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BEYOND *the* DEAL

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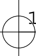
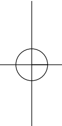
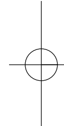
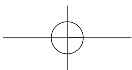

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BEYOND *the* DEAL

Mergers & Acquisitions that Achieve Breakthrough Performance Gains

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Introduction: Beyond the Mirage

Beyond the Deal offers a strategic approach to leveraging mergers and acquisitions to achieve extraordinary performance and create unprecedented value. The stakes in major acquisitions are high, both for the acquirers and for the targeted acquirees. The companies that are going to acquire other companies successfully are those that have cultivated the best capabilities for effecting the right acquisition and that can best integrate the new company. This may sound quite simple, but achieving quantum leap outcomes from an acquisition requires a disciplined, comprehensive, and highly proactive effort.

Because of changing economic conditions, record numbers of companies are becoming involved in sizable strategic acquisitions. However, mergers and acquisitions are often not structured in a way that will create greater value from these potentially high-risk undertakings.

Although making a good "deal" and achieving extensive expense savings are very important, they can also be a mirage. Both may be necessary for mergers and acquisitions (M&As) success, but they are only the start of that successful journey, not the end point. In fact, many acquisitions *lose* value, typically for any or all of the following reasons:

- Inadequate readiness to undertake an acquisition
- A poorly thought-out approach to acquiring another company
- A lack of ability to integrate the newly acquired company effectively

Companies and managers who target the "deal" and focus on eliminating expenses often give short shrift to the issues involved in integrating another company and to how the newly combined company functions *after* the integration gets under way. Yet the data show that most acquisitions either succeed or fail during the critical integration phases.

That's why we wrote this book.

Beyond the Deal focuses on significant (i.e., large-scale) acquisitions that require major realignments both inside and outside a company. It takes into account the intangible assets, as well as all the tangible assets, of both companies involved in order to make an acquisition an opportunity for true transformation. The intangible assets are what enable breakthrough leaps in performance and strategic outcomes. We explore the role of capabilities in every interrelated phase of the predeal acquisition process, and we strongly emphasize the critical integration phases. We look at what is needed to engage in a quantum leap process and the things that block most companies from making that leap effectively. We illustrate how *your* company can make major gains by using the real-life experiences of people who played key roles in *their* company's acquisitions and in integrating the acquiree into a stronger company.

This book emphasizes larger acquisitions, those that are 15 percent or more of the acquirer's value. We deliberately focused on larger acquisitions because they have far greater requirements and ramifications. Because of their size and complexity, they demand that companies rethink their strategic intent, recalibrate the products and/or services they offer to their customers, and reevaluate their relationships (with customers, suppliers, and other stakeholders) to make this decision:

Will we seize the opportunity to stage a quantum leap transformation into a new entity? Or will we simply mutate into a larger version of what we already were?

In particular, this book focuses on preparing for the integration phase of these larger acquisitions and implementing the integration effec-

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tively. These are the least extensively examined and yet the most crucial phases of a successful acquisition. Much has been written about "the art of the deal," but far less about what is necessary to make that deal pay off for all key stakeholders.

Although our focus is on larger acquisitions, many of the principles and practices discussed are highly applicable to more limited and smaller acquisition pursuits. Smaller acquisitions are primarily add-ons; they are simpler and usually can take place without major changes in the nature of the acquiring organization. Although smaller acquisitions may be significant over time, they do not offer the full set of challenges or possibilities, either in the acquisition process or in the integration process, that larger acquisitions do. A company can, however, use the lessons from its smaller acquisitions to develop a quantum leap perspective that will enable it to stay ahead of its competition and carve out new markets. For example, Cisco had a very successful strategy of making a series of smaller acquisitions that worked very well for it for over a decade. The quantum leap challenge came when Cisco made major acquisitions and found that the requirements and capabilities were on a considerably different scale. Acting as if larger-scale acquisitions such as Dow Chemical's acquisition of Union Carbide or Daimler-Benz's acquisition of Chrysler have the same dynamics and requirements as smaller acquisitions is a costly mistake.

A breakthrough approach first requires establishing acquisition "readiness" by developing a core set of capabilities. When capabilities readiness is applied to opportunities, the result is exceptional returns. Second, our methodology focuses on *creating value* in the newly combined company. It links the two traditional approaches to M&As—cutting costs (the expense synergy approach) and increasing capabilities (the growth synergy approach)—in order to raise the performance of the newly combined company to new levels and separate it from the rest of its field of competitors. The outcome of a successful integration is the emergence of a new, transformed company. Hubert Saint-Onge draws extensively from his experience as senior vice president at Clarica (one of the largest Canadian life insurance companies), where he was directly involved in its acquisitions and integrations, and subsequently in the integration of Clarica into Sun Life of Canada after the acquisition took place.

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Who Can Use This Book

This book is for everyone who is in the crosshairs of an acquisition and its integration, either as an acquirer or as an acquiree. This includes senior executives, middle managers, and practitioners responsible for integration, as well as members of acquisition teams who

- Are currently engaged in an acquisition.
- Are considering an acquisition.
- Are at the integration stage of an acquisition.
- May be an acquisition target.

The ability to conceive, plan, and carry out strategic acquisitions needs to be part of the repertoire of business leaders. If you want to achieve quantum gains in your company's performance, you need to cultivate a set of skills, values, perspectives, and relationships that together will enhance the value of both the acquiring and the acquired companies. Here's what each level of management needs to do:

- *Senior leaders*. You need to appreciate how the value proposition of your business must keep changing as a result of market shifts, and you must formulate your business logic for combining the capabilities of two companies. Will your company be better able to achieve your growth objectives organically, or do market conditions require you to grow by acquiring another company? The siren attraction of "trophy acquisitions" may be enormously appealing to you, but such targets should have a strategic fit with your company, and you should be able to integrate them effectively without losing momentum in your marketplace. With the enormous growth in the value of intangible assets (which we'll describe in Chapter 2), you need to reconsider the old yardsticks that focus solely on the final *financial outcomes* of an acquisition, and you need to take into account the increasingly important impact of *intangible assets* as precursors to your

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company's sustainable performance. Senior leaders must make high-quality decisions quickly, in order to maintain both momentum and a positive climate during the integration. The framework and principles we outline will provide you with useful reference points for making these decisions.

