

# The Value of *Pre-Merger* Integration

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Most large acquisitions fail, in the sense that they generate little gain in shareholder value. What accounts for the winners? The answer is effective management of the integration of the two firms. Here is a guide to M&A success, through early preparation and a focus on six specific areas.

Corporations pursue acquisitions for many reasons, but one force drives virtually all M&A strategies: the pursuit of value. In seeking attractive candidates to acquire, managers aim for targets that will increase shareholder value. The widely held perception is that if a transaction adds to existing cash flow, a good outcome is virtually guaranteed.

In reality, however, large acquisitions rarely lead to a rise in shareholder value; given the relatively poor stock performance that follows many large acquisitions, managers might reassess how they design and execute M&A. Amid all the analyses and due diligence meetings preceding a major acquisition, consider adding one more element: setting the stage for effective post-merger integration.

**The Elusive Search for Shareholder Value**

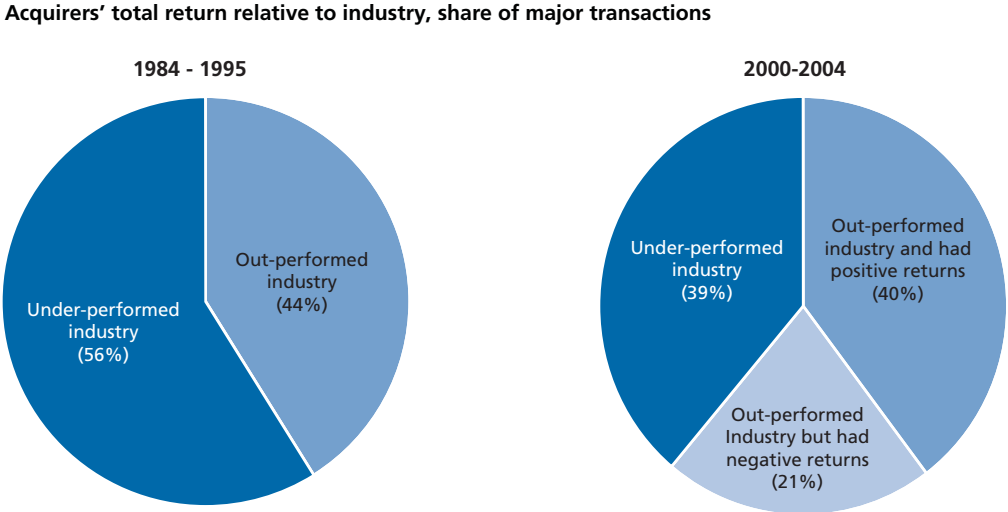
Most acquisitions valued at more than \$500 million have produced meager gains in shareholder value, according to *Mergers and Acquisitions* magazine. Indeed, measured against industry peers, the consolidated companies that emerged after

large-scale acquisitions in the 1980s and 1990s stood a 56% chance of losing ground against their competitors. Among more recent transactions, a comparable share of merged companies either under-performed their industry peers or yielded negative absolute returns (Exhibit 1).

Managers may be tempted to dismiss the data as evidence of the market’s distaste for strategic missteps, or buyer’s remorse about expensive premiums invested in hard-to-justify deals. But a careful review of the data suggests otherwise. Oliver Wyman analyzed three-year total returns (share price appreciation plus dividends) for the largest M&A transactions completed between 2000 and 2004. Comparing acquirers’ returns with industry returns for the same period, one conclusion stands out: Price premiums exert virtually no influence on post-acquisition shareholder returns (Exhibit 2).

Similarly, the specific intent behind an acquisition—whether the company purchased represents a consolidation or a diversification—

Exhibit 1 Post-acquisition performance has improved, but it is still difficult to extract value from acquisitions

