Diethard Engel

Integration Pitfalls

Nine Simple Examples of What-not-to-do in Post-merger Integration

Learn from common mistakes in post-merger integration, and unlock the power of prevention strategies for your program's success

Contents

1st Edition December 2021

Diethard Engel
Management & Consulting Services
Marc-Chagall-Str. 37
55127 Mainz
Germany

Cover picture by Gratisography. Thanks to Pexels for license-free provision of all pictures in this booklet.

Introduction

Any post-merger integration project is a critical exercise: In case of failure it can take down entire corporations, or at least their management.

Much has been said (and written) about successful integration processes, and contributing factors, from deal-sourcing strategy to cultural integration. (This, by the way, includes myself and my publication “Inside Post-merger Integration - A Practitioner’s Guide to a Successful PMI Project”.) Sometimes, however, it seems that we learn faster from negative examples than from positive. Why that is? I couldn’t say, but maybe Schadenfreude is an element.

Remember the merger between the US carmaker Chrysler and the German manufacturer of luxury cars, Daimler? Daimler’s CEO, Hans-Jürgen Schrempp, celebrated the 38b DM-deal in 1998. After seven years of merger-struggle, he resigned in 2005. Eckhard Cordes, responsible for Daimler’s strategy, was earmarked as Schrempp’s successor, but also left the Corporation because Dieter Zetsche had been nominated new CEO.

Eventually, the “merged” business became unmerged again in 2007, and Private Equity firm Cerberus took over Chrysler. McKinsey estimated Schrempp’s damage to run at an unfathomable 74b US$, making this one of the top capital-destroying mergers ever. The DaimlerChrysler merger of cause has been of uncommonly gigantic dimension, however, the reasons for its failure are not uncommon at all: Cultural differences, incompatible strategies, management distraction, unclear integration focus – the same drivers letting post-merger integrations of all sizes fail.

In this booklet I describe nine common scenarios, each of which I have witnessed personally, and each of which may lead to integration failure. You might recognize some of them from own experience, and if so – I hope you and your business came out of it with no more than a black eye.

The good news is that the factors potentially inhibiting integration success can be mitigated and addressed by adhering to only a handful of proven prevention strategies unlocked at the end of each chapter.

Diethard Engel
December 2021

Chapter 1

Just get it done!

Where stakeholders push hard for completion and a signature, and cut corners in discussion and review, the goal post is shifting from what's good for the business to what's good for them.

Picture 1: Resisting pressure - from stakeholders in particular - is difficult, but might turn out to be just the right thing to do

In M&A, many deals see closure although financial or strategic objectives of the acquirer may not be met, and pre-defined models are thrown overboard. Frequently, it is certain groups or individuals who may want to see a deal through, no matter what. While this seems surprising at first glance, it often carries deeper reasons – reasons on very personal level:

- Banks, consultants and advisors: They all take their share of the deal, and have a legitimate interest to make their piece of the cake as large as possible. However, if a deal falls through, they may still write a few bills, but the lion's share of the gain is gone; their resource investment is largely in vain.
- Other stakeholders may fear that they will lose face or credibility if their proposal to acquire a certain business was rejected.
- Yet others may view an acquisition as their very own and personal undertaking, and will not support a decision that would mean a stop to their pet project.

Looked at it from an individual's perspective, there is some logic behind such personal desires. From a corporate vantage point, however, closing a deal for the wrong reasons bears a large risk.

The truth of the matter is that rejection of a potential investment due to failed target criteria conformity is a sign of strength, rather than of weakness. Strong leaders and managers stand out in adverse conditions and rather take a moment of heat than carry the long-lasting consequences of a failed project.