If you're a senior leader in the target company, you also have a key role in the success of an acquisition. Once you've carried out your duties to optimize value for your company's shareholders, you must decide whether you can focus your effort on giving shape to the newly combined company with an equal level of commitment. Most often, you can make an invaluable contribution to the success of the integration.

- *Midlevel managers.* You carry on your shoulders the day-to-day responsibilities for making the new organization work. You will participate in the due diligence investigations to gather, distill, and analyze the data that will determine whether or not to proceed further, and to validate whether the combined companies will be able to realize the anticipated expense and capability synergies.

  Then, whether you are part of the acquiring company or the acquiree, you are likely to be on integration teams to facilitate the integration of the two companies. Eventually, you will become the backbone of the emerging company and will be intimately involved in achieving your new company's high levels of performance.

Both senior and midlevel leaders need to communicate clearly, both internally to employees and externally to shareholders, investors, regulators, and the community at large, about the plans for integrating the two companies. Everyone will have some degree of uncertainty about the future when the news of an acquisition becomes public. Some people will have their lives disrupted by reorganization and relocations, and some will lose their jobs. Short- and long-term communications initiatives provide information on the change, the beginning of the new oper-

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ating model for those who will be remaining with the new company, and, where necessary, exit plans for those who will be discharged.

Individuals who are prepared for the tumult and the challenges involved will be in the best position to navigate these rough waters. The framework established in this book will enable these different players to deal with the challenging tasks they will face and equip them to be proactive actors who can make quantum leap gains.

How This Book Is Organized

Beyond the Deal is organized into two parts:

1. *Part I* focuses on what happens *before* you make a deal to acquire or merge with another company. This is the predeal phase. Chapters 1 through 4 cover the critical issues you need to attend to during this time period:

    - *Chapter 1* presents a new approach to acquisitions, one that goes beyond the traditional approaches of either cutting costs or increasing company capabilities, and instead truly *creates value* in the newly combined company. Chapter 1 then describes how to determine whether your company is ready to acquire another company and how you can prepare to acquire another company that will catapult your company to breakthrough, quantum leap performance. To illustrate these points, the chapter includes a number of case studies: Hewlett-Packard's acquisition of Compaq Computer, Dow Chemical's approach to acquisitions, as well as examples from Clarica, Boeing, and Siemens.
    - *Chapter* 2 provides deep background for the ideas in the book. (We think this background information is critical to understanding the rest of the book, but if you're in a hurry to "cut to the chase," you may want to skip to Chapter 3.

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Still, if you skip this chapter now, you may find that you want to come back to it later.) Chapter 2 begins by describing why M&As are more important now than ever before—and one of the reasons is that companies are no longer measured solely in terms of their *tangible* assets, but also by the growth of their *intangible* assets. The chapter then describes three types of intangible assets—human capital, structural capital, and customer capital—that are key to implementing the value-creating approach to acquisitions that is described in Chapter 1. Finally, the chapter clarifies the difference between a company's *stock* (or inventory) of knowledge and its *flow* of knowledge—and how both relate to a successful acquisition.

- *Chapter 3* focuses on what your company needs to do *before* you should even *think* about acquiring another company: set your overall strategy and determine what you want to achieve, as well as recognize and compensate for risk factors. Once you know that, you can consider how acquiring another company—and what type of company or even what specific company—will help you achieve those goals. Chapter 3 identifies and develops ways to respond to *risk management* issues. It also describes four different acquisition strategy scenarios and four different ways to combine companies. To illustrate these points, this chapter includes examples from a broad variety of companies and industries, including Dow Chemical, a U.K. equipment company, a midsized pump company, Symantec (software), SAIC (technology consulting), Siemens, Elan (pharmaceuticals), and Clarica (insurance).
- *Chapter 4* reviews the first four steps involved in acquiring another company:

  1. Targeting a company (or companies)
  2. Doing due diligence to ensure that you're making the right decision and that the targeted company is worth acquiring and will be a good fit

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3. Negotiating the deal
4. Getting approval for the deal

To illustrate these points, this chapter includes examples from General Electric's attempt to acquire Honeywell, Washington Mutual bank, Cisco, Dow Chemical, SAIC, and Clarica. That might seem like a lot of information to cover in one chapter, but the focus of this book is not on these four steps, so this chapter is intended to be only a brief review. Unfortunately, too many companies think that these four steps are all that they need to do, but we've seen too many M&As fail, and we know better: the real work of making an acquisition successful is in the *integration*—which is why we've titled our book *Beyond the Deal*. What comes *after* you've acquired another company is what will determine whether you can achieve a quantum leap in performance. So let's move on to Part II of the book.

2. *Part II* focuses on what you need to do *after* you make the deal, to ensure that your acquisition goes smoothly. This is the postdeal integration phase, and *Beyond the Deal* focuses on effective integration planning and integration; everything that goes before is a prelude to carrying out a successful integration.

   - *Chapter 5* addresses the first challenge to successfully integrating a newly acquired company: *planning* how you will integrate the new company into your existing company. A successful plan outlines how you will handle the following activities:

     1. Developing an *integration playbook*, which serves as a comprehensive guidebook for integration planning
     2. Exploring your newly combined company's *new markets* and *new customer requirements*
     3. Auditing all the *capabilities* of your newly combined company

4. Determining the *governance* of your new company in terms of leadership, values, behaviors, and overall identity
5. Deciding how you will handle all the *people issues* involved in an acquisition

This chapter has examples from Pfizer, Cisco, Bristol-Myers Squibb, Clarica, and Alcatel.

