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Corporate Finance

The artful synergist, or how to get more value from mergers and acquisitions

Keeping your deal team small ensures confidentiality, but pinpointing synergies requires bringing more people on board. Here's how to strike the right balance.

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Making sure that large M&A deals create value is as much about knowing whom to involve—and when—as it is about knowing how to capture synergies.[1] The larger the deal, the more critical the need to ensure confidentiality by keeping the team small during the early stages of planning. Such teams may lack breadth, but they're sufficient to produce a rough valuation that allows planning to move ahead.

As planning progresses, more people eventually have to be involved. But many M&A practitioners make the mistake of clinging to too small a team late into the due-diligence stages of a deal. This overly conservative mind-set creates problems, leaving deal planners to perform their roles in isolation. Without others to challenge assumptions and cognitive biases,[2] the planners' synergy estimates, performance benchmarks, and cost and revenue targets can be off the mark. High-priority issues and complex integration challenges can get lumped together indiscriminately with lower-priority and simply managed ones—creating an adversarial, political, and highly emotional working environment. Business managers complain that their synergy targets are too high—when in fact, they often prove to be too low. And companies lose precious time as those tasked with implementing a deal try to reconstruct the expectations of those who planned it. That often squanders internal goodwill, organizational buy-in, and even hard cash.

A more inclusive approach to estimating synergies can create more value and promote a culture of shared accountability and buy-in. But pulling more people into the process requires an artful balance of often-contradictory objectives. Managers must promote both transparency and confidentiality, as well as embrace both skepticism and a shared vision, all while keeping a ruthless focus on efficiency.

A more inclusive approach to estimating synergies

As smart as many executives are about keeping their M&A teams small in the beginning,[3] they make the wrong trade-off as they get deeper into the diligence process. As a result, they lay out a framework for integration and develop synergy estimates based on the insight of a small, isolated team—without the buy-in they need from critical stakeholders. These include not just the executives who will carry the heaviest burden of integration execution but also the full complement of a CEO's direct reports.

In our experience, the diligence process can't happen in a vacuum. Synergies vary from deal to deal. Even a straightforward synergy target for general and administrative costs can vary significantly depending on the current state, the assumptions, and the appetite for change. Some functions, such as IT systems or human resources, can enable, delay, or completely prevent other functions from integrating, which renders synergy estimates meaningless. And functional leaders are often wary of committing to performance and budget targets they haven't seen before. Imagine the pushback from a manager at one acquirer when he learned he'd be expected to absorb a 40 percent cut in staffing—instead of adding people, as he had expected, given the complexity of the transaction.

Involving functional-group managers on a deal-specific basis can help, especially when framing the cost and revenue assumptions behind the valuation model for due diligence. These managers can help articulate the risks of cutting too deeply or too quickly, for example, or identify opportunities to build on an existing transformation program. And getting their input early on can create a shared understanding of the final synergy targets—even setting a higher cognitive anchor for them.

Such dialogue needn't take a lot of time. A few targeted conversations and a straightforward information request made over the course of a few short days can dramatically increase the level of insight. That was the case for one acquirer when it sought to buy a business in a deal that included transitional service agreements with its former parent. The acquiring company's CIO helped the M&A diligence team review the transition timelines, which shed important light on the associated costs and risks of the service agreements. Bringing the CIO into the process allowed her to get a head start on integration planning, which is critical for systems that enable synergies elsewhere. It also helped her accept the final synergy targets, even though they were higher than for other functions. Moreover, the dialogue between the CIO and the team revealed that the baseline costs of the transitional service agreements were unreasonably high—and the synergies could be higher if the business quickly transitioned to the acquirer's systems.

Many managers we've talked with find such dialogue to be so successful that they use it for all large deals, bringing most, if not all, top leaders into parts of the diligence discussion. Even for smaller deals, the company typically includes some subset

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of top leadership to validate costs and deal assumptions and to pressure-test risks.

Balancing competing objectives

The advantages of a more inclusive team doesn't mean extending an invitation to a cast of thousands. But it does come with risks—especially for larger deals. Not only is maintaining confidentiality more difficult, but larger teams also tend to move more slowly and are more likely to include skeptics who challenge a deal's strategic rationale. Balancing these interests tests managers' cleverness in finding the overlap between seemingly exclusive objectives.

