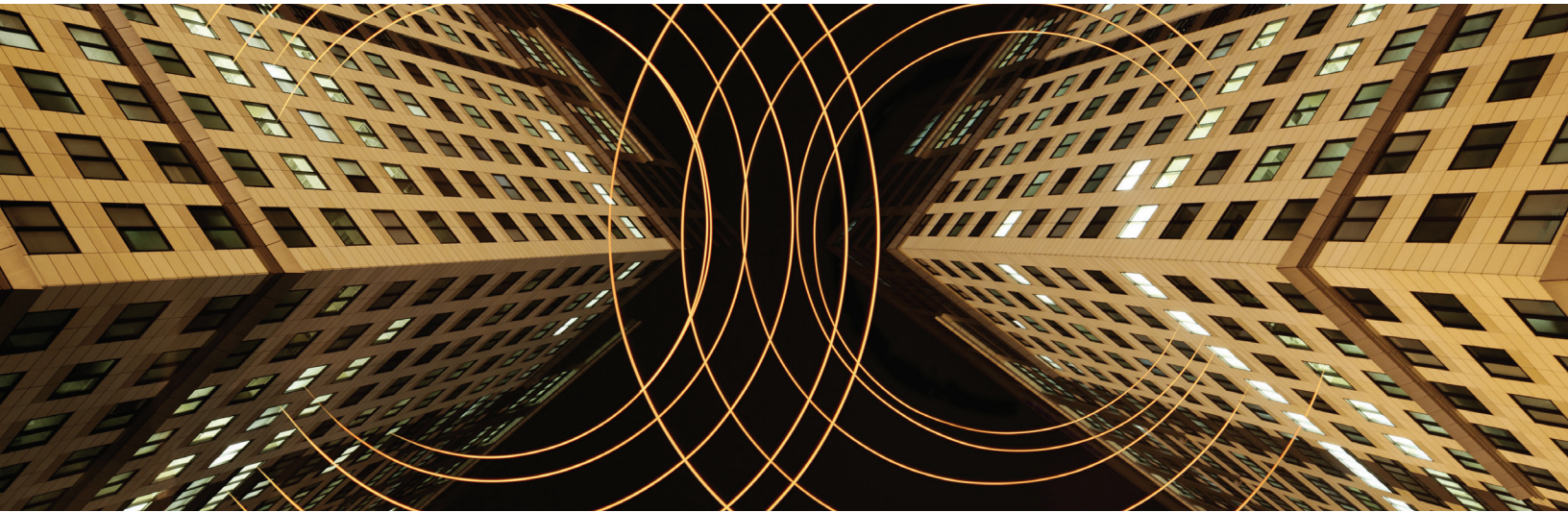


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CORPORATE FINANCE PRACTICE

# How the best acquirers excel at integration

The same handful of integration challenges vex companies year after year. New survey data suggest how high performers stay on top.

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Integrating merging companies requires a daunting degree of effort and coordination from across the newly combined organization. As the last step in an M&A process that has already been through many months of strategic planning, analysis, screening, and negotiation, integration is affected both by errors made in earlier stages and by the organizational, operational, finance, cultural-alignment, and change-management skills of executives from both companies. Those that do integrate well, in our experience, deliver as much as 6 to 12 percentage points higher total returns to shareholders (TRS) than those that don't.

The skills and capabilities that companies need to improve most when they integrate are persistent

and, for many, familiar. Grounding an integration in the objectives of the deal, bringing together disparate cultures, setting the right performance goals, and attracting the best talent are frequently among the top challenges that bedevil even experienced active acquirers.<sup>1</sup> They're also the ones that, according to our experience and survey research,<sup>2</sup> differentiate strong performers from weaker ones.<sup>3</sup>

## Ground integration in the objectives of the deal

The integration of an acquired business should be explicitly tailored to support the objectives and sources of value that warranted the deal in the first place. It sounds intuitive, but we frequently

encounter companies that, in their haste, turn to off-the-shelf plans and generic best practices that tend to overemphasize process and ignore the unique aspects of the deal.

Since the deal rationale is specific to each acquisition, so is the integration approach, and it's important to think through the implications of the deal rationale and the sources of value for the focus, sequence, and pace of the integration. Consider, for example, the experience of two companies where R&D was a primary source of value for an acquisition. After prefacing their integration plans with a close review of their respective objectives, they each took a different approach to integration.

For the first, a technology company, the objectives of its deal were to build on the acquired company's R&D capabilities and launch a new sales channel in an adjacent market. Extrapolating from those objectives, the integration managers designed the integration around three core teams for R&D, sales, and back-office consolidation. By prioritizing these areas and structuring groups to tackle each one, the company ensured the proper allocation of talent, time, and management attention. Specifically, steering-committee time was regularly dedicated to these issues and ensured a proper focus on the areas likely to create the most value. As a result, the team quickly launched cross-selling opportunities to similar customers of the acquired company and deployed resources to accelerate ongoing development and merge R&D road maps.