- *Chapter* 6 examines the development of an integration framework that ensures the continuity of the core businesses of the new company and supports the extensive reorganizations and continuing change that will produce a quantum leap company. This involves

1. Creating the *operating structure* of your new company
2. Developing an *accountability structure* that ensures employees' accountability for the goals that are set for the acquisition
3. Establishing *metrics* to gauge how the company is performing and maintaining continuity of operations
4. Making sure that the integration planning makes it a priority that the *continuity* of the company's core business is maintained during the integration, providing seamless service to customers

To illustrate these points, this chapter includes examples from Sun Life-Clarica and Dow Chemical.

- *Chapter* 7 describes six springboards that jump-start your integration to achieve quantum leap performance. These six springboards are

1. Customer strategy and branding
2. Company strategy
3. Culture and leadership principles
4. Knowledge inventory and business logic
5. People strategy (especially for recruiting)
6. Information technology and systems

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If you don't align these six key areas, your acquisition won't really succeed. To illustrate these points, this chapter includes examples from HP, Best Buy, NationsBank, Norwest, Clarica, Newell Rubbermaid, Dow Chemical, and BP's acquisition of Amoco.

- *Chapter 8* examines the set of critical success factors that, when taken together, form a guidance system for the integration—specifically:

1. Focus on the primacy of your *customers*.
2. Create a strong—but flexible—*business plan*.
3. Keep in mind that *speed* is critical to successfully combining two companies.
4. *Partner* with the company you're acquiring.
5. Establish clear *accountabilities* for every task involved in the integration.

This chapter then describes the four critical actions that your company needs to take:

1. Set time, cost, and performance targets.
2. Select the leaders who will run the new company.
3. Manage people.
4. Manage change.

To illustrate these points, this chapter includes examples from Sprint Nextel, Dow Chemical, Siemens, Sun Life-Clarica, and BP.

- *Chapter 9* explores how the leadership and transition teams for the postdeal integration implementation take over from the predeal acquisition team to make the transition from the two existing businesses to one ultimate business. This involves how to

1. Cull, transfer, and combine capabilities from the acquired company to create the new company.

2. Allocate the necessary resources of time, people, and finances.
3. Make the integration plan broadly available to everyone involved in implementing the integration.
4. Carry out a comprehensive communications strategy.
5. Engage the leadership steering committee in ongoing strategy decisions.
6. Maintain the flow of knowledge and information to keep all parties to the integration in synchrony.

The chapter illustrates these points with an example from Sun Life Financial-Clarica.

- *Chapter 10* describes the engines of breakthrough that you need to employ to mobilize your new company to achieve unprecedented levels of performance and value creation:

1. Focus on renewal strategies that leverage the core capabilities of the two legacy companies.
2. Enlist employees' commitment by creating a vision and engaging them in realizing that vision.
3. Create a cohesive culture in which people are driven to collaborate in order to succeed.

Examples from Bristol-Myers Squibb, Sprint Nextel, and Clarica show the benefits of using these engines to produce remarkable outcomes as well as the costs incurred by an acquisition when these engines are not brought into play.

- Finally, the *Epilogue* shows how the number of major acquisitions will continue to grow. The companies initiating those acquisitions will be coming not only from North America and Europe, but increasingly from Asia and the oil-producing countries as well. What the successful acquirers among these companies will have in common is that they will implement the integrated capabilities perspective we put forward in this book. These companies

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will focus on building the dual priorities of your company's acquisition readiness and its need to have the ability to create remarkable value and unprecedented high performance. By subscribing to the principles and practices outlined here, these companies will become quantum leap companies that make their own future.

Special Features in the Book

Throughout this book, we've shaded all the examples so that you can easily find them and learn from what other companies have done during acquisitions. In addition, we've included questions for you to consider at each stage of your acquisition to help you move it forward smoothly. Finally, each chapter concludes with a list of "success factors" and "derailing factors" for each stage of the acquisition, and another set of questions to help you think through the critical issues you're likely to encounter during each phase. These questions are derived from a questionnaire used in our case study research on acquisition readiness and effectiveness; use them as a checklist to see how well your company has taken key issues into account.

In addition, *Beyond the Deal* includes three appendixes:

- Appendix A provides a brief recap of three other ways (in addition to M&As) in which a company can partner with other companies: it describes licensing arrangements, strategic alliances and partnerships, and joint ventures.
- Appendix B is a recap of all the end-of-chapter questions. Feel free to copy this checklist and use it for all acquisitions you're considering or embarking on. You can also use it as a starting point for conversation on what is necessary to prepare your company for quantum leap performance through acquisitions.
- Finally, Appendix C is an exercise for auditing your company's strategic capabilities.

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The Journey

This book is the culmination of a continuing reexamination of direct experience, research, and theory. New tools were developed, particularly the questionnaire that was used in company research to cull the essentials of the acquisition experience. The work that companies do to enhance the way they acquire and integrate companies has largely remained hidden. Most companies that make an acquisition soon discover that more traditional approaches did not adequately reveal, capture, or leverage the value embedded in the company they acquired. As companies start carrying out a large integration project, many discover that their processes are inadequate. This is what we set out to do in this book: to provide more effective approaches and custodial frameworks.

At the same time, very few companies have mastered all the dimensions of the acquisition process. Several are very skilled, and there is much that can be learned from them. Yet these experiences and sets of practices came out of particular companies with very specific conditions. The general principles can be identified, but it is up to the leadership and practitioners of each individual company to take these frameworks and lessons, try them out, and make whatever changes are necessary to have them work better. Quantum gains in both value and performance through acquisitions are very possible. With the perspectives developed in this book, there is no need to leave value on the table. At the same time, the most significant gain is to cultivate the capability for mapping and carrying out effective acquisitions as part of a continuing strategy for enhancing performance and creating the future company. That will be your ultimate competitive advantage!

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1

A New Approach to Acquisitions: Creating Value in Combined Companies

How many dollars, euros, and yen are left on the table when approximately two out of three of current acquisitions do not reach their goals?[1] This is an enormous and often preventable waste. The reality is that the collective common wisdom on mergers and acquisitions (M&As) is not on the mark, especially in the knowledge era we are operating in. The question is: *what can be done differently?*

The high failure rate of mergers and acquisitions is the result of serious limitations in how companies approach M&As and carry them out. In too many cases, a company is unprepared when an acquisition opportunity arises. Not being ready leads to all of the following problems:

- A limited skill base to execute the acquisition
- A one-sided focus on financial synergies that underpins a limited view of the strategic gains from an acquisition
- Poor due diligence
- A weaker position in negotiating the deal

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- Unrealistic expectations about getting regulatory approval
- A slow and ineffective integration of the acquirer and the acquiree into a newly combined company

This creates a situation of unwarranted high risks and low success rates.

