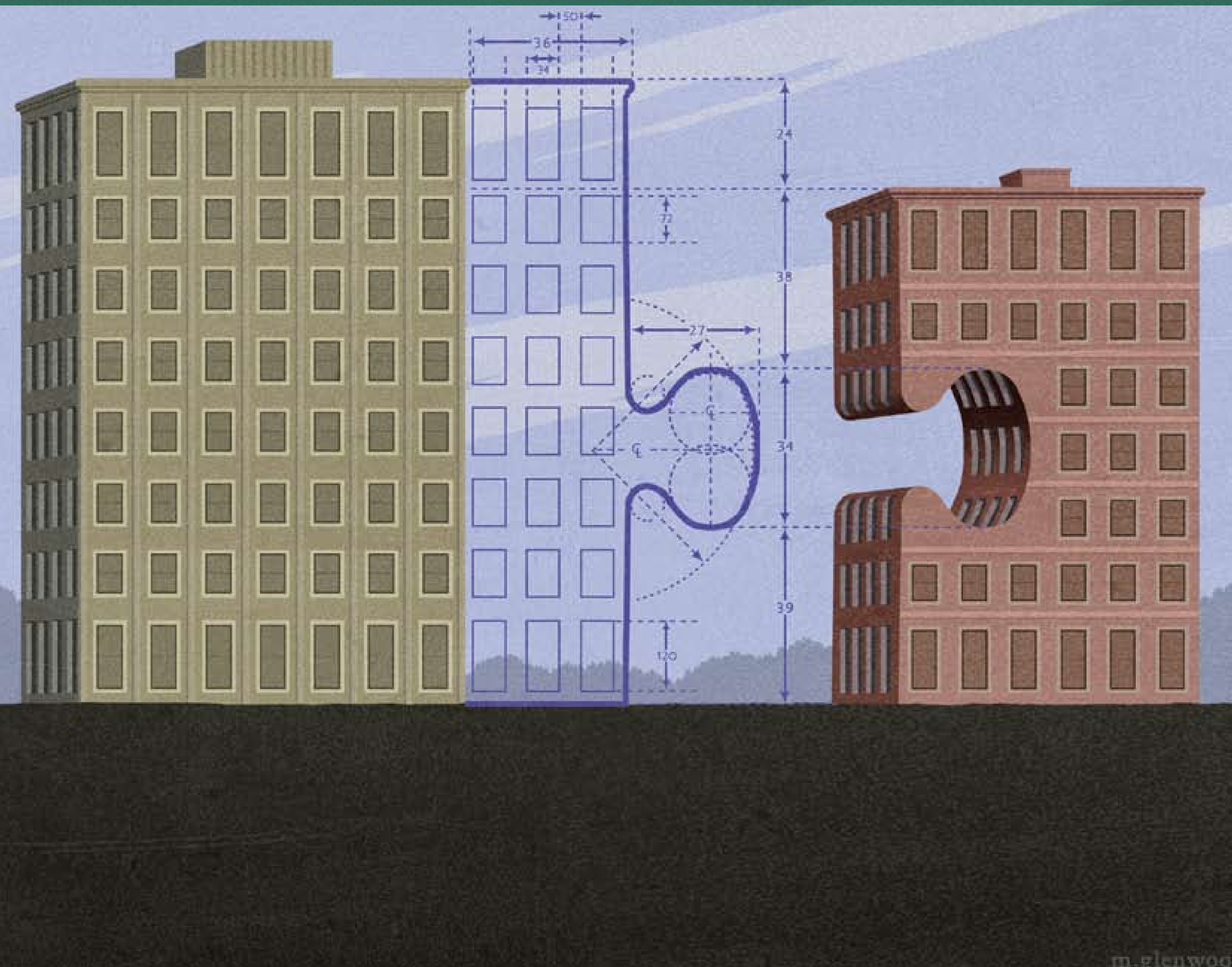
The Boston Consulting Group

Trends in Postmerger Integration VI

Enabling PMI

Building Capabilities for Effective Integration



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AT A GLANCE

Acquisitions, while essential to many companies, often fail to deliver on their promised value because of inadequate integration. Under pressure to complete deals quickly, companies cut corners and miss out on expected synergies. By building their integration capabilities, companies are more likely to conduct this delicate work expeditiously and effectively.