The deal objectives also shaped the sequence and pace of the integration. On a function-by-function basis, managers determined where to accelerate, stage, or delay integration activities, by considering which created the most value while sustaining the momentum of the integration. Hence the company prioritized must-have functional areas to ensure compliance and business continuity—for example, ensuring that the finance group was ready to

support month-end close procedures—and accelerated value-creating activities in sales and R&D. Year-on-year revenues were up well over 10 percent as of the last quarter for which figures were available.

In the second company, a key player in the pharmaceutical industry, R&D again was a primary source of value. But because the acquired biopharmaceutical business was in an emerging area that required different capabilities and entrepreneurial thinking, the acquiring company's managers decided that the acquisition's culture and processes would be a critical aspect of its value. While they would reevaluate whether to integrate more fully once products cleared development and were ready for market, they decided that it would be best in the short term to integrate only select back-office functions to take advantage of the combined company's scale. They would ensure the proper linkages with legal, regulatory, and financial-compliance activities, but to protect the target's business momentum, the acquiring company's managers allowed the target's managers to retain their local decision rights. The acquirer also provided resources, such as capital, to help the business grow—and rotated managers into the business to learn more about it and its market.

### **Tackle the culture conundrum**

Culture isn't about comparing the mission and vision of two companies—which on the surface can often appear very similar. And culture is much deeper than a good first impression, a sense that you share the same values, or the more trivial practices of, say, wearing (or not wearing) jeans on Fridays. Instead, the essence of culture is reflected in a company's management practices, the day-to-day working norms of how it gets work done—such as whether decisions are made via consensus or by the most senior accountable executive. If not properly addressed, challenges in cultural integration can and often do lead



to frustration among employees, reducing productivity and increasing the risk that key talent will depart, hampering the success of the integration.

Companies often struggle to assess and manage culture and organizational compatibility because managers focus on the wrong things. Too often, they revert to rites, rituals, language, norms, and artifacts—addressing the most visible expressions of culture rather than the underlying management practices and working norms. Managers often return from initial deal interactions convinced that the cultures of the companies involved are similar and will be easy to combine.<sup>4</sup> As a result, they almost always apply too few resources to the cultural side of the integration, often leaving it to human resources to lead.

For cultural integration to be successful, employees must view it as core to the business. That may not happen if business leaders are not visibly leading and prioritizing the cultural integration. Culture is also difficult to address because it permeates an organization—spanning levels, geographies, and organizations. Therefore, addressing it just at headquarters or a few key sites is insufficient; real cultural integration needs to be addressed in a distributed fashion across geographies and at all levels in the company. It should also be treated seriously at all stages of the acquisition process: due diligence, pre-close integration planning, post-close integration, and ongoing operations.

For example, in one healthcare deal, the acquirer began its assessment of culture during the due-diligence process. Managers took an outside-in look at the likely culture of the target company and used this input to shape the initial approach to due diligence, top-management meetings, and initial integration planning. They even used the insights for more tactical decisions, such as limiting how many people attended initial meetings. Specifically, rather than bringing dozens of finance professionals to assess synergies, the company started with a smaller group to understand the target better. Then, at the integration kickoff, they built in an explicit discussion of working norms, so integration leaders could begin identifying, understanding, and addressing some of the differences head-on.

Maintaining the momentum of cultural integration well into the integration process is equally important. In an integration of two European industrial companies, managers identified and evaluated ten potential cultural goals as joint areas for improvement, joint areas of strength, or areas of difference. The managers weighed these potential goals against the sources of value in the deal, deciding to focus on four that were most closely linked to this value and that struck a balance between areas where the two companies were similar, as well as areas where they were different. Quickly achieving the benefits of their similarities created the momentum and trust required for addressing many of the thornier issues the managers faced. To ensure that cultural integration would be linked to and led by the businesses, not just by human resources, the company assigned a senior-executive sponsor from each business to tackle each goal. Every sponsor then created and implemented a plan that managers could monitor well past the close date and into ongoing operations—including specific consistent metrics, such as achieving a certain score on an ongoing employee survey.

## Exhibit 1 Companies face challenges in translating sources of value into synergy targets.

% of respondents (n = 1,841) who “strongly agree” or “agree” that their companies have each integration-related capability



Source: McKinsey survey on global M&A capabilities, May 2015

### Translate sources of value into quantifiable performance goals

The results of our global M&A-capabilities survey suggest that companies are significantly better at identifying sources of value than they are at translating those sources of value into quantifiable performance goals (Exhibit 1). The explanation is intuitive: understanding the theory behind how two companies can come together and brainstorming revenue-synergy opportunities are exciting, but operationalizing the ideas is more complicated.

Companies find this work to be challenging. The value-creation process requires setting a granular baseline; setting targets; putting together detailed, milestone-driven plans; making tough decisions and trade-offs; and visibly tracking progress over time. The first step alone is daunting, since setting an objective baseline requires an apples-to-apples comparison of each company's costs and revenues, and that means preparing financials in a way that's usually foreign to both the acquiring and the target company.