For many companies, acquisitions are unique opportunities to make a *quantum leap* in performance. However, that quantum leap requires

- Building the capabilities to be ready for making an acquisition
- An approach that *creates value* and fully realizes both the financial *and* growth advantages that can occur when the resources of two companies are integrated to form an entirely new company

There is some evidence that the more frequently a company acquires other companies, the greater its success. Although this is true, companies that go through the acquisition process *mechanistically* are not necessarily incorporating the lessons they learned during earlier acquisitions, nor are they using their experience to transform their processes as they integrate. Instead, they are simply *repeating* the same process over and over, without taking their acquisitions to the next level and seeking the quantum leap gains that may well be possible.

For example, one North American bank carries out five acquisitions a year, each in very much the same manner, and it is efficient at getting the job done. The problem is that the bank is primarily having the same experience five times in the course of each year, instead of incorporating *new knowledge* and taking its acquisition process to *new levels*. The bank's leaders are seeking sequential growth, but they would have the opportunity to achieve an exponential quantum leap in performance if they used the *value-creating* approach that we describe in this book and introduce in this chapter.

This chapter describes how to determine whether or not your company is ready to acquire another company (or be acquired) and then shows how to get ready to acquire another company. It also reviews the two traditional approaches to M&As—one that focuses on cutting costs

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and one that focuses on growth—and then offers a third approach that fuses the two traditional approaches into one overall approach that focuses on creating value in the newly combined company. Finally, it describes what you need to do to acquire a company that will truly catapult you forward in your marketplace.

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2

Leveraging Intangibles: A More Effective Business Model for Mergers and Acquisitions

In the current business context, what creates value in a company has radically changed: *intangible assets* have become the most valuable resources your company (indeed, any company) can acquire. These intangible assets include your company's overall knowledge of your business, your relationships with your customers and suppliers, and all the other weightless wealth of your company. These assets have become the drivers for generating most of your company's value and future.

Although physical and financial assets are still essential ingredients in any company's recipe for realizing its goals, the driving force for success and competitive advantage is your company's ability to respond to your customers' needs rapidly and often globally, and that response is based on having the intangible assets you need available and being able to mobilize them well to address your issues. These include your understanding of market conditions, business philosophy, strategies, technology platform, relationships with customers and suppliers, vision, culture,

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values, quality of leadership, and level of engagement of people throughout your company, The fate of your company depends on the quality and vibrancy of your intangible resources.

This chapter describes these intangible assets and shows how you can use them to enable your company to hit your growth targets and remain competitive *after* your merger or acquisition has been completed. Intangible assets complement the much more universally acknowledged financial assets. Your intangible assets are where you can achieve synergy after a merger or acquisition; therefore, integrating and leveraging these intangible assets successfully is critical if you want to achieve quantum leaps in performance and increase the overall value of your newly combined company.

Three Types of Intangible Assets

Most managers in most companies believe that a successful acquisition is defined as one that yields certain types of results, including these:

- Enlarging the physical plant's capabilities
- Expanding product lines
- Increasing financial assets
- Cutting redundant costs substantially
- Increasing market share
- Increasing overall operational efficiencies

In other words, the perception is often that a company that is pursuing a merger or an acquisition is buying "things." Although this is true, there is also a whole array of powerful intangible capabilities that underlie the ways in which these physical and financial assets are used to create value. These intangible capabilities include the systems, practices, values, behaviors, and relationships of both the acquiring company and the company it acquires. To better understand what intangible assets are and the role they play in companies—especially in *your* company—let's

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look at intangible assets in terms of these three inputs (which interact dynamically with one another):

1. Human capital
2. Structural capital
3. Customer capital (also called relational capital)

These three intangible assets are the critical drivers for creating your company's wealth or value. For these three areas of capital to have true value, you must ensure that they ultimately come together to yield financial value for your company.

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3

Framing Your Company's Strategy to Achieve a Breakthrough Acquisition

To achieve breakthrough performance following a merger or an acquisition, you first need to fully understand how your company operates currently, *before* you combine with another company. That may sound obvious, but many M&As fail because the acquiring company didn't have this basic understanding! Therefore, it's worth stating that you need to be fully aware of all of the following:

- Your company's strategic position
- Your company's business logic
- Your company's strengths and weak points

Full understanding of these three critical areas will enable you (the M&A decision makers) to anticipate shifts in customer preferences and the capabilities that you need to build to satisfy customers' expectations.

This chapter reviews why you should avoid the "quick-fix" approach to acquisitions and why you should be wary of letting people outside your company target possible acquisitions for your company. It also describes

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four scenarios for the types of customers and business solutions you're looking for in the companies you're considering acquiring and four ways in which you can integrate those companies into your own. Finally, this chapter offers detailed case examples of how many companies, including Symantec and Siemens, tackled these problems and acquired other companies successfully after honing their company strategy.

Developing Your Post-M&A Strategy

Strategy is a response to what is happening in the marketplace. It provides direction for the achievement of organizational goals. Strategy is a plan of action that encompasses the sum of a company's objectives, including the company's broader goals and the actions involved in accomplishing those goals. *Strategy making* is the organizational capability that underlies strategy, involving the capability to renew strategies constantly based on trends both inside and outside the company that affect its performance.

There is a need for a constant flow of new knowledge to keep strategies calibrated to the customer. It does not matter how effective the other organizational capabilities are; performance will falter if the company's strategy is not relevant to the customer.