A common strategy to prevent the "Just get it done!" M&A pitfall entails the upfront agreement of certain rules in deal sourcing and preparation, for example:

- Monitor more than one potential M&A target
- Discuss the possibility of saying "no" prior to due diligence, and be ready to say it if needed
- Define the target financial outcome as part of a structured M&A program
- Use a defined financial model. Do not change it in the process
- Invest into a professional due diligence, and include potential IT/legal/technology risks in the assessment
- Confirm asset valuation and balance sheet integrity independently

- Perform extensive impairment tests on immaterial assets
- Do not rely on external consultants only, and build internal capabilities

Chapter 2

Justify it!

At times, people know the outcome of the analysis before the analysts have started the evaluation process, or even completed their model. They *want* a certain result – a result in line with their personal preference.

Picture 2: Anything can be justified - if one decides to bend or ignore the rules

In the context of M&A, such expectation to hit a certain mark can lead to grave consequences, yet still it is not unheard of. Evaluation methods use parameters, and parameters can be changed – sometimes they get adjusted, tweaked and changed until the arithmetical result fits the bill. The downside obviously is that the parameters may not be reflective of reality, risks are being ignored, and sensitivities are left unconsidered in the decision process.

Therefore, an independent check of the model and the applied assumptions is helpful. Other prevention strategies include:

- Do not change assumptions without substantial reasoning.
- Apply the 80/20 rule: Calculate the most important synergies only.
- Be sure to have the resource to implement any planned initiatives, in terms of manpower, competence and funding.

Chapter 3

We'll be fine!

"Don't worry - benefits are coming." Well – sometimes they don't. Overestimation of synergies is one of the key reasons for unsuccessful M&A projects. If all and any – even remotely possible – synergy effects are included in the financial M&A model, any shortcoming will have an unrecoverable negative impact on ROI. Overestimation of financial benefits is a true ROI-killer.

M&A Managers and C-Level Executives should consider risk adequately in their models. Amongst other, risks may emerge due to timing, market or lifestyle developments, competitor reaction, or innovation/substitution. When pulling the model together, a couple of prevention strategies can be applied to avoid overestimation of synergies and M&A benefits:

- Calculate and consider only major contributing synergies, and apply a decent risk factor
- Model what-if-scenarios with delayed timelines
- Consider potential competitive retaliation strategy
- Play with alternative models of the future
- Use corridors instead of fixed numbers

Chapter 4

We can pull it off!

A post-merger integration represents an enormous effort. Many businesses underestimate the resource drain.

Deal preparation is important, however, the true integration effort starts after signing. As a matter of fact, even if you do have an in-house M&A team at your disposal, most of the work lies with functional management and their teams. Only very few organizations – actually close to zero – got an additional layer of competent resource available to do the occasional integration work.

Picture 3: Management often underestimates the resource drain an integration takes on the organization. Bullish commitments might turn into resource nightmares.

That is one reason that integration teams are frequently staffed with people unqualified for the job – their only merits were that they were available at the time. In addition, day-to-day business takes priority in many cases, leading to a distraction of management and their operative employees. If teams get overloaded, frustration builds, people resist change and eventually they may even leave.

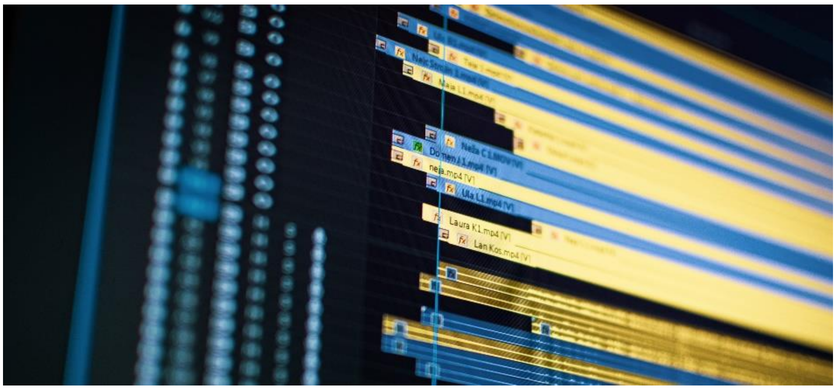
Prevention strategies include:

- Assess resources before signing
- Bring in M&A experienced resource
- Align management and set realistic expectations
- Consider changing the reward system to achieve integration goals
- Create a positive atmosphere for change and creativity

Chapter 5

Timeline? What Timeline?