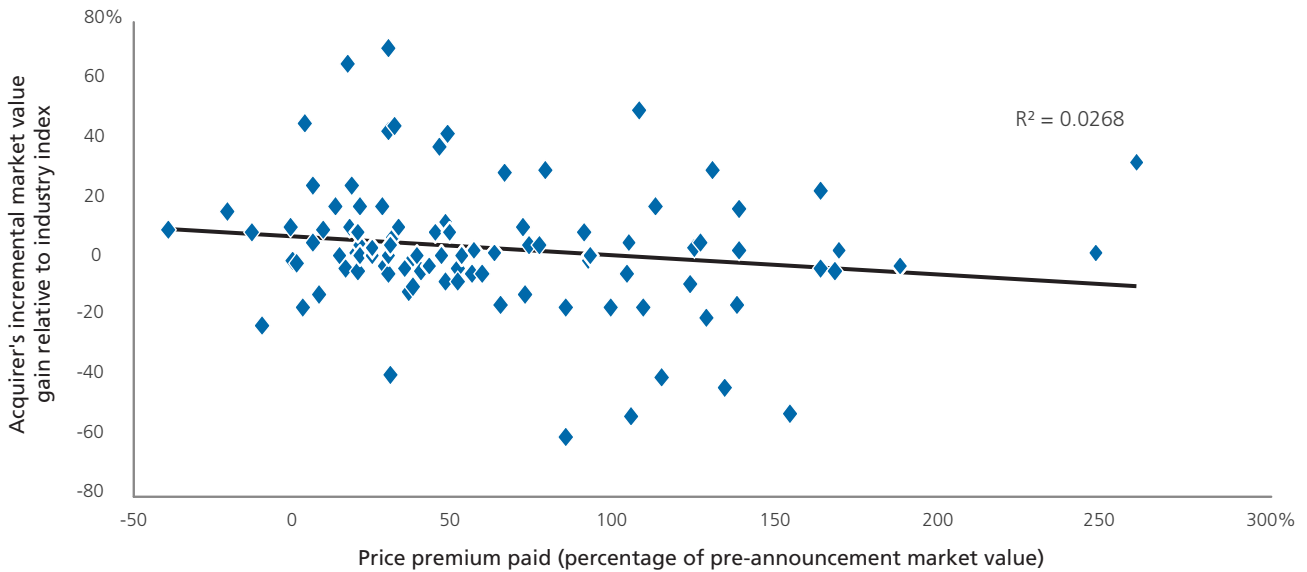


Notes: Transactions from 1984-1995 over \$500 million; transactions from 2000-2004 over \$4.75 million listed on U.S. stock exchanges (American Depository Receipt or normal listing); performance measured used total return (share appreciation and dividend payout) of the acquirer versus the relevant S&P industry index measured from three months prior to 36 month after the acquisition announcement month.

Sources: S&P Compustat, SDC, *Mergers and Acquisitions* magazine, The Public Press

Exhibit 2 **A price premium does not lead to market value**

Market value gains versus price premium, 2000 to 2004



Notes: Transactions from 2000-2004 over \$4.75 million listed on U.S. stock exchanges (American Depositary Receipt or normal listing); Market value calculated by total return (share appreciation and dividend payouts) of the acquirer minus the return of their relevant S&P industry index measured from three months prior to 36 months after the acquisition announcement. Premium calculated as percentage paid above target's stock market value four weeks prior to the acquisition announcement.

Sources: S&P Compustat, SDC, *Mergers and Acquisitions Magazine*, The Public Press

has been found statistically insignificant in affecting shareholder value.

By contrast, the evidence shows that one variable does matter: effective post-merger integration management. Careful planning for life after a major merger can substantially increase the odds for success. In one survey of managers who participated in more than 300 deals closed by 37 companies between 2002 and 2006, firms that judged themselves “successful integrators” enjoyed post-merger performances that exceeded expectations by nearly 10%, worth hundreds of millions of dollars in shareholder value. As for the primary source of poor post-merger performance, “poor integration” topped the list at 44%, far more than “inaccurate valuations”

and “strategy formulations,” each cited by 28% of respondents.

In addition, when Oliver Wyman consolidated 15 major studies of post-merger performance to identify the elements that executives see as sources of successful M&A outcomes, the consensus top choice is “merging culture and maintaining employee morale.” As one executive quoted in a *Harvard Business Review* article said: “You have to create a single organization, with common processes and standards, common values, and a way of working.”

With the stakes so high and the evidence conclusive, it's well worth the effort to master effective post-merger integration.

## **A Proven Approach to Building Value After the Merger**

Experienced and savvy executives increasingly recognize that planning for effective integration *before* a major M&A deal can dramatically influence post-merger outcomes. But the challenge of putting that insight into practice can be daunting for executives who know they will soon be buried in the paperwork and long days that accompany any major transaction. Even if the right people are available to handle integration-related tasks, they are typically the same ones who will be burdened with many other merger-related tasks. The Corporate Strategy Board recently noted how a record number of transactions are being completed within narrowing timeframes that constrain every ingredient that goes into a deal; the average number of days between announcement dates and deal closures decreased 38% between 2001 and 2005, with the average M&A team having only 68 days to completely map and execute a transaction.