Two Dimensions of Strategy

There are two dimensions of strategy: the strategy capability that deals with *predefined conditions* and the strategy capability that deals with *emerging conditions.* In a merger or acquisition, both dimensions must be involved. There will be a number of actions that are routine and can be planned for in every acquisition. However, the strategy capability must also allow for novel circumstances and conditions that are unique to each specific transaction. Working from the viewpoint of strategy making allows you to detect and respond to emerging conditions and opportunities.

A company can have predefined practices for dealing with routine acquisition issues. This allows it to carry out much of the acquisition process in an efficient and rapid manner. At the same time, it needs to continually search out and be able to respond to emerging problems and

opportunities. The company needs to be able to shift gears as needed. It needs to have two different kinds of responses and to be able to handle these two different types of situations in the context of an acquisition. The chapter also explores three basic risk management issues.

In most companies where there is acquisition and integration planning, those efforts are primarily geared to tackling the predefined requirements of the acquisition. The challenge most often is to build the capacity to respond to emerging conditions. The acquisition can often be stymied and flounder unless this capacity is brought into play.

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4

Targeting, Due Diligence, Negotiation, and Deal Approval: Four Steps to Creating Value in M&As

When you're working through your company's strategic issues (as described in Chapter 3), you need to identify what capabilities you currently have, what capabilities you need, and how you will grow or obtain those needed capabilities. Once everyone has agreed that the way to acquire those capabilities is by acquiring another company, you can move on to the targeting, due diligence, negotiation, and approval processes—all of which are covered in this chapter. The aim of these acquisition processes is to bring substantial expense and growth synergies to your company.

In an acquisition, every stage of the journey adds to the basis and carries over to the next stages. Strategy development (covered in Chapter 3) forms the background for targeting possible companies to acquire, which in turn frames what is required in doing due diligence on the target company, negotiating the deal, getting approval for the deal, and integrating the acquired company into your existing company. A common error is to see these stages as completely separate efforts, often with distinctly different sets of participants. Although specific expertise and experience are necessary at each stage, so are inclusiveness, feedback learning loops, and continuity.

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Case Example: How Dow Chemical Prepares for Acquisitions

Preparing for the acquisition is critical. Here's the way Randy Croyle, director of Dow Chemical's Mergers and Aquisitions Expertise Center, describes how he helps everyone involved prepare:

> *I personally spend a lot of time with that business leader, making sure they understand what it is going to take, what the time commitment is, and what the issues are. I spend a lot of time setting up their organizational structure to be able to handle that M&A, via putting together due diligence teams, or putting together the integration teams. We share with them the failures or the successes of Dow's M&As, where are the lessons learned. After they come into my office, they end up spending about two hours with me. By the time they leave their eyes are glazed over regarding all of the things they have to consider. Then we say, by the way, we are going to be right with you, mentoring you and your teams as we move forward. That is how we prepare these individual lines of businesses for their acquisition.*

As they move from stage to stage, the better and more successful M&A efforts have intentional overlap of participants to support knowledge gathering, sharing, and learning during the entire process. Less successful M&A efforts do not have an adequate degree of preparation for the things that are necessary if the acquisition is to take place on the best terms, or even to happen at all, as seen in the next case.

The business planning process is not a form or procedure where one merely checks the boxes, nor is it something that can be done on the fly; rather, it is a cumulative, in-depth process that needs to begin immediately after you've identified your acquisition target. The business plan is a sketch outline at that point, but the knowledge gained at each stage shapes and continuously fills out the plan so that when you've completed your negotiations and obtained all necessary deal approvals, you will have a fully formed business plan, ready for implementation.

The stages of the acquisition process are multilevel and multidimensional. As the participants move from stage to stage, they move forward on several levels of the process, not just on that particular phase. This iterative approach requires a high level of readiness and integration capability but is central to capturing value throughout the acquisition process.

5

Integration Planning: Positioning the Acquisition to Succeed

The value and effectiveness of an acquisition depend on how well you carry out the integration—and that depends on how carefully, thoughtfully, and thoroughly you do your up-front planning. Unfortunately, too often, integration planning starts only at the closing of the acquisition agreement. This late start in planning the integration could be a key factor in reducing the success of your acquisition. The acquisition may be a financial coup, but a successful ultimate outcome will take place only if you follow up the deal effectively by ensuring that your integration team has clearly laid out how the integration will actually take place.

This chapter examines the elements involved in planning for the integration, along with who is involved, in what ways, and at what points in the preintegration and integration processes. A successful approach to integration planning incorporates the capability to carry out the following activities:

- Developing an *integration playbook*, which is a guide that your company can draw on to create specific integration plans

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- Exploring your newly combined company's *new markets* and *new customer requirements*
- Auditing all the *capabilities* of your newly combined company
- Determining the *governance* of your new company in terms of leadership, values, behaviors, and overall identity
- Identifying and developing ways to respond to *risk management* issues
- Deciding how you will handle all the *people issues* involved in an acquisition—first to make sure that everyone is engaged in, committed to, and invested in combining the two companies, then to assign new or changed responsibilities to some employees, and to announce and manage any necessary termination of other employees or groups

The Integration Playbook

A playbook is designed to be a guidebook for incorporating the essentials of an integration. Playbooks are the comprehensive templates that are to be used in integration planning to leverage the cumulative knowledge and experience gained from previous integrations to inform upcoming integration plans and allow them to be produced with greater speed and with appropriate breadth, depth, and precision. Playbooks help create a continuity and a learning model from one acquisition to those that follow, providing a common approach, a shared set of guiding principles, and an ever-expanding toolkit of effective practices.

Integration teams have increasingly been adopting integration playbooks as a way to bring strategy making and project management together in a comprehensive and coherent way. Playbooks started out as a collection of templates and tools that were taken from different acquisitions, but they have gone significantly beyond that to become vehicles for governing the integration implementation itself. A playbook differs from an integration plan in that it is a repository of the cumulative learnings of how a company carries out a merger or acquisition, whereas the integration plan is the plan for the specific integration. The ability to put together a good playbook has become an important part of building a

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company's integration implementation capability. You can incorporate learning from past acquisition initiatives and from other companies into your playbook development process to renew it as a cutting-edge manual for current and future acquisitions.

