Deloitte.

July 2017

On the board's agenda | US

Post-merger integration

In search of growth and value creation, public and private corporations alike often turn to mergers and acquisitions ("M&A") to pave the path to superior long-term returns. However, there are numerous studies indicating that many M&A transactions fall short of attaining their anticipated return on investment, and in some cases, don't deliver any upside at all. Further, in every year since 2008, shareholders have litigated against at least 54 percent of all deals valued in excess of $100 million involving Delaware-incorporated companies.[1]

The spotty track record of many deals and the proclivity by shareholders to sue companies is—or should be—an area of importance to any company's board of directors. In our experience in dealing with thousands of acquisitions over time, one critical, often-overlooked contributory factor to the success of a deal—and steering clear of the pitfalls that bedevil so many of them—is post-merger integration ("PMI"), the events that unfold after a deal is agreed and signed.

PMI isn't always an area of board concern, though it should be. Boards can play a crucial role in helping their companies succeed by providing an oversight role regarding PMI—similar to the role the board often plays in its business-as-usual tasks: asking questions, identifying areas of risk, and providing guidance on solving problems. This is also the role many boards play during the early stages of an M&A deal, for areas such as due diligence and agreeing on the deal terms.

When management has not structured PMI planning appropriately, resourced it sufficiently, and/or put in place the internal controls needed to monitor implementation, the integration process may well become a company performance issue during execution—a trend we have repeatedly seen and a leading cause for the lack of success of many deals. Alternatively, a well-structured, well-planned, well-resourced, and well-executed PMI program with appropriate and sufficient internal controls usually delivers superlative integration results. Board oversight of these areas and of integration itself is a strong contributing element of success.

[1] https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-2016.pdf

Center *for*
Board Effectiveness

M&A and governance

Companies naturally focus on the early stages of an M&A transaction. Management addresses the central question: "Is this a good deal?" In other words, does it have ample potential to spark sales, propel the business into new territories or product lines, or add key manufacturing facilities or technological capabilities?

Boards often oversee due diligence—frequently robust—to satisfy themselves that the basis for predicted value and the terms of the deal are in order. Getting the right deal at the right price is critical to deal success.

At many companies, management often assumes it will be able to successfully attain value through integration execution, and boards often assume that management can handle the complexities of running a transformational program while management simultaneously runs the business, without the need for board oversight. This shared confidence in outcome has frequently proven to be a fatal flaw.

Companies that understand the complexity of PMI and therefore fully prepare for integration, are companies that are more likely to deliver success. Companies that are not prepared may end up in the tall stack of deals that fail to deliver a sufficient ROI. For large deals, just as the board provides oversight and approval to move forward with the transition, boards should also provide oversight to the integration program and process.

PMI challenges

It is not uncommon for companies to struggle with post-merger integration in the following critical areas: talent, technology, internal controls, and strategy.

One of the biggest challenges is how the unknown will impact talent—both from an external, client-facing vantage point, as well as inside the organization. Employees in a post-merger company can often find themselves unsure of their roles, their responsibilities, and their future. There are often differences in culture—sometimes major differences—that can impact how individuals at all levels (and on both sides) see their roles after the deal closes. Even small differences, such as how performance is recognized on a day-to-day basis, can lead to uncertainty and a sense that employees in the new environment may not be valued. Tension rises; productivity and focus can dwindle. Key individuals often leave, lose their motivation, or are poached. Customers recognize the turmoil and defect to the competition. There are internal consequences as well. Some employees overlook or don't step up to meet compliance or other issues. They might mistakenly be under the impression that another employee is handling such matters.

An additional critical post-merger challenge involves technology. The acquirer and acquired entity often have different computer systems or technological platforms incapable of talking to each other. This can lead to snags in certain critical areas of business, such as communication with suppliers and relationships with customers. Further, systems that do not communicate with each other or are in conflict with each other can lead to internal problems—potentially severe ones.

Post-merger integration should also focus on melding the parties' internal control systems and processes, so that there is a seamless set of such systems and processes in place on Day 1 or as soon as possible thereafter. The target company's internal controls (or both parties' internal controls in a merger of equals) should be, and often are, considered during the due diligence process (including review by the audit committees of one or both companies. However, two high-quality systems that do not work well with each other may create control problems, leading to reportable deficiencies or even material weaknesses—something that no company wants. In a related area, public companies need to focus on integration of disclosure controls as well as controls over financial reporting, as failure to meet the requirements of the SEC and Sarbanes-Oxley can have significant consequences as well.

A final critical challenge is having the right strategy delineated early and clearly. In successful transactions, this typically takes shape by having a separate integration team structure that enables line-leaders to focus on running the business, clear Day 1 and future state operating models, a detailed synergy plan, and a focused roadmap that enables a company to achieve its intended return on investment from the acquisition.

Many companies forego this step and expect management to run the company and manage the integration phase at the same time. That's usually a mistake, as developing a synergy plan that is drilled down to the detailed action-oriented project level with full costs and benefits, requires time and focus and distracts from running the business. Instead, a separate focus on integration can afford a far greater likelihood of success. The elements of a synergy plan include having detailed, granular steps needed to achieve the cost reductions and revenue enhancements that drove the transaction in the first place. Such details might include a timetable to close a specific facility or to introduce new products into a certain region.