Building Capabilities in Tandem with a Deal

Companies often build integration capabilities immediately before, during, or just after an actual deal. They benefit from a sense of urgency and from learning by doing, but must avoid letting the current deal be the model for future integrations.

Fostering Capabilities Independent of a Deal

Some companies prefer to build integration capabilities apart from any active deals. While this standalone approach allows for greater breadth, companies need to reinforce what they've learned before actual integrations take place.

Focusing on Value Drivers

Essential to all integration capabilities is a focus on value drivers. Success depends on identifying a deal's sources of value and capturing them.

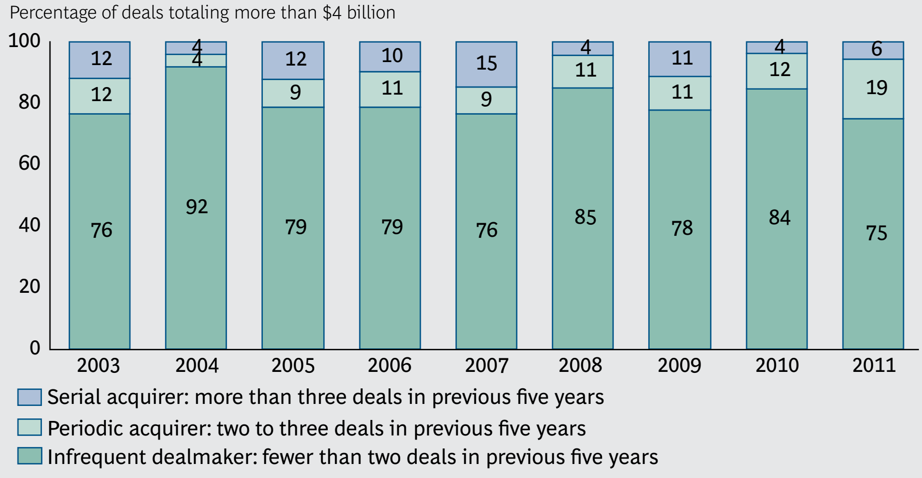
Acquisitions are a vital component of growth for many businesses. Yet a high proportion of deals fail to deliver value. Why? A common reason is that, because of time pressures and complexity, many companies struggle to integrate fully after the deal. Synergy targets that were so enticing in the run-up to the deal melt away under the realities of meshing two often very different organizations in a short time.

Most executives are quite aware of how to integrate properly. They are also ready to devote resources to making sure postmerger integration (PMI) gets the attention it requires. Yet during the stresses of the actual integration, they find that their organizations lack the ability to follow through. The trouble is not in any specific area but rather a multifaceted weakness.

For the vast majority of companies, acquisitions are infrequent events. (See Exhibit 1.) Most companies respond by reallocating resources and building or hiring temporary capability to handle integrations on an ad hoc basis.

Some companies, especially those whose strategies lead to more frequent acquisitions, are choosing to build more of this capability on a permanent basis in-house.

Exhibit 1 | Infrequent Dealmakers Carry Out Most Acquisitions



Sources: Mergermarket.com; BCG analysis.
Note: The companies we analyzed are based in North America.

They have trained people, designed processes and templates, and set up structures, moving beyond the common ad hoc approach. They have consolidated and spread the specialized PMI knowledge held by some people to the wider organization. But building these capabilities can be time consuming and difficult. Serial acquirers will most likely have the necessary commitment, experience, and ongoing incentive to overcome these hurdles. Others will need to be clear in advance about what it will take.

We have observed two principal models used by companies that choose to build a more lasting integration capability. (See Exhibit 2.)

- *Tandem PMI Enablement:* Boosting integration capabilities immediately before, during, or just after an acquisition. Here the difficulty is to make the capabilities broad and flexible enough to handle a variety of integration types.

- *Standalone PMI Enablement:* Boosting integration capabilities independent of an actual deal. The challenge here is to make the capabilities concrete and compelling enough to be sustainable.

Both approaches to building integration capabilities have merit. It is important that leaders fully understand the dynamics of tandem and standalone PMI enablement before committing to either one.