A playbook provides an overall framework and template to support the formulation of an integration plan. In addition to providing definitions of key terms, the playbook gives a model for shaping all of the following:

- Guiding principles
- Roles and responsibilities
- Accountability structures
- A road map and timeline for the integration implementation

A playbook provides a framework that allows integration planners to go through all of the steps and stages of the integration process systematically, synthesizing all of the strands that need to come together during the integration implementation process. It presents you with an effective way to plan an integration process, countering the tendency for an integration plan to fragment into a collection of unaligned parts. It is a readily understandable operating manual for integration planning.

Because there is no such thing as a standardized integration, you use your playbook to provide an outline into which you can incorporate unique integration planning requirements. Playbooks are geared to address the approach and process for any upcoming M&A with a well-defined, step-by-step methodology.

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6

Getting Your Integration Structure Right

Chapter 5 examined how to set the basis for developing an integration plan that positions the new company for success. This chapter examines the framework that needs to be developed for the implementation plan and indicates how an accountability structure, linked to that framework, can ensure that the integration will be implemented in ways that meet your company's goals. Extending from that accountability structure is a set of measures that allows the steering committee and the integration team to evaluate how well the integration is being implemented. Having these elements in place builds into the integration plan the actions to be taken and the lines of responsibility necessary to maintain a continuity of the core businesses of the company, while at the same time carrying out the fundamental changes required to set the stage for the new, quantum leap company to emerge.

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Integration Framework, Accountability, Metrics, and Continuity Structure

Every company needs to develop a framework through which it can support its acquisition and integration processes. The framework is the structure in relation to which the leadership and staff from both companies define their roles and institute the accompanying accountability and responsibility linkages. This allows for the continuity that the two companies need if they are to continue their operations and gradually emerge as one new and transformed company.

In a large-scale acquisition, the acquiring company needs to design its integration framework to accommodate the reality that both it and the acquired company have to change themselves in "midflight" as it continues to carry out business during the integration. In an acquisition of this scale, the acquired company cannot be merely bolted onto the acquiring company. Rather, the acquiring company has to assimilate what is positive about the acquired company. The acquiring company's framework needs to have the capacity to work through the major issues involved in fusing organizations that have business logic, structure, customer relationships, distribution channels, technology platforms, and other such elements. At the same time, the framework must support maintaining core business operations and flawless customer service. It has to achieve both continuity and change without stumbling or giving its competition the least opportunity to take market share away from the two companies as they are integrating. Planning the development of a robust framework that has the capacity to manage these demands is a must to avert the downsides and realize the upsides of the acquisition.

The framework has to be malleable because the challenges facing the acquisition and integration teams will change from phase to phase during the acquisition. It also must adjust to the changing tasks and responsibilities at each stage of the acquisition. If the framework's structure is too cumbersome or top-heavy, it could overburden the company, making the integration sluggish and disconnected. If the structure is too meager, it will provide inadequate support for the tasks that need to be

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accomplished. If the acquiring company has developed an integration playbook, it can draw on the background knowledge in that playbook to design its integration structure to be a good fit for the challenges it will meet in its implementation. The acquiring company can also look at major reorganizations it has gone through to see how well the framework it used enabled it to succeed, as well as where the framework fell short during those initiatives. In all of these cases, there are significant learnings that can be incorporated to guide the development of the framework structure so that it will facilitate the new company's reaching its integration goals.

7

The Integration Team Takes Over: Six Springboards for a Quantum Leap Integration

The first day of your newly combined company is the first day of your integration stage: you've consummated the "deal," and the two independent companies are now under one ownership, so you are facing the challenge of making the promise of the deal become reality. This is when your integration team should take over your integration plan, to implement the integration of the two companies. Your integration planners will have designed a framework and process for integration to jump-start your new company. A major element of the integration plan is determining the key drivers that can open the space of your new company to tackle the array of challenges you face and to seize the opportunities to lead you to quantum leap achievements.

The seeds for breakthrough performance are planted and cultivated as your company goes through each stage of acquisition, and they are framed during integration planning. Your newly emerging company should start with the capabilities it has been developing and then apply

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all six of these key springboards during integration implementation to transform it into a high-performance, quantum leap company:

1. Customer strategy and branding
2. Company strategy
3. Integrating culture and leadership principles
4. Integrating knowledge insights and business principles
5. People strategy
6. Information technology and systems

Using these springboards effectively provides the thrust to move the integration forward much more rapidly and effectively. Springboards enable you to work through and attack potentially paralyzing issues and areas, while at the same time energizing the people and the emerging structure of your new company.

Planning and then taking action to become a high-performance company strongly contrasts with what most often happens after acquisitions. Instead of moving to a higher level of value creation, too many newly integrated companies end up performing at the lowest common denominator of the two previous companies. In most of these cases, the primary gain is in sheer bulk, in terms of more customers, more distribution channels, more products, and more overall revenue. However, bulking up does not necessarily go hand in hand with achieving high performance. Enhanced bulk may help a company gain a higher market share, but it is another thing to transform a company from one that is simply *bigger* to one that *performs better*. Instead, a frequent outcome is that the increased bulk results in a clumsy, plodding company with a slower response time than it had before it acquired the new company. Let's look at how each springboard can help your company reach a higher level of performance.

Capabilities + Springboards =
Quantum Leap Performance Outcomes

8

Guiding Your Integration to Success

Activating key springboards prepares the ground for the integration to achieve the new company's strategic goals. The actions of the integration team now need a guidance system to make sure that the integration incorporates key factors and indicators that will keep it on track, on time, appropriately targeted, and yielding the extraordinary gains that will realize the promise of the acquisition.

There are several critical success factors that, when taken together, form a guidance system for the integration—specifically:

- Focus on the primacy of your *customers*.
- Create a strong—but flexible—*business plan*.
- Keep in mind that *speed* is critical to successfully combining two companies.
- *Partner* with the company that you're acquiring.
- Establish clear *accountabilities* for every task involved in the integration.