What can boards do?

Today's public company boards generally are highly qualified to oversee every aspect of M&A transactions. They are independent of management, and, thus, in a position to question and challenge management appropriately. Moreover, boards do not have the financial incentives, such as completion bonuses or success fees (or the lack thereof) that can impact management, investment bankers, and other external advisors involved in a transaction.

The board's role in the M&A process—as in other areas—is typically one of oversight. Boards commonly understand this as it applies to pre-deal activity leading to transaction approval. To oversee a transaction holistically, however, boards should oversee not only the due diligence process and grant transaction approval, but also PMI preparedness and execution.

The board's role obviously should not be to supplant management or micro-manage a transaction before or after it's completed. Rather, board members should look to see that management has set a robust PMI strategy with appropriate resourcing and be held accountable for delivering against it, providing the board with regular updates and dashboards on timing and actions on critical issues, challenges, and milestones.

Many boards assume that everything after this phase will naturally fall into place. Often, that is not the case. In many M&A transactions, it is not until the deal is signed—or later—that the two companies have ample exposure to the leadership style and aptitude of the other company and can begin to know who the key employees will be—and where the problems are.

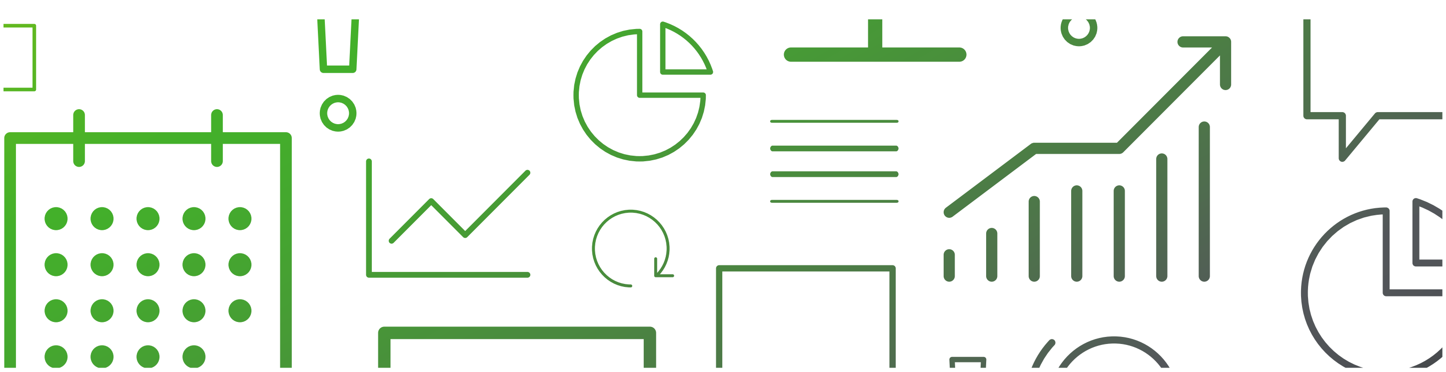
As a result, the board should gain visibility into the integration leadership decisions, including the appointment of a strong integration leader who can make decisions swiftly and who has the clout to execute on key decisions. A leader who understands cultural issues and is able to navigate the associated challenges is critical. Having that leader ready to combine the two entities is a key part of Day 1 preparedness and sets the stage for a successful PMI program.

Boards should also be satisfied not only that the right integration leadership structure is in place, but also that the team has a defined integration philosophy, a set of guiding principles that can move the entity forward from an operational standpoint.

The role of the board and committees

1. The board's role in the M&A process should be that of oversight, as a matter of corporate governance.
2. Boards should work with management to oversee all aspects of the M&A lifespan: due diligence, valuation, final deal terms, Day 1 readiness, and post-merger integration.
3. Directors, ideally, should oversee the post-merger integration, to help ensure that a plan is established and regularly evaluate it and hold management accountable for its implementation.

To address the critical PMI issues, a board should be satisfied that the designated PMI leaders establish a detailed, well-thought-through synergy plan both on the cost and growth sides of the business, and that they have a deep, real understanding of the steps needed to implement the plan and achieve its goals. Moreover, boards should question whether the internal control environment at the combined entity properly measures and assesses the progress of the PMI program, or provides red flags when the program isn't achieving



desired goals so that appropriate remedial action can be taken, if needed. Many companies fall short in these areas; they do not develop those robust plans and boards do not insist on establishment of appropriate internal controls to provide effective oversight. Without a centralized plan, integration structure and controls, management teams can very easily get distracted by the need to run the business and integrate an acquired company at the same time. Boards need to understand this and consider having mechanisms in place to monitor.

Management should set a timetable for achieving its desired projects and milestones and update the board regularly with a dashboard on their progress. The board should understand the reasons for any missed deadlines, variances in synergies and other areas where the plan may have been missed.

For some boards, especially those with new members or those who have not overseen an M&A deal, training that demonstrates leading practices of a successful deal, could help in visualizing what a structured integration program looks like.