This report, the sixth in The Boston Consulting Group's series on PMI, concentrates on the two different models used by companies in building capabilities for integration. Drawing on BCG's extensive experience with clients in this area, it describes the models used as well as the challenges involved.

Exhibit 2 | PMI Capabilities Can Be Built Alongside or Separate from an Integration

Tandem PMI Enablement

Building integration capabilities in conjunction with a deal

Standalone PMI Enablement

Fostering integration capabilities independent of a deal

Source: BCG analysis.

Tandem PMI Enablement

Many organizations choose to boost their integration capabilities immediately before, during, or just after an acquisition. That approach has the major advantage of an actual integration target being uppermost in everyone's minds—it is no theoretical exercise.

For example, a midsize Australian bank invested in building its PMI capabilities at the same time that it was preparing to integrate a large wealth-management operation. That timing gave the effort a tangible concreteness, turning it into on-the-job training. Designers and project managers were highly engaged. They learned by doing—which researchers in education have long known is the best way to learn.

Building capabilities in tandem with an actual integration, however, has two dangers. The first is that capability building plays second fiddle to the actual integration. The second is that the people involved get stuck on the particularities of that one integration experience.

- *Playing Second Fiddle.* Building PMI skills can quickly slip into the shadows of an integration effort when people aren't clear about why they need to improve their capabilities. It is easy for busy managers to see capability building as merely nice to have or something that other people need to do. Under the pressures of the integration, they will be tempted to delegate capability building by having subordinates attend the training, try out the new templates, and write down and report on their experiences. They aren't actively trying to undermine the effort; they are just making hard choices under time pressure. But their absence runs the risk of marginalizing the entire effort.

  The Australian bank avoided this danger partly because its managers realized that they were about to take on deals that were much bigger and more complicated than those in the past. With the financial services landscape changing so quickly, the bank's leaders also won people over to the need to be more flexible and inquisitive in the integration process. It helped that the bank began capability building before the actual integration started, so that skill enhancement wasn't competing directly for most people's time when the PMI was under way.

  When capability building takes place simultaneously with an integration, companies need to work harder to make sure that the integration's leaders are fully engaged. The bank addressed this issue by building time into the schedule, after completing each major stage, to record what happened and consider improvements or alternative approaches.

- *Getting Stuck on One Experience.* The second danger of tandem PMI enablement is that the people involved in a PMI, like generals fighting the last war, think that what happened in that deal is common or standard. The very concreteness of the experience freezes their imagination. They might hear a lot about different kinds of acquisitions, but what they actually work on is likely to be so powerful that only this kind will stick.

The major advantage of tandem PMI enablement is that the integration target is uppermost in everyone's minds—it is no theoretical exercise.

One large industrial-goods company met that challenge with a special postmortem effort. Looking ahead to the kinds of companies it was likely to acquire in the future, it rigorously examined where its current PMI capabilities were likely to fall short. That assessment, in conjunction with a detailed audit of the just-completed integration, made participants open to real improvement. It also helped that the company invested in additional resources and training to go with its newly expanded PMI handbook.

Simultaneously conducting an integration effort and building PMI capabilities means that an organization has to wait a little longer before realizing a deal's benefits. But an organization committed to lasting improvement—especially a serial acquirer—can make it happen.

Done right, tandem PMI learning covers a variety of possible deals, not just the current deal. But even so, acquirers following the tandem model will need supplemental capability building with each substantially different type of deal. That is because there is a limit to how much people can really learn without the opportunity to reinforce their learning with practice.

Standalone PMI Enablement

Building integration capabilities separately from an actual deal has the opposite dangers. People may discuss and debate a variety of capability-enhancing possibilities, but even with detailed exercises the learning may not stick. Organizations may benefit from improved tools and processes in their PMI handbooks, but they will need a good amount of reminding when the next deal occurs.

For that reason, we've found that standalone capability building works well mainly for acquirers who already have some experience and are looking to raise their game to a higher level. Maybe they are embarking on a strategy that involves far more complex deals than in the past—including those that will help adapt their business model to new competitive realities. These companies are often adept at integrations involving small companies or those with a similar business, but struggle when they undertake disruptive or large deals, or when they do several deals at once.

Standalone capability building works well mainly for acquirers who already have some experience and are looking to raise their game to a higher level.