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How well your company attends to these factors will determine whether you achieve a quantum leap in performance and create outstanding value in your newly combined company. The first half of this chapter describes each of these factors in detail; to ensure that you deal with these factors, the second half of the chapter describes four critical actions that your company needs to take:

- Setting time, cost, and performance targets
- Selecting the leaders who will run the new company
- Managing people
- Managing change

Let's begin by looking at the first success factor you need to consider when integrating an acquired company.

Focus on the Primacy of Your Customers

Although many companies say, "The customer is king," that is more often lip service than actual practice. The reality is that as pressures accumulate during the intense work of integration, companies often orient themselves inwardly and focus their energies on internal reorganization. As this happens, customer relationships easily slip into a second tier of importance, and customers frequently experience extended periods of uncertainty about the company and even lack of interest from the new company. Customers may not know who will deal with them, whether they will face significant changes in pricing or products or services, or even if they are going to find themselves without a core supplier.

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9

Building the Foundations for Quantum Leap Performance

At this point, the preparation work for jump-starting the company on its path to integration is done. A plan and operating principles are fleshed out. Success factors and performance indicators to guide the integration are defined. The stage is set for the implementation to get under way the moment the transaction is closed, and the foundation for optimizing the performance of the newly formed company is in place. Your communications process becomes active as you share your company's preliminary vision and goals with the world. At the same time, you need to define your synergy goals by business area, developing an organizational design for each business unit that is in keeping with those goals. To ensure business continuity, you need to appoint managers and employees within business areas, and you should begin outplacement, severance, and relo-

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cation programs. On the program management front, your integration implementation project teams get under way to achieve first-level tasks.

This chapter explores how the leadership and transition teams for the postdeal integration implementation take over from the predeal acquisition team to build your new company. The focus of the integration implementation is to make the transition from the two existing businesses into one ultimate business. This involves how to

- Choose and transfer capabilities from the acquired company to the new company, and begin the process of combining those capabilities into new capability configurations that are unique to the new company.
- Allocate the necessary resources of time, people, and money to enable the teams to reach the target goals of the integration.
- Make the integration plan broadly available to everyone who is involved in implementing the integration.
- Carry out a comprehensive communications strategy to inform all stakeholders of the changes being brought about by the integration.
- Have the leadership steering committee engage in ongoing strategy decisions, making changes so that it can recalibrate the integration as necessary.
- Maintain the flow of necessary knowledge and information so that all parties to the integration are in sync and provide the continuing feedback needed to guide the integration.

A transition structure is put into place to implement this migration. This structure concentrates executive time and talent on how to obtain the strategic synergies of a combination. The major work of this transition structure lasts between three and six months, but its oversight role extends out between one and two years to provide coordination and support during the implementation of all necessary change initiatives.

10

Breakthrough: Moving to Unprecedented Levels of Performance and Value Creation

All the steps in the pre- and postacquisition phases (covered in Chapters 1 through 9) are the stepping-stones to realizing the accelerated growth that can be achieved in the breakthrough phase, which is geared to bringing your new company to a level of performance that no one thought possible before. Breakthrough is not just an extrapolation of the capabilities of the two legacy companies; instead, breakthrough takes the essential core capabilities of the two merging companies and leverages them to bring your newly integrated company to a new level of performance. In this process, you've shed what is no longer relevant to your customers from the original, separate companies, and your new, streamlined company is set to create a new future for itself.

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The Engines of Breakthrough

As you complete the initial integration implementation, your transition to the breakthrough phase begins. At this point, you've identified your new company's leadership team, you've streamlined and filled all positions in the new company, and you've defined the principles and initial strategic objectives of your newly combined company. Now you're ready to start the engines for breakthrough:

- Focus on renewal strategies that leverage the core capabilities of the two legacy companies.
- Enlist employees' commitment by creating a vision and engaging them in realizing that vision.
- Create a cohesive culture in which people are driven to collaborate in order to succeed.

When these engines are in place, your company will create the trust-based relationships that are necessary if your company is to engage all employees to mobilize it into breakthrough mode. Let's look at each of these three engines in more detail.

Leveraging Your New Company's Core Capabilities

A major reason for choosing an acquisition path to growth is the belief that new, stronger capabilities are required, and that it will be faster and more efficient to capture the needed capabilities by acquisition rather than through the slower process of organic growth. The breakthrough phase is when all the work of identifying capabilities and harnessing these capabilities in the new organization pay off.

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Epilogue

The Evolution of the Role of Acquisitions

The thinking surrounding acquisitions has been dominated for a long time by financial strategy. It has now become apparent to many people that making successful acquisitions will require a substantial change in the manner in which these acquisitions are undertaken, planned, and realized. A company's need to develop and renew its capabilities will be at the heart of this new perspective. This perspective has gained currency in the last decade, but a great deal needs to be done to realize the promise that it holds. To gain the full value from this perspective, we will need to continue actively experimenting.

Eventually, all organizations reach their limits, even if they are quantum leap organizations. Any particular competitive edge is susceptible to erosion. It is only a matter of time before the next generation of revolutionary technologies or business models will come into play. However, in this world of rapid and exponential change, it will be those organizations that

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are cultivating their readiness and recasting their generative capabilities that will have the best chance of surmounting these challenges.

A powerful acquisition and integration capability gives an organization the foundation for going to its next level of possibilities. It enables a quantum leap organization to go beyond the possibilities of organic growth by taking advantage of the opportunities for strategically acquiring other organizations and then imaginatively integrating their hidden wealth into the new organization that emerges from the integration implementation process. Organizations will need the capabilities to excel at organic growth and, if they have these capabilities, will be able to complement this work with selective, strategic acquisitions that can be integrated to boost their growth. If an organization does not have the inherent capabilities to realize organic growth, it is unlikely that it will be successful at using an acquisition to bring about a sustainable quantum leap in its level of performance.