Conclusion

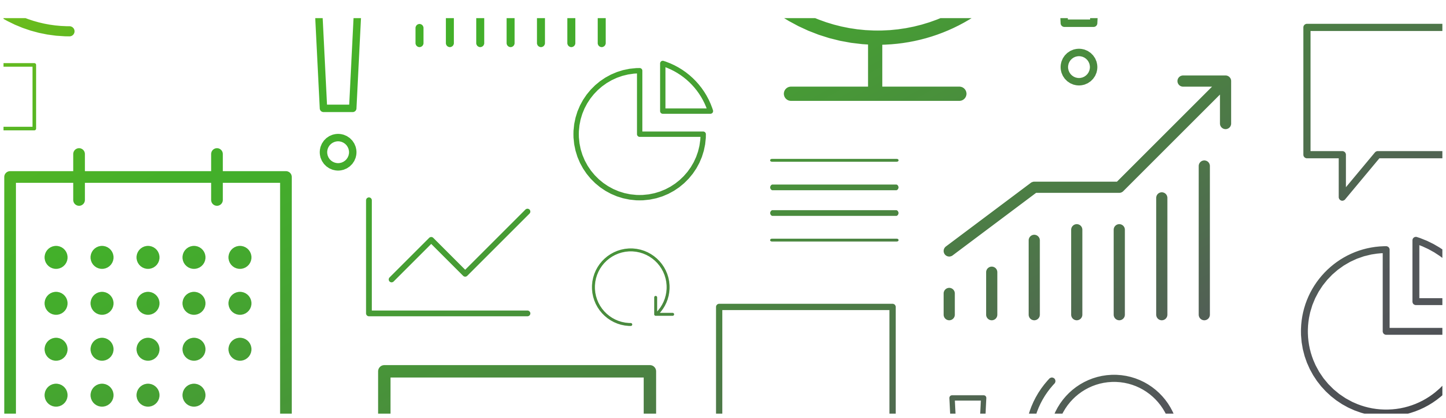
Because M&A activity is a critical part of the growth strategy of many companies, boards should take active oversight of the entire life-span of a transaction, not just the due diligence, but also Day 1 readiness and post-merger integration.

Considering PMI as an integral part of the M&A life-cycle is also important because integration issues may affect the terms of the deal to begin with. It also can drive the conclusion that the inability to execute—due to, say, operational or cultural issues—could render the transaction inadvisable. At a minimum, considering PMI early on and thoroughly can make the transition smoother, enabling deals to succeed where they otherwise might not.

Many merger and acquisitions, even promising ones, can fall short of delivering anticipated results. And shareholders often rarely pause to litigate. In other words, the potential consequences of M&A activity loom large to companies and to their boards. Thus, it is commonly in the board's interest to emphasize the importance of, and to oversee, a well-thought out M&A plan, including the often-overlooked post-merger integration.

The following are some key post-merger integration questions that board members should consider asking:

1. Has management considered post-merger integration issues in proposing the deal and/or its terms?
2. What does management see as the most significant integration challenges—and how does management plan to address these challenges?
3. Who is on the post-merger integration team? Who is leading it, and does he/she have the clout to get it done?
4. What is the integration schedule?
5. What are the key integration milestones—and how will management inform the board at regular intervals of the progress reaching them?
6. Should the board set a separate committee to oversee integration?
7. When is integration deemed completed?
8. What is the internal control environment and culture of the newly acquired company? Are there any unique considerations that may impact the ability to effectively integrate internal controls processes, particularly over disclosures and financial reporting, in a timely manner?



Authors

Joel Schlachtenhaufen
Principal
M&A Services
Deloitte Consulting LLP
jschlachtenhaufen@deloitte.com

Bob Lamm
Independent Senior Advisor
Center for Board Effectiveness
Deloitte LLP
rlamm@deloitte.com

Contacts us

Deborah DeHaas
Vice Chairman, Chief Inclusion Officer, and National Managing Partner
Center for Board Effectiveness
Deloitte US
ddehaas@deloitte.com

Henry Phillips
Vice Chairman, and National Managing Partner
Center for Board Effectiveness
Deloitte & Touche LLP
henryphillips@deloitte.com

Maureen Bujno
Managing Director
Center for Board Effectiveness
Deloitte LLP
mbunjo@deloitte.com

Debbie McCormack
Managing Director
Center for Board Effectiveness
Deloitte LLP
dmccormack@deloitte.com

Krista Parsons
Managing Director
Center for Board Effectiveness
Deloitte & Touche LLP
kparsons@deloitte.com

About this publication
This publication contains general information only and is not a substitute for professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. The authors shall not be responsible for any loss sustained by any person who relies on this communication.

About the Center for Board Effectiveness
The Center for Board Effectiveness helps directors deliver value to the organizations they serve through a portfolio of high quality, innovative experiences throughout their tenure as board members. Whether an individual is aspiring to board participation or a veteran of many board experiences, the Center's programs enable them to contribute effectively and provide focus in the areas of governance and audit, strategy, risk, innovation, compensation and succession.

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.

Copyright © 2017 Deloitte Development LLC. All rights reserved.