People can draw on their own experience to make sense of what they are learning, so training is more likely to stick with those working at an experienced acquirer than with those at an inexperienced acquirer. The standalone setting allows for a more thoughtful, comprehensive series of improvements, including an audit of existing capabilities that is difficult with an actual integration in play.

- *Internalizing PMI Practices.* A large electronics manufacturer, for example, had been a serial acquirer, buying and selling a variety of businesses as it shifted its strategy. It had a strong capability in doing deals but a tendency to stop short of fully integrating acquired businesses. Eventually it realized it would gain value from more actively integrating these purchases, so it set up a dedicated integration team.

  While frequent integrations made the team competent enough on its own, it found itself working largely in isolation, with weak links to the business owners responsible for the new acquisitions. It also had minimal communication with the M&A group, which continued to pay scant attention to integration issues in carrying out deals. Too often that group was doing little more than throwing the deal over the fence to the integration team.

So the company proceeded to improve its integration capabilities. While some small deals were in progress, capability development took place apart from the main work of the team. Much of it involved improving communication among the acquirers, integrators, and business owners. The integration team physically moved to the same floor as the M&A team at headquarters. It also augmented a handbook that codified past learning and added new practices.

Most important were steps to ensure that the M&A team conveyed the value drivers for each deal and that the integration team planned accordingly with the business owners. The handbook included a framework laying out different possible deals with corresponding integration programs to consider.

To prevent the handbook from becoming a sterile repository of static knowledge, the integration team worked over time to update the document with lessons from completed projects. Vignettes from the projects added realism to the details. In building out the handbook over time, the team would internalize the message and the practices. This was all possible because the team already had so much experience with integration work.

- *Overhauling PMI Practices.* Another example of standalone PMI capability building comes from a midsize industrial-goods company that had made an initial foray into acquisitions as part of a growth strategy. The results from a profitability perspective were disappointing, and the company realized it was going about acquisitions without an eye toward value creation. Integrations were done at a bare-bones level that left many synergies on the table.

  Since future acquisitions were likely, the company decided to overhaul and expand its entire approach. That was better done without an active integration at hand, and it started with identifying talented people to take on the expanded PMI responsibilities. Once they were onboard, they could lead the way with training on a customized tool kit for assessing value. The standalone effort helped to send the message that the company was embarking on acquisitions in a fundamentally new way.

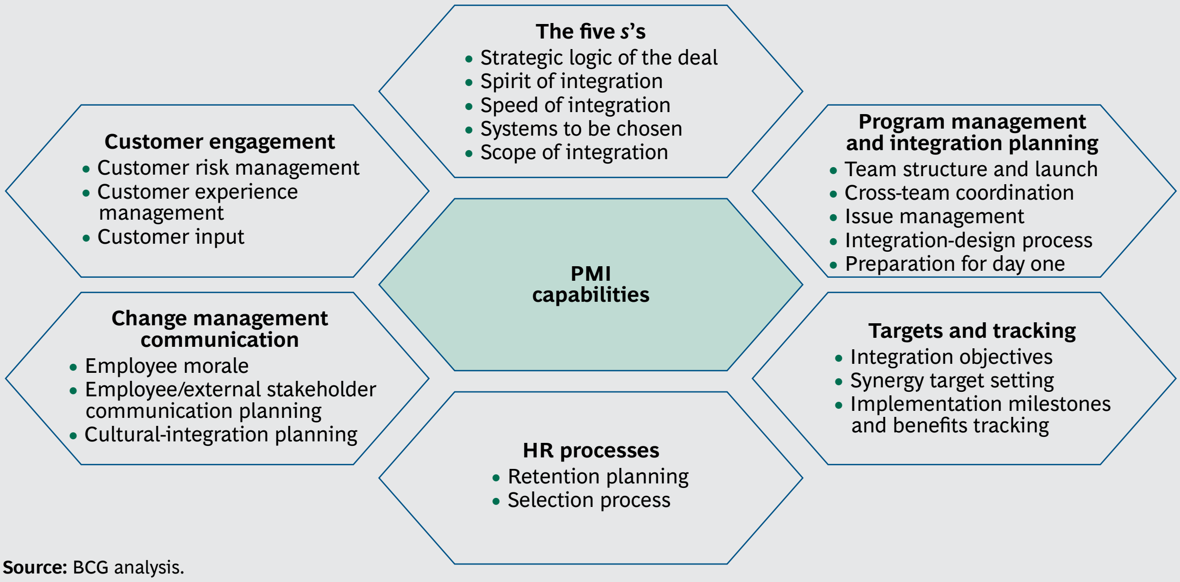
  Even so, the company needed to do much more to drive home the benefits of the effort. Supplemental training and postmortem work with the first actual integration were essential for the learning to stick. Building capabilities is not a fixed, one-time event but an ongoing process of internalizing and improving on a given set of structures and practices.