Transparency and confidentiality

We have found it is possible to be both transparent and confidential. For example, the CEO of one serial acquirer balanced the two interests this way. First, she expressed a very clear perspective on the importance of large deals and the appropriate role of executives in evaluating those deals—creating a time and place for open dialogue and promoting explicit challenges to a deal's rationale. But then she made it clear that once a decision was made, everyone was expected to champion it.

As a result, the members of the executive team understood and respected their roles. They knew they would be engaged, and when, and they didn't second-guess the process. This engendered a sense of trust that they would be aware of all important M&A efforts and would have a chance to react to potential deals before any became final. Their trust was affirmed over time, with each potential deal forming the basis for confidential discourse. Finally, the CEO herself stressed confidentiality. She chose a core M&A team she trusted. But she also established explicit repercussions for leaking. In one instance, a senior executive was let go after it became clear he was disclosing information about potential deals in the works to people throughout the organization.

Skepticism within a shared vision

In our experience, few deals ever achieve a shared vision among the executive team. But proceeding without one can be destructive. Three months after the close of one recent deal, one senior executive launched an attack of his synergy target while explaining a shortfall in planned savings. Such exchanges were commonplace across the executive team. Later, the executive explained that the deal should never have been done in the first place and that he was worried about his career prospects after being involved in such a bungled deal.

For large deals, it is the CEO's job alone to ensure that his or her executive team has a shared vision for the deal. This sounds simple, but in most deals, we have observed at least several direct reports to the CEO remaining skeptical throughout. The CEO must sell his or her direct reports on the strategic merits of a deal, through conversation—often one-on-one—and through participation. There is no other way to form a productive team that will capture all the value possible from a deal. For smaller deals, similar obligations fall to division and business-unit heads.

Productive teams will challenge aspects of the deal, such as strategic fit and synergies. But they do so with a mind-set of trying to make the deal work and creating the best possible outcome. With that mind-set, even the most stubborn skeptics can actually help bring about a better outcome. We have observed a sort of peer pressure at play in these sorts of situations, in which dedicated leaders help reinforce commitment among each other and among lower layers in the organization. CEOs can encourage this mind-set by surrounding themselves with diverse backgrounds and promoting contrarian thinking and risk taking, often leading by example.

Building efficient M&A processes

The best acquisitions aren't the ones that close the fastest, but rather those in which the leadership team comes together to create the greatest amount of value. That takes time. To allow that time, a company must have ruthlessly efficient M&A processes.

To be efficient, companies must have a robust finance function with a transparent view into its own cost structure, the better to quickly interpret and categorize a target's costs. In one recent merger, for example, financial planning was led by two capable and respected executives, who in only three weeks managed to build a comprehensive and detailed combined baseline of performance across the two companies. Because they worked with executives across both companies to make sure they agreed with the baseline, the acquiring CFO was able to present synergy and financial targets for a dozen or so areas of the company less than a month into integration planning, three months before the deal closed.

This proactive approach allowed the leaders of each organization to apply their energies toward creating the leanest and most efficient organization they could, rather than iterating and debating the fact base and targets. The result was a process that was among the most efficient we have ever seen and that encouraged collaborative work across both organizations. We ultimately credit the acquiring CFO, who decided to invest in the right finance professionals to lead this effort.

Efficient M&A teams should also be able to learn from each deal. No set of best practices will ever replace the feel that great executives have for getting a deal done and getting value from it. This means an executive team must come together and review *how* past deals were done, not just *how much* they earned. And they must learn a bit of what others involved in the deal did, once that information can be shared freely in the light of day.

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Taking a more inclusive approach to deal making won't eliminate tension from your company's large M&A deals, and it won't turn a bad acquisition into a good one. What it will do is create the conditions in which your management team can artfully build a good deal into a great one. ■

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[1] Our focus is on large deals (more than 30 percent of the acquirer's size by revenues or market cap). Smaller deals are often different because they don't affect most areas of the business, are often focused entirely—or not at all— on cost cutting, and lack the leadership and organizational challenges of large deals.

[2] See, for example, Tim Koller, Dan Lovallo, and Zane Williams, "Overcoming a bias against risk," August 2012, McKinsey.com.

[3] Patrick Beitel and Werner Rehm, "M&A teams: When small is beautiful," January 2010, McKinsey.com.

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