Regardless of which resources a firm deploys on post-merger integration, our experience in these situations suggests a focus on six specific areas can substantially improve the odds of success.

### **1. Organizational Structure and Culture**

There are two choices on how to approach organization design in an M&A situation. Typically, the acquirer integrates the acquired company into its existing structure and processes. Although widely used, this approach can limit the value creation that was the basis for the transaction, ignoring valuable organizational characteristics, systems, and processes in the target company. Moreover, the people retained in the transition may be the most flexible employees, not necessarily the most valuable employees.

A better alternative, particularly with large transactions, recognizes that an M&A transaction results in a new company being formed. This approach requires actions that preserve the valued

characteristics of both firms and combines them into a new entity that is better designed to exploit this new set of strategic competencies and talent. The new entity should include existing elements of both companies, as well as new elements needed to build competitive advantage. Effective organization design requires creating a clear, high-level vision of how the merged entity will operate and developing detailed operational blueprints and implementation plans to fulfill that vision.

Organizational culture must be a key component of both the vision and the operating plan. Thus, the acquiring company should conduct an in-depth assessment of its own culture, that of the target company, and of the degree of fit between the two companies.

### **2. Project Management and Leadership**

Name your integration coordinator at least a month prior to the deal announcement. This person is probably being groomed for a significant operations role in the eventual merged company, and he or she needs three skills to be successful: an exceptional ability to juggle multiple tasks at once; the confidence to make quick decisions; and adherence to the highest standards of accountability. Integration coordinators need to be able to make both long-term strategic choices and short-term tactical decisions—all the more reason to get them started early on.

### **3. Communication and Metrics**

Communication is critical to integration success, and key constituents should include executives, the project team, employees, and external stakeholders. In particular, the strategic vision behind the transaction needs to be communicated clearly, forcefully, and regularly to employees at both companies. Along the way, it's worth installing key performance metrics for post-merger integration, establishing objective assessments of how initial post-merger results will ultimately compare to the goals set early on.

#### 4. Risk Management

Every company has areas that deserve elevated priority during the run-up to the merger. Risk ownership should be assigned to appropriate subject-matter experts who may or may not be on the acquisition team. These experts will become conduits for information that senior executives need in order to track how risks are being managed during the integration process. For example, oil companies merging their exploration and production businesses should have their subject-matter experts collaborate to continue with current drilling commitments, as a major amount of work has already occurred to design these wells. Without understanding underlying geoscience and drilling engineering work, rig commitments, permit specifications and expiration dates, partner and other contractual commitments, it would not be prudent to immediately discontinue or alter

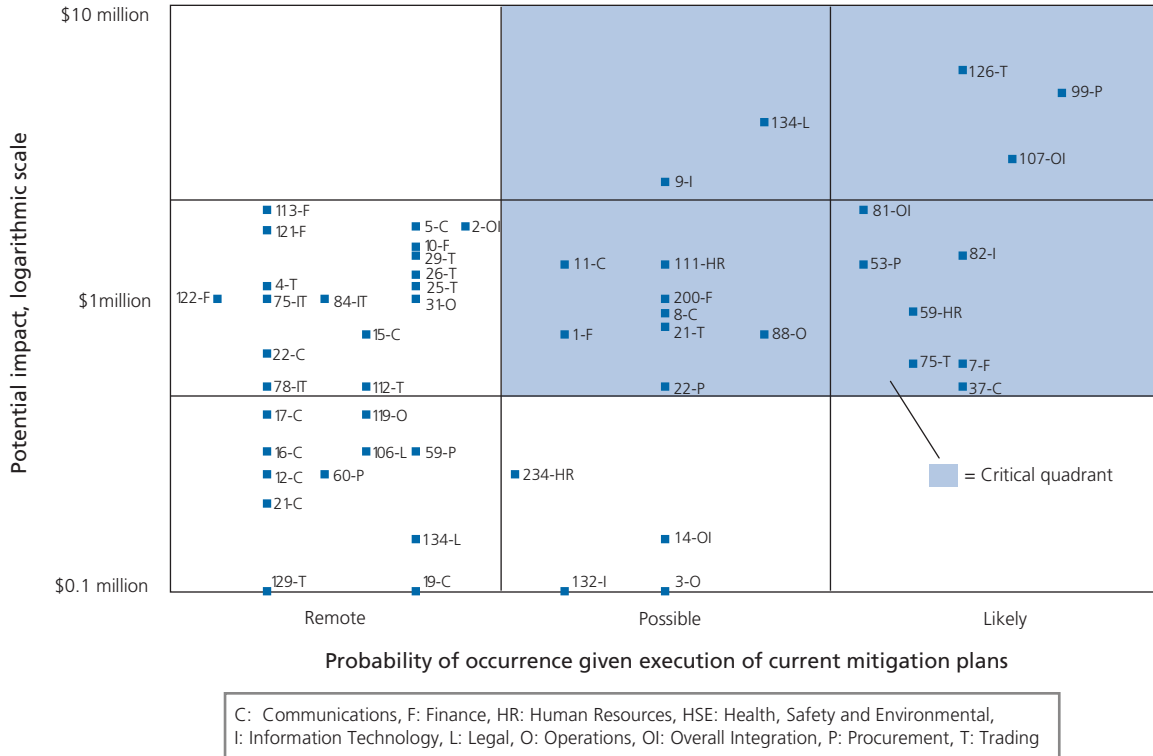
current drilling programs. Such disruption can often lead to significant financial loss.