The controller knows it: ROI hinges on various factors, mainly on investment amount, future income flow, and time. The latter tends to get ignored.



Picture 4: Managing the timeline for integration and benefits delivery is crucial to a project's financial success

More often than not, external integration managers get called to support a project that is past due already. At the time they arrive on site, management has already realized that the original timeline cannot be met, and that integration progress is behind target. In other words: The original timeline is shot, with the knock-on effect that the entire financial model does not work anymore. In most cases, the time loss is unrecoverable, and all acquisition benefits and future growth scenarios will be delayed.

Mostly, a lack of planning during due diligence can be identified as the root cause: The effort linked to integration is larger than anticipated, there is no structured project management or controlling, risks and progress (or the lack thereof) are not clearly communicated. In addition, frequently day-to-day business and integration work are not properly aligned, leading to competing priorities.

There are, however, a few things management can do to avoid this scenario:

- Start integration planning with due diligence (or even earlier)
- Implement a strict project governance
- Assign strong managers to the project team
- Communicate, discuss and review priorities
- Develop transparent project KPIs (financial and non-financial)
- Use continuous visual progress reporting
- Routine team meetings
- Share and celebrate successes

Chapter 6

We will integrate in full!

Managing a post-merger integration is a mammoth task. Integrating everything is not a requirement.

Objectives should be challenging – no doubt. The objective to integrate an acquired business in full may be a little too much, though: Full integration is rarely required to achieve the major acquisition goals, and is usually only asked for if a clear business strategy has not been formulated.

A full integration approach is less targeted than a focused strategy, and often leads to a scenario in which everybody integrates something, but nobody understands the true integration objective and benefit. A lack of prioritization of integration goals will inevitably lead to resource issues, and resource issues lead to frustration. A thought-through change concept does not exist. Consequently, the organization will be very busy, but likely also another example for an unsuccessful integration attempt.

Prevention strategies include:

- Management involvement in developing the future organization design
- Developing a target operating model (a.k.a. "TOM" – compare this article)
- Leadership commitment to the TOM
- Identification and elimination of leadership that will not be part of the joint business

Chapter 7

Cultural differences are minimal!

Getting a grasp on corporate culture is difficult, but ignoring culture can destroy value.

Picture 5: Cultural differences are generally viewed as a key contributor in difficult integrations

A common mistake in post-merger integration is the underestimation of cultural differences between the acquirer and the acquiree. If employees cannot identify with the new organization, and a "It doesn't work like this here!"-mentality is spreading, the risks of customer neglect and ultimately business failure are increasing.

Triggers may be the abolishment of dear symbols and brands, or the change of policy, rituals or processes without proper communication. And we all know: People get really mad if you take their perks away.

Prevention strategies include:

- Identify important cultural building blocks.
- Describe the future state and develop a transition path.
- Leadership communication of vision and purpose is mandatory.
- Walk the talk!
- Read early signals. Pull in lower and middle management.
- Be patient! Cultural change does not come overnight.

Chapter 8

We will not shed any people!

Decisions on people, their jobs and future are often the hardest. They have to be taken anyhow.

Picture 6: Management's credibility is at stake if promises are not lived up to.

No one likes to communicate unpopular decisions, however, avoiding decisions on people and their future is not helpful in most cases, and certainly not in M&A scenarios. Yet, Management frequently chooses the easy way out and prefers to communicate that there will be no job loss with the merger. More often than not, that's a promise which cannot be held up.

