



© Getty Images

Managing M&A in chemicals: Meeting the new challenges

The chemical industry is seeing a record level of M&A, higher multiples, and growing activist-investor activity. Chemical companies must strengthen their M&A and integration capabilities to ensure they create value in this environment.

Greg Gryzwa, Elisabeth Hirschbichler, Chantal Lorbeer, and Ulrich Weihe

Chemical companies have always used mergers and acquisitions (M&A) to grow, to change strategic direction, and to consolidate the segments they are active in. The industry has recently been seeing a major expansion of M&A activity, with the aggregated value of deals reaching an all-time high in 2016. But it's important to recognize that besides the expanded activity, a more complicated set of dynamics is at work. Prices and multiples are significantly up and deals are getting bigger and more complex to execute. And the rapid increase in “merger of equals” transactions is an important contributor to that complexity. At the same time, the stakeholder landscape is becoming more difficult to navigate, notably with the greater involvement of activist investors.

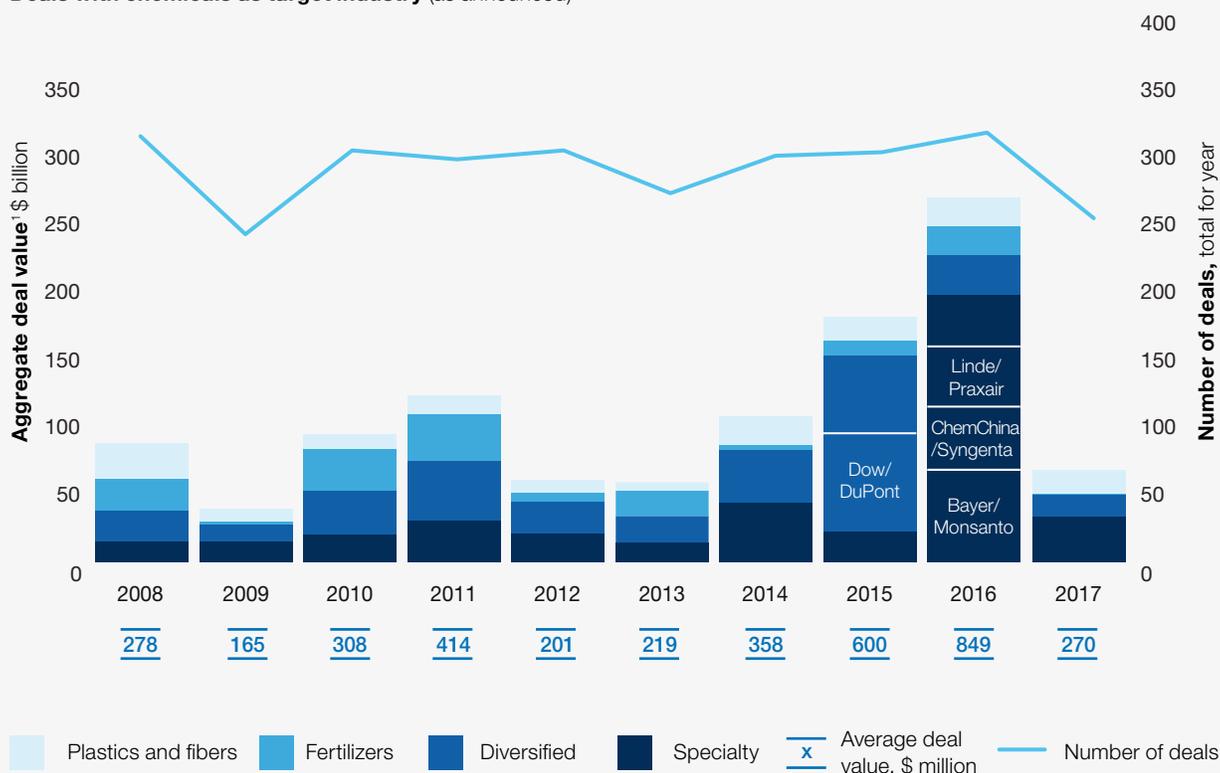
Chemical companies need, more than ever, to make sure that deals are creating value. In this article, we describe how chemical players can sharpen their capabilities in M&A and merger management to achieve just that.

Chemical industry M&A: More big deals, more complexity

Let's first review the current state of play in the chemical industry. The value of industry M&A globally has reached unprecedented levels in the last three years, with a handful of large deals taking the value of M&A in 2016 to the record level of \$260 billion, more than double the 2011 peak of the last cycle (Exhibit 1). The value of deals concluded in 2017 is down from the heights reached in 2015 and

Exhibit 1 Total M&A deal value in chemicals reached record heights in 2016.