There will usually be more risks involved in a merger integration than can be mitigated early on. Exhibit 3 shows a simplified example of a tool that Oliver Wyman uses to prioritize integration risks.

#### 5. Continuous Learning

Any single M&A transaction usually comes in the context of other major deals for a company, and it's worth archiving the best practices that contribute to their success. Some of the business processes from the acquired company will deserve to be continued, or even implemented throughout other parts of the organization, and lessons learned from the current deal can benefit future transactions. In our work with clients on their transactions, we have seen a wide disparity across business

Exhibit 3 Risk matrix (illustrative)



processes that confirm the value of getting the processes right.

## 6. Tools and Templates

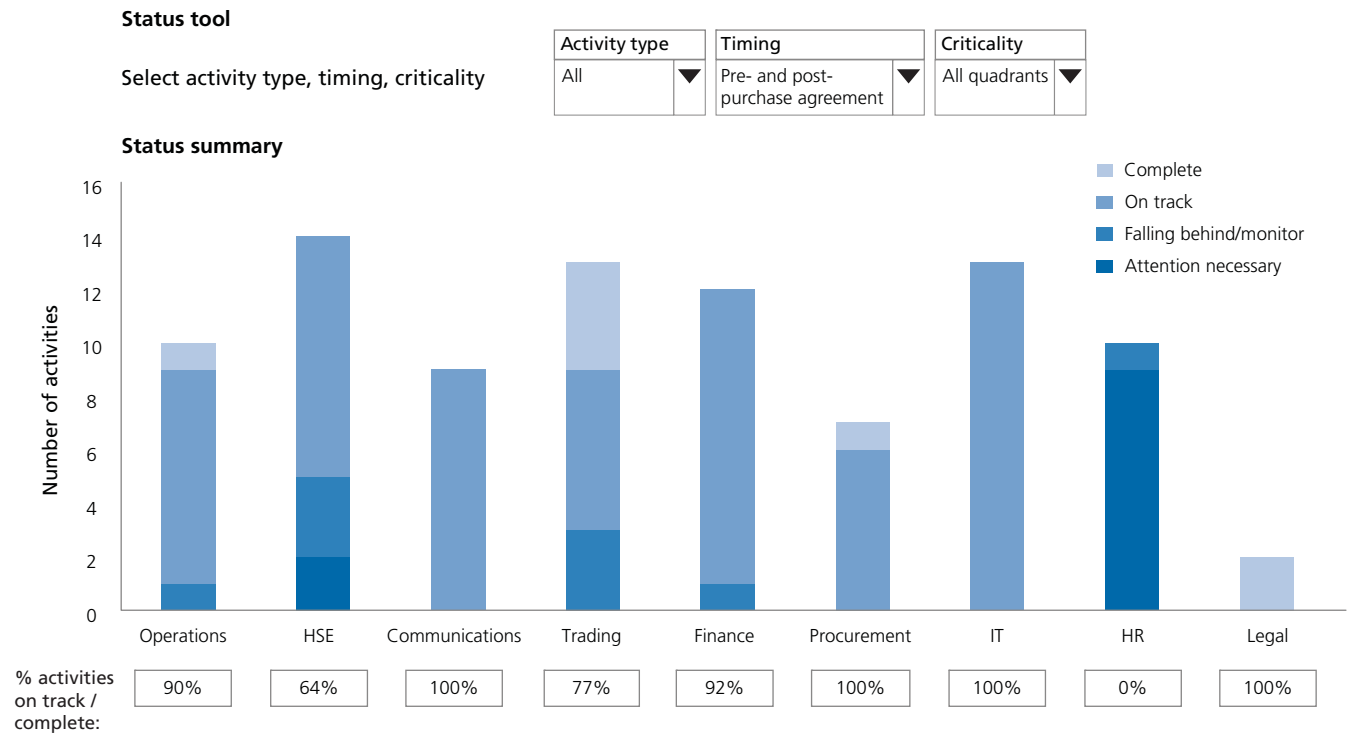
A proven set of tools and templates should be made available to all major functional areas such as Human Resources and Finance as the march toward merger begins. These elements help focus staff attention on specific tasks, and many of them include easy-to-understand dashboards that incorporate strategic goals, performance expectations, and alignment tools. Properly employed, these tools will help establish a stable and shared framework to guide senior managers to