Consolidation of functions and departments (HR, Finance….) usually goes along with a reduced resource need, starting from the heads of department, and ending with the lowest qualified positions. Duplicity of roles is commonly not warranted, neither under a cost perspective nor for organizational clarity. In the new setting of a combined business qualification requirements may change (in IT, for example). Also, holding people in undefined roles will lead to frustration and unhappiness.

Overall, mergers routinely create the need to deal with redundancies – it's a fact, and should be accepted and communicated as such. Ultimately, reality will catch up with Management, and spreading a message which will be proven wrong over short or long will eat into leadership's credibility.

Prevention strategies include:

- Development of a TOM and role definitions for key personnel.
- Leadership changes are not inevitable, but common. Communicate it.

- Early involvement of works councils to manage expectations.
- Prepare the organization for changes.
- If the future is unknown, say it, but at the same time point out specific future decision points in the integration timeline.

Chapter 9

Performance Indicators are overrated!

A golden rule in Controlling says "Anything that is not being measured is unlikely to be achieved." It's true.

Controlling of acquisition benefits delivery is essential to program success: It helps the team focus on what it takes to be accomplish integration objectives, and obviously also identifies deviations from plan (positive and negative). And still, KPIs measuring integration success are often not defined, defined but not measured, or measured but not shared.

Picture 7: Synergies are feeble. Unmeasured, they might escape.

It is difficult to think up good reasons for not spreading the news of success, but certainly if the expectation is non-compliance with the set parameters, relevant management has a vested interest in disguising underperformance.

More commonly, KPIs measuring integration success may be new to the business: For example, if market share growth was the strategic objective behind an acquisition, the key to measuring success lies in market data which may not be easy to get. In other cases, access to new technology resulting in increased innovation success may be a driver for an acquisition, to be measured in "New Product as % of Sales". However, if this is an uncommon concept to the business, the KPI needs definition (what qualifies as a new product, how long is product "new", when is a product considered "launched", …), and it needs to be measurable. In some instances, the systems may not support the new metrics, leading to increased manual controlling effort.

In addition, since integration is a massive task which usually comes on top of day-to-day business, it eats severely into available resources (compare Chapter 4: We can pull it off).

Taking the eyes of the ball may lead to shortfalls in routine business. If these go undetected, the business may suffer even though integration was successful.

Prevention strategies may include:

- Early definition of “integration success”
- Ensure measurability of defined parameters
- Agreement on reporting standards as part of project governance
- Monitor ongoing business closely, and identify any deviations from standard early (conversion rates, time-to-market, delivery times, customer complaints….)
- Regular review of KPIs, both in terms of adequateness and achievement
- Routine review of financial success vs. financial acquisition model

Chapter 10

Lessons learnt

At times, it seems easier to learn from failure than copy success. It is my hope that the nine chapters of this little booklet have raised awareness of the many pitfalls and trapdoors post-merger integration holds ready for Management. It will not matter - neither in the eyes of history nor in those of your shareholders - whether it was learning from scientifically proven post-merger integration studies or anecdotal stories which contributed to your program’s seamless completion. In any case, heeding the prevention strategies described above will increase the probability of post-merger success dramatically.

My personal rule #1: Top teams deliver top results. Any program started with competent, capable and available team members (please note there is no “or” in this enumeration) is likely to accomplish its goals. Unless your team is PMI-seasoned, bringing in external program management might be the factor tipping the odds to the right side for you.

This booklet describes the reverse side of the golden post-merger integration medal: Nine brief and easy-to-read chapters illustrate scenarios which let PMI programs fail on a regular basis. Experienced M&A professionals will have seen most of these – and yet they represent very common pitfalls for businesses of any size.

About the Author:

Based out of Germany, Diethard Engel is an independent consultant and interim manager, focused on ***Business Transformation, Post-merger Integration / Carve-out and Executive Finance****. He has run multiple post-merger integration/carve-out projects for international businesses.*

Diethard Engel
Management & Consulting Services
Interim Management for Strategic Projects
Business Transformation, PMI/Carve-out, Executive Finance
www.de-mcs.de