There is little doubt that major acquisitions will grow in significance over the next decades. A vast arena for acquisitions is emerging in the increasingly globalized economy. The lowering of legal barriers to cross-border acquisitions all around the world, the development of massive enterprises in China and India, extensive capital accumulations in oil-producing countries, and changes in the valuations of currencies are some key factors creating an unprecedented potential for large-scale acquisitions. Chinese and Indian firms have begun to acquire major stakes in North American and European companies. Major infusions of capital into American companies from the oil-producing states in the Persian Gulf are the start of what is coming to be a much more open acquisition environment. The fluctuating values of the dollar, yen, yuan, rupee, and euro make different acquisitions affordable at different times. These trends will only increase in size and scope. The result is that major acquisitions will continue to play a significant part in capital realignments that would not have been conceivable even a decade ago.

Appendix A

Is Acquisition Always the Answer?

The acquisition option is often the answer to a company's strategic requirements, but not always. There is a range of combination options that a company can use to achieve its strategic goals, each with its own benefits and limitations:

- Licensing
- Strategic alliances or partnerships
- Joint ventures
- Mergers and acquisitions

Each option can be the best fit for a specific purpose and be part of an overall combination strategy. Having the full range of options available enables a company to evaluate the alternatives and pursue the best course of action to achieve its goals. When deciding which option is best for your company, you need to evaluate and balance the costs, the level of effort required to carry out the option, and the degree of management

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that will be necessary against what you think you will achieve. You might even consider this as a mathematical equation:

Moving from Simpler to Greater Degrees of Complexity and Higher Levels of Effort

Licensing > Strategic Alliances > Joint Ventures > Mergers/Acquisitions

Here's a brief definition and comparison of each option:

Licensing. This is the simplest way of obtaining a product, service, or trademark. It may be appropriate when a company has very clearly defined requirements and a limited need to have control over what is licensed and how it can be exploited.

Strategic alliances or partnerships. These are cooperative efforts in which two or more companies agree to pursue common activities and interests for specific strategic advantages. On the positive side, strategic alliances are flexible arrangements that may appear to be relatively more easily arranged and do not require as great an investment of financial capital as an acquisition would. There can even be partnerships in which companies collaborate in certain areas but compete in others. Strategic alliances are also advantageous in countries where there are restrictions on acquisition activity or where the risk of ownership is too high. On the other hand, managing strategic alliances and allocating the resulting gains may be difficult.

Joint ventures. These are a more structured option because each company remains a separate, formal organization with its own policies, rules of governance, and methods of operation. Although a joint venture is typically comprehensive and rigorous, each company may still face the challenge of maintaining its desired levels of control and alignment and of allocating specific outcomes on an ongoing basis.

Mergers and acquisitions. These require the most investment and effort, as they involve targeting, planning, and integrating another company; however, complete ownership provides the greatest opportunities for recombining and realigning resources to accomplish quantum leap gains. For the most part, the capital costs are significantly higher, but the ability to generate substantial rewards can also be higher.

Appendix B

Beyond the Deal Question Set

The following is a compilation of questions that explore a set of issues that need to be worked through to achieve quantum leap (M&A) goals. The answers to these questions that you develop will contribute to your understanding of how you can best proceed through the phases of an M&A, from predeal acquisition and beyond the deal to integration implementation and breakthrough.

Think of this question set as a practice field for assessing your readiness and as a set of capabilities for taking on such a major challenge. Use these questions as a starting point for a conversation on how to prepare to use the M&A and integration as a quantum leap springboard for taking your organization to sustainable breakthrough performance and value creation.

Getting Started

- What do we think the key issues will be that we will face in an acquisition and integration?
- How open is our company to systematically looking into growth option synergies as well as expense synergies?
- What unprecedented gains could our company achieve through a major acquisition as far as performance and value creation are concerned?
- What could block us from achieving those gains?
- What could enable us to achieve those gains?

Lessons Learned from Previous Mergers and Acquisitions

- Are there any stories from the merger (or mergers) we have been involved in that especially evoke the achievements and problems we encountered?
- What were the key issues we experienced during *previous* M&A and integration processes?
- What are the key issues we need to address in *future* M&A and integration processes?
- What lessons have we learned from previous M&A processes?
  - Have we incorporated those lessons into the way our company approaches mergers and acquisitions?
  - Looking back, would we have done things any differently to make more of a quantum leap in performance enabled by the M&A?

The Link between Acquisitions and the Strategic Intent of the Organization

- How does our approach to M&As relate to the way our company is carrying out our strategic intent and enhancing our company's strategic position?

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Appendix C

Auditing Strategic Capabilities in the Context of the Deal Exercise

This is a strategic capabilities audit process that each of the organizations in a merger or acquisition can undertake to identify what capabilities are present in each organization. The acquisition and integration teams can use this audit to determine similarities and differences in capabilities. Those capabilities are the basis for complementarities that can come together in the new combination and act as the drivers enabling the new organization to achieve its strategic intent.

Both the acquiring and the acquired organizations need to *determine how capabilities are accessed, shared, and used, and with what effect, and also note who is involved in activating and mobilizing these capabilities.*

1. Senior leadership lists the top three to five core organizational capabilities that enable the organization to meet its strategic goals and differentiate it from its competition.
2. Each business unit manager and his or her subunit managers list the top three to five core capabilities that enable that unit

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to meet its strategic goals and differentiate it from its competition.

3. Senior leadership and the business unit managers and submanagers from both organizations compare the two sets of capabilities and discuss how they can be accessed and leveraged, and who would be involved in creating greater value and higher performance in the new organization.
4. Chart out a list of projects that the new organization can undertake to mobilize these capabilities for specific outcomes, noting the investment of time, people, and funds required to achieve these outcomes.
5. Evaluate the potential costs and gains from the work of leveraging these capabilities.

Two additional steps in this exercise are:

1. Map out the value creation path for the organization and each of its business and subbusiness units, and determine what capabilities are used to create new value at each major point on that path. Again, the leaders and managers from both the acquiring and the acquired company would then compare what those capabilities are, how they can be shared and leveraged for specific effect, and with what investment costs.
2. Compare the sets of capabilities found in each of the exercises with the capabilities of key competitors. Carry out a gap analysis to determine where the new organization has advantages and where it has gaps. Develop a plan to build the specific configurations necessary to achieve strategic goals and create a sustainable competitive advantage over the competitors.