Deals with chemicals as target industry (as announced)



¹Announced deals above \$10 million (excluding withdrawn or cancelled deals) for target chemical industry; for “merger of equals” the company with the smaller market capitalization was chosen as the target, with manual adjustments made possible by Dealogic to best reflect economics of the deal. Mergers are never recorded as a newly established entity acquiring each of the two companies separately and are never valued for the combined entity.

Source: Dealogic; McKinsey analysis

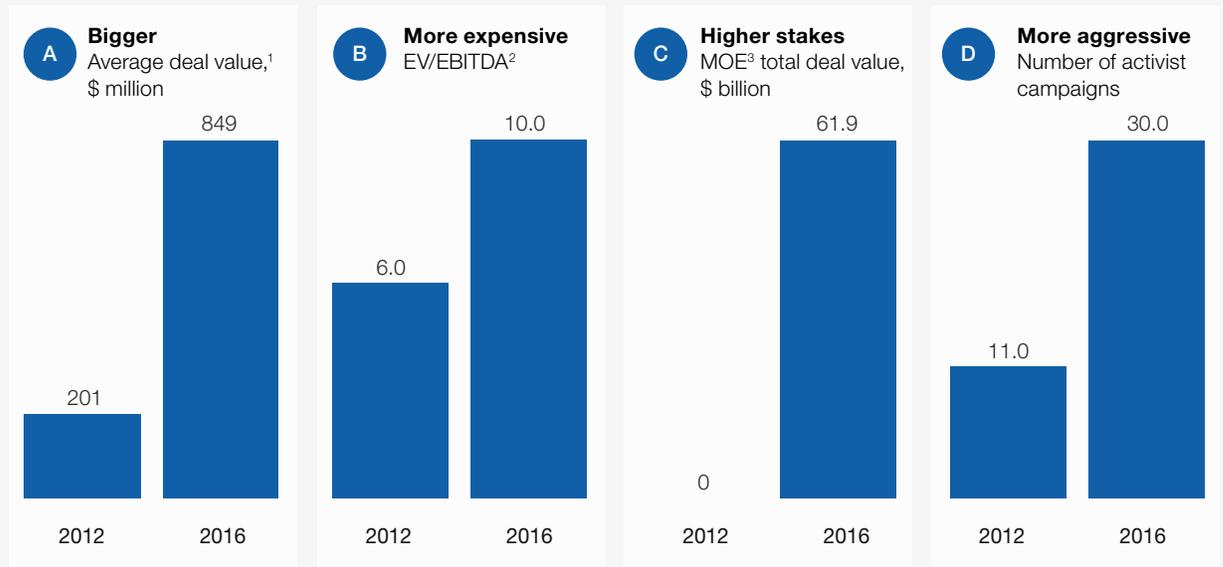
2016, but there continues to be considerable deal-making activity across the industry.

Several trends are behind the deal-making boom:

- The chemical industry has experienced a slowdown of organic sales growth in most of its subsegments and across most regions. As a result, many companies are considering M&A a necessity to secure higher growth.
- Pressure on margins caused by new entrants, lack of innovation, and diminishing opportunities to differentiate against competitors is spurring consolidation in segments that traditionally have been high in value creation, such as crop protection and seeds. But the trend is also touching a wider selection of specialty-chemical areas, including pigments, additives, and engineering plastics.

Exhibit 2

New dynamics have emerged in chemical-industry M&A—bigger and more expensive transactions, more ‘merger of equals’ deals, and a wave of activist-investor campaigns.



¹As announced.

²Enterprise value ÷ earnings before interest, taxes, depreciation, and amortization.

³Merger of equals.

Source: Dealogic; McKinsey analysis

- Many diversified companies have experienced sluggish capital-markets returns and are trying to focus their portfolios to capture the higher valuations that capital markets typically give more focused companies, particularly in specialties.
- CEOs don't want to miss the boat: in an environment where competitors are making moves and where capital is plentiful, leaders of companies tend to take bolder decisions on M&A, even if the immediate value-creation logic may not be obvious.
- Private-equity players with deep pockets, access to low-cost finance, and a track record of performance improvements are often acting as catalysts for

increased M&A activity. This has lifted valuations, and it also in effect doubles the volume of transactions through entry and exit moves.

What is happening in the chemical industry, however, is not just a matter of more large deals. A closer look at the nature of deals shows there has been a decisive shift in the dynamics of M&A over the last five years (Exhibit 2).

