Possibility of consolidating volumes and renegotiating contracts Hedging strategy used as part of commodity management Impact of outsourcing noncritical functions on business Unfavourable payment terms with large volume suppliers and potential to negotiate
Make	Critical assumptions to rationalize manufacturing network Potential to reduce manufacturing cost and increase asset utilization Scope of increasing uptime by predictive and preventative maintenance Impact of QMS to reduce defects and increase first-pass yield
Deliver	Potential to rationalize number, size, and location of DCs Scope to change decisions around own versus lease facility Impact of geographical spread to (i) enhance fleet strategy, (ii) implement a core carrier program, and (iii) improve warehouse layout and configuration

As organizations put together a plan for execution, it is important that supply chain projects are viewed and assessed as part of the integration. While internal organizational dynamics are at times a roadblock to allow this, careful and objective alignment with appropriate performance management can address these issues. The decisions made at this time about people, process, technology, and organization will likely have a long-term impact, for better or worse. Therefore, it is vital to develop a detailed supply chain integration workplan to ensure these decisions are taken with a long-term view.

Successful Case for Integration Planning

Background	Approach	Result
<ul style="list-style-type: none"> Two leading pharmaceutical wholesale distributors merged together to form the largest pharmaceutical distributor supplying many of North America's pharmacies and retailers, primarily generic, branded, and over-the-counter pharmaceuticals, as well as toiletries, sundries, and medical supplies. The combined entity will have annual sales exceeding \$35B by serving more than 30% of the pharmaceutical market. The transaction was valued at \$2.4 billion. Deloitte was hired to assess competencies and remedy the difficulties with balancing strategic, operational, and integration issues while continuing to successfully conduct business on a daily basis. 	<ul style="list-style-type: none"> Deloitte created a joint team with the client managers and created an enterprise-wide integration plan, which focused on the important processes (rather than functions), to be addressed in achieving the strategic vision. Deloitte performed maturity model assessments to identify capability gaps across the sourcing and procurement function and developed a procurement strategy for the new company. Deloitte helped design the new procurement operating model, organization structure, and infrastructure template for the combined company. Deloitte helped train and transition the procurement workforce to the new operating model. 	<ul style="list-style-type: none"> Post Integration the parent company was ranked No. 1 in terms of number of stores and second in overall revenue. Delivered formal methodology for the delivery of future process and systems enhancements to a massive and widely scattered store network. A two-phase training process was selected to drive the implementation of parent company strategies, processes, systems, and culture.

Conclusion

Successful “Planning” with Operational Perspective

Deloitte’s experience suggests that companies can greatly improve their ability to set proper stretch goals and achieve them by placing more emphasis on supply chain integration planning. Companies must identify the supply chain leadership, governance structure, and cross-functional teams early in the due diligence process to ensure collaboration, control, and proper ownership for the integration.

Leadership should develop a clear integration strategy and end-state vision connecting the target business model to a target supply chain operating model for the new entity. The focus should be on developing business and operations strategies that build a supply chain organization driven by a performance-based culture and a self-assessing DNA.

A collaborative involvement of supply chain leadership can further help bring a timely comprehensive operations perspective into the M&A integration process. This also encourages that a comprehensive view of operations is taken into consideration across all the major processes of supply chain (Develop, Analyze, Source, Make, and Deliver).

Effective planning for supply chain due diligence explores the performance of the company’s supply chains to provide valuable input into the M&A decision. The output from supply chain due diligence is a portfolio of initiatives, which defines the path forward for the supply chain organization. This portfolio of initiatives addresses the supply chain opportunities and challenges that may result from the M&A operational integration process for the leaders to begin ‘Preparing’ for the merger of the operations and supply chain. These initiatives consist of supply chain cost-reduction opportunities, revenue growth opportunities, constraints, and risks.

A major contributor to achieving the identified post-merger integration synergies is in the manner the combining entities manage supply chain issues throughout the genesis, structuring, and consummation of the deal. Many supply chain integrations typically extract short-term financial synergies efficiently, but fall short of creating high-performing supply chains.



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