the ultimate goal: strong post-merger integration that melds two distinct teams into a cohesive force capable of generating maximum value. Exhibit 4 shows one simplified example of a risk management dashboard.

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Large mergers and acquisitions live or die on how well the two organizations are integrated. The right level of resources, deployed early in the planning process to focus on the six areas discussed here, will raise the odds of sustained value creation once the union occurs. ❖

Exhibit 4 Risk management dashboard, illustrative

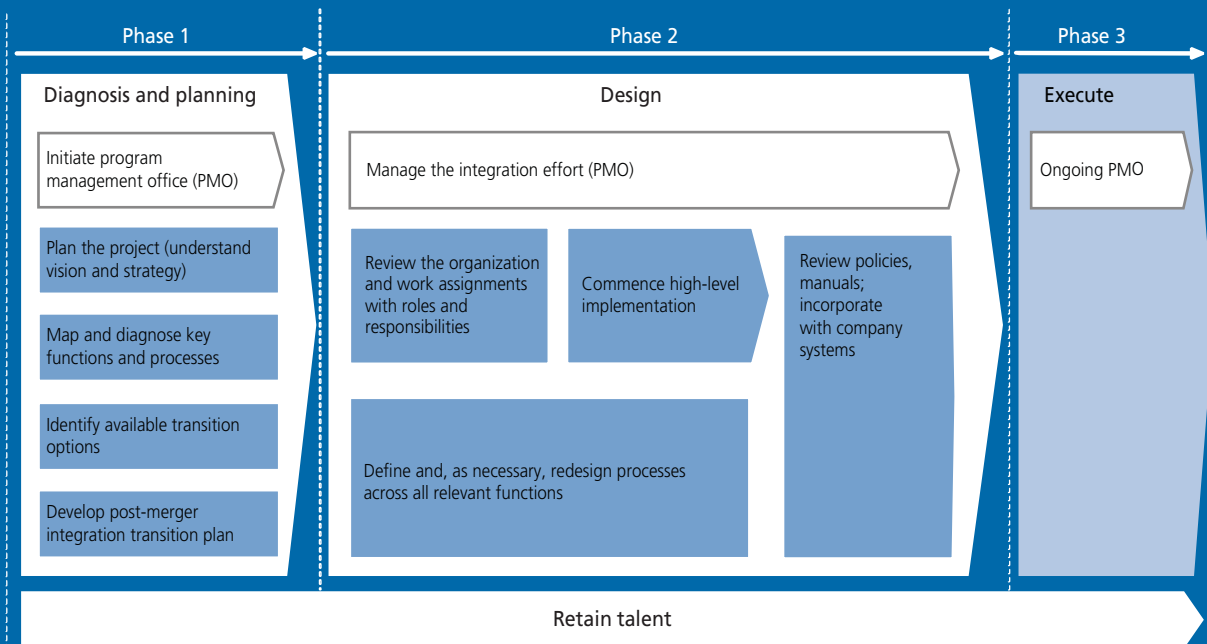


## About Oliver Wyman

With more than 2,900 professionals in over 40 cities around the globe, Oliver Wyman is the leading management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit [www.oliverwyman.com](http://www.oliverwyman.com).

Oliver Wyman has worked with hundreds of major corporations on pre-merger integration planning and post-merger integration execution. Our proven processes for integration, shown below, have been shaped by our learning from these transactions.

### Oliver Wyman's integration planning approach



Given the constraints of time-compressed transactions and merger integrations, we add an important element of objectivity that can help build consensus and ownership among key managers who will become teammates in the merged company. To discuss the business development and merger integration challenges in the oil and gas industry, please contact your Oliver Wyman account partner or one of the following partners:

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