Prices are up significantly

These peak M&A conditions are reflected in the prices currently being paid. Multiples have risen, suggesting a sellers' market, and this has been particularly the case for small- and medium-size acquisitions, where prices are very high now.

Average multiples measured on the basis of enterprise value divided by earnings before interest, taxes, depreciation, and amortization (EV/EBITDA) have risen from eight to ten since 2010, led by specialty-chemical segments where multiples have increased by one-third since 2010, from nine to 12.

Merger-of-equals deals are rising

The number and size of merger-of-equals deals are increasing significantly. These types of deals could indicate that the days of pure portfolio shifts and add-on deals are waning, and that the industry is moving to an era of full-scale consolidation. Merger-of-equals deal making is driving consolidation in segments such as industrial gases, crop protection, fertilizers, and coatings, and it is taking consolidation in many sectors to unprecedented levels.

The activist investor is gaining influence

Activist investors have become increasingly important in the chemical industry. They have taken a significant role in the restructuring initiatives that sparked a number of major deals in the past five years, in particular activist-led moves to focus the portfolios of the industry's remaining large diversified companies. The number of activist campaigns in the worldwide chemical industry has more than tripled since 2010, from eight to 30.

The confluence of a high level of activity, high multiples, and the presence of activist investors and more merger-of-equals deals presents a new round of challenges for chemical company CEOs seeking to create value through M&A. What should they focus on?

The key to success in chemical-industry mergers

Our research shows that in deals where best practices in merger management are employed, total returns to shareholders are at least six percentage points higher than deals where these

practices are not implemented.¹ Based on our extensive experience across the industry, we believe there are a few invaluable and well-proven approaches that chemical companies can and should use to capture the full value-creation potential of their M&A moves.

Build a strong value-creation story and communicate it clearly

When drawing up the vision for the new company, top management should take full advantage of the discontinuities that are presented by the deal and be bold in its plans. A compelling deal rationale will focus on value-creation opportunities made possible by the deal, including a clear strategic view of where the new company is heading. The aim should be to capture the strengths of both companies and go beyond that to build a world-class entity. Unambitious compromises that just aim to keep the new combination operating will not resonate with shareholders.

The importance of communication in a merger is, in our experience, often underestimated in the chemical industry. The importance of this step has been made all the more clear by the higher-profile role taken by activist investors in recent deals they have deemed unsatisfactory: facing this, a compelling, ambitious, and clearly articulated value-capture plan may serve as “shark repellent.” At the same time, chemical companies can themselves learn from looking at deals through an activist lens, which can bring into focus what will be gained, presenting both the short-term benefits of the deal and also explaining its long-term value-creation promise.

Deliver the full synergy potential, and don't overlook the transformation potential

As simple as it may sound, truly understanding the full potential of the transaction is a decisive factor in making it work. The merger should be used to fundamentally review the new portfolio and

manage it for increased profitability and growth. The merger should also be used to open up for debate the new company's organizational structure and operations setup. The potential for savings and synergies should be examined on the following three levels:

- **Combining overlapping activities.** It is essential to first identify the savings that can be captured by combining the two businesses, looking at overlaps in product offering, customers and markets being served, and in technological capabilities and R&D projects. This review should also take regulatory requirements into consideration. These are the classic synergies.
- **Stand-alone improvements.** In all companies we have looked at, we have found potential for managing the company better. This potential could theoretically be captured without the deal taking place, but integration programs are well suited to triggering a holistic review of the performance of both parties being merged and to deploy best practices from either side, and they add significantly to the value creation of the deal.
- **Transformation.** The third step is to address transformational opportunities for the new combined company, with its broader product range and geographical reach, and combined competences. Such opportunities often include raising the bar for performance by building on the functional strengths of the two prior organizations and transforming NewCo into a world-class performer in areas such as operations, procurement, and sales and marketing. In one recent large chemical deal, a comprehensive review of manufacturing practices that was jointly undertaken led to substantial performance improvement on both sides, and to value creation well above estimates at the time the deal was signed.

Build best-in-class, end-to-end merger-management capabilities

Successful merger practitioners follow a disciplined approach. The importance of making an early start on preparing the merger-management process and shaping the integration strategy cannot be overemphasized: it makes it possible to move fast on capturing savings and to complete the integration within 12 months of closing the deal. Designing the integration should be tackled during the due-diligence phase of the acquisition. The integration program itself should be deeply woven into the deal rationale, with the setting of priorities for the merger program following on from the strategic and the value-creation logic of the merger. Decisions must be taken in advance on what to integrate, what not to, and at what speed.