Building capabilities is not a fixed, one-time event but an ongoing process of internalizing and improving on a given set of structures and practices.

The Importance of Value Drivers

Whatever the model chosen, all the companies cited here faced some general challenges in building integration capabilities. (See Exhibit 3.) Effective integrations

EXHIBIT 3 | PMI Capabilities Consist of Six Key Elements



Source: BCG analysis.

draw on a variety of roles, structures, and processes. Yet these practices, while important, aren't enough.

Integrations take place in a hothouse. Eager to defray the costs of an acquisition and generate value, acquirers want to move quickly and decisively. At the same time, integrations involve a great deal of uncertainty. Unexpected problems and opportunities emerge. How are people to decide which items to prioritize and work on and which to postpone or drop?

In order to best use the limited resources available for an integration, acquirers need to focus on what matters most—specifically, where they expect to create most of the value from a deal. The only way to gain that focus is to set up an overarching discipline around value drivers.

The focus on value drivers should start early in the process. Acquirers should have a strong sense of the main cost savings and growth opportunities well before they ink a deal. A clean team, if used, can then validate or adjust the value drivers. (See *Powering Up for PMI: Making the Right Strategic Choices,* BCG Focus, June 2007, the first in BCG's series on PMI.)

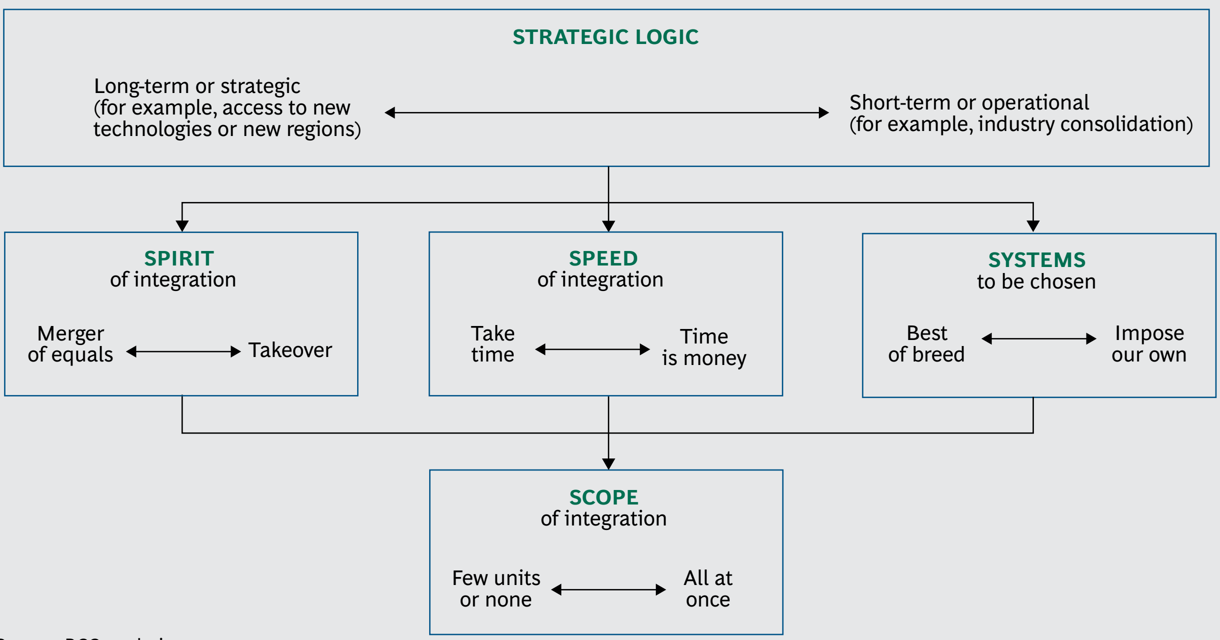
Once they understand the value drivers, organizations can determine what we call the *five* s's. The *strategic logic* for a deal: is it mainly about consolidation, growth, or in some cases both? The *spirit* of an integration: a takeover, or more of a merger of equals drawing on the best of both? The *speed:* how quickly does the organization need the synergies to start? The operating *systems:* choose best of breed or impose our own? And finally, the *scope*—integrate only a few units or just about everything all at once? Two deals with companies of similar size, for example, could have radically different integrations. (See Exhibit 4.)