As soon as the deal is signed, draw up a master plan—an integration road map that covers the most important design choices, particularly on the timeline and top-level appointments. If a company can accelerate preparations before day one of the new company's launch by using clean teams² and systematically planning how functional activities will be integrated, it will be able to immediately capture synergies. Transparency on performance metrics and effective performance management from day one is another essential component for success and should be applied in selecting candidates for appointments.

Choosing the leadership of the new organization and communicating it early in the process is another essential step, in alignment with progress on the deal's regulatory-approval process. Doing this enables those future leaders to shape their own organizations ready to launch effectively on day one, and ensures ownership of initiatives to capture synergies.

With the road map and leadership in place, immediately set up an integration infrastructure with a strong and dedicated management team. To do that, engage dedicated high-performance

people both at senior and junior levels from both companies. This integration-management team needs to oversee and coordinate the integration process on a day-to-day basis, including handling interdependencies across work streams, managing stakeholders, and communicating and tracking progress along the masterplan's critical path.

[Approach cultural integration with the same rigor as business integration](#)

Many mergers fall short of their full potential because of the failure to recognize and act upon cultural differences, or misalignment on management philosophies. In the chemical industry in particular, we have often heard management teams dismiss cultural integration as “soft stuff”—but this is a serious misconception.

Overinvesting early on cultural integration is crucial to truly bringing the companies together and capturing maximum value. Organizing events so both parties can undertake a mutual and appreciative discovery of each other is imperative, including operations visits and activity workshops. In all too many cases, we have seen the individual deal partners' management philosophies persisting in NewCo in an unaligned fashion, or found a perception lingering in the organization that one party has been the winner. We also recommend being sure to address head-on key differences in management practices and ways of working, and to overexplain to all employees the new ways of working and the rationale behind them.

What we have seen working well is a fully dedicated work stream that includes a comprehensive diagnostic of both cultures, identification of potential pain points, and includes rigorous communications work to resolve differences. Mutual discovery needs to play a key role in all work streams—both businesses and functional departments—to find the best of both worlds and to build the path forward together.

Acquiring a bolt-on business to bring growth brings specific challenges: it is essential to balance the rigor of integration with the need to preserve the entrepreneurial spirit and culture that the bolt-on brings. Otherwise, the acquirer runs a high risk of loving the new toy to death.

Our research shows that mergers with a dedicated effort focused on culture have a success rate that is three times higher than mergers where cultural integration has not been on the top of the agenda.

[Keep the business running](#)

Focus on the day to day: all the synergies that can be captured cannot make up for sales left on the table because management and the sales force were not paying enough attention to their customers. Make sure that undistracted attention is being devoted to customer relationships on both sides, continue to develop opportunities, and fulfill business plans right up to day one. This includes continuing to push forward already ongoing programs such as sales-force effectiveness and cost-reduction initiatives, since the benefits from such programs will also be essential components of the future company's success.

Avoid dis-synergies: an integration is always a time of uncertainty. Competitors will certainly seize any opportunity to poach your customers and your top-performing employees. Communicate early on to your customers the rationale and new value proposition of the combined company. Especially in cases when a long period of regulatory approval extends the date of closing, a clean team can help prepare the sales force to hit the ground running on day one with clear account plans and responsibilities, a view of the integrated portfolio, and the services the joint company will provide. This way you avoid losing ground in the weeks after day one.



Chemical company leaders face an unprecedented wave of deals where transactions are becoming more complex and more challenged from a value-creation point of view, and clearly need to further sharpen their merger-management capabilities. Embracing the five key elements outlined above can drive successful merger integration and lead to significantly higher value capture. ■

¹ See Rebecca Doherty, Oliver Engert, and Andy West, “How the best acquirers excel at integration,” January 2016, McKinsey.com.

² Clean teams are legally separate from the acquirer and target companies and operate outside the participating organizations prior to the closing of the deal, in ways that respect antitrust rules.

Greg Gryzwa (Greg_Gryzwa@McKinsey.com) is a partner in McKinsey’s New York office, **Elisabeth Hirschbichler** (Elisabeth_Hirschbichler@McKinsey.com) is an associate partner in the Vienna office, **Chantal Lorbeer** (Chantal_Lorbeer@McKinsey.com) is a consultant in the Munich office, and **Ulrich Weihe** (Ulrich_Weihe@McKinsey.com) is a partner in the Frankfurt office.

Copyright © 2017 McKinsey & Company.
All rights reserved.