Building a disciplined focus on value drivers means learning how to make those critical early decisions. Deals focused on cost reduction, for example, usually involve a quick takeover and consolidation of the entire organization around the acquirer's systems. If new revenue possibilities are the goal, by contrast, acquirers will want to proceed carefully and integrate on a case-by-case basis. In some situations they may even make the acquired company's practices the new standard. Project managers and the steering committees that oversee them need to be aware in advance of how different value drivers will determine different answers to the five *s*'s.

Only with that foundation can a company have the understanding and focus to turn what can be a bureaucratic process into a creatively organized, targeted integration that maximizes returns. That is what the midsize Australian bank, discussed above, found when it sought to reconfigure its offerings in order to better pursue fast-growing customer segments. Acquisitions were a major plank in that strategy. But its few previous integrations, all involving small purchases, were formulaic and process driven. As it geared up for its first big purchase, it wanted a better approach.

First up were the design teams, which had relied on detailed templates up until then. The company invested in training to get them to switch over to simpler, planning-oriented templates that focused on developing and testing hypotheses for how to find value in a merger. That change brought about a pivotal redirection in the design teams' efforts. They would have more work to do up front in an integration, because they would have to customize it according to the potential value drivers. They would also have to fine-tune their designs as the integration proceeded and as they learned more.

Exhibit 4 | The Five *S*'s of PMI Support Value-Driven Integrations



Source: BCG analysis.

In practice, however, the new approach also saved some time. Using the discipline of value drivers, the teams were less likely to be sidetracked by political debates over competing structures for the merged company.

As for the project management office (PMO), it used road-mapping software closely tied to the value drivers specified for each deal. Training to get project managers to work closely with the integration teams was equally important. Before, project managers had been fairly passive, waiting for reports and complaints to come in. Now they learned from the training to take initiative and not just wait for problems to bubble up; they took responsibility and communicated frequently with the teams. They got involved early when it came to items connected with value drivers.

Building PMI capabilities can have double benefits—greater confidence in delivering results and an expanded field of potentially attractive deals.

Some of the integration teams complained that their projects got a "code red" designation when things didn't really seem so bad. But the newly energized PMO was keen to get at problems when there was still time to adjust course. The PMO had made itself accountable for delivering on the value drivers.

From the outside, it looked as if the bank had merely fine-tuned its integration capabilities. But the new focus on generating value was transformational, and the investment in training and structures had yielded a team ready for larger deals. That gave the bank much more confidence to undertake what was likely to be a series of acquisitions in the future. The bank initiated this effort in the course of an actual integration, but the need to focus on the deal's value drivers applies just as well to standalone projects.

Expanded Options

Many businesses will continue to rely on acquisitions. They will find that they have an ongoing need to shift their portfolio of assets—divesting some and acquiring others. Deals, in many cases, may become more complex, and some will be transformative.

For some organizations, building permanent PMI capabilities will have double benefits. It will increase their confidence in their ability to successfully integrate mergers and acquisitions; and, by creating greater confidence in delivering benefits, it will expand the field of potentially attractive deals.

But fostering integration capabilities isn't just a matter of giving people a series of structures, processes, and templates along with training. Companies will want to time that effort to align with organizational needs. Integration teams also must start with a deep understanding of and discipline around a deal's value drivers. From there, they can make the hard choices necessary so that an acquisition delivers on its promise.

The business world already has plenty of uncertainty. Building up integration capabilities is a solid way of reducing some of the risk in acquisitions. The result will be greater value derived from deals, not just because of more thorough work but also because a prepared team can start earlier and realize the benefits of integration faster.

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