One best practice we observe is that managers, before setting detailed performance goals (and the actions to achieve them), update expectations

on synergies after the due-diligence phase by looking more broadly at capital productivity, revenue enhancement, and cost efficiency, as well as transformational opportunities. By this point, the acquirer will know a lot more about the target than it did during due diligence and may even have a different purpose and mind-set. In fact, in our experience, the best acquirers revisit value creation in a very formal way several times during the integration, both encouraging and resetting the expected synergy results to higher and higher levels.

To do so, managers at one industrial company brought key employees from both sides of the deal together in separate cost and revenue value-creation summits, where they were tasked with identifying bottom-up opportunities to meet the aspirational goals that had been set top-down. These summits were staggered, with costs coming first, followed by several rounds on revenues. The first summit, held before the deal closed, focused on only headquarters costs—the most immediate cost synergy of the deal. During the summit, the participants—a mix of subject-matter experts, finance specialists, and members of the core value-creation integration



team—brainstormed ideas and crafted initiatives to achieve performance goals endorsed by the CEO. Managers later held revenue value-creation summits in the countries with the greatest opportunities, holding each country leader accountable for regional targets. By creating a space away from the day-to-day business to brainstorm ideas, summit managers set a tone that encouraged collaboration and promoted creative thinking. Coming out of the summits, managers understood who had accountability for which targets and initiatives, and how progress against targets would be visible to the most senior executives of the company.

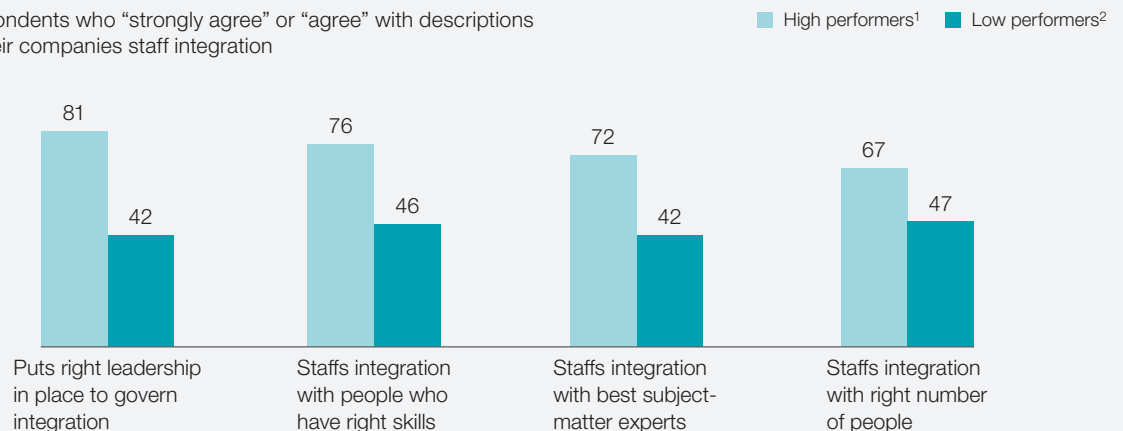
### Promote until it hurts

Compared with other stages of M&A, integration is where companies perceive their capacities and capabilities to be the most deficient. Survey respondents were 12 to 18 percent less likely to report

that their companies had the right capacities for integration than for any other M&A activity, and were 12 to 19 percent less likely to report that they had the right capabilities. This is probably because integrations require so many people with such diverse capabilities for a substantial period of time. Most companies have at least a few leaders who fit the bill, but some companies find it difficult to task enough people for an integration. That makes it challenging to build the right integration team with top-notch players—though this is one area where high-performing companies across the board distinguish themselves. Overall, respondents at 76 percent of high performers surveyed report that they staff an integration with people who have the right skills, versus 46 percent of respondents at low performers. The contrast is even starker in staffing different aspects of the integration with the right talent (Exhibit 2).

## Exhibit 2 Companies that meet or surpass their M&A objectives are more effective than others at staffing integration.

% of respondents who “strongly agree” or “agree” with descriptions of how their companies staff integration



<sup>1</sup> Companies where respondents to a survey on global M&A capabilities report that those companies have met or surpassed their cost- and revenue-synergy targets in their transactions (n = 464).

<sup>2</sup> Companies where respondents report that those companies have achieved neither their cost- nor revenue-synergy targets in their transactions (n = 302).

Source: McKinsey survey on global M&A capabilities, May 2015

From a CEO's point of view, it can initially appear risky to move a top performer out of the day-to-day business and into integration. In some cases, key business leaders should be kept running the business, but in others, there is an opportunity for companies to backfill the position and move a high performer into integration. If it's not a hard personnel decision, it's probably not the right one. There are instances where we see companies do this well. In one retailer, a top-performing business-unit head was assigned to lead the integration full-time. In a medical-device company, a celebrated COO was relieved of his day-to-day duties and appointed lead manager of integration.

Moreover, uncertainty about the career implications for employees can make it difficult to attract the right talent, since employees may be hesitant to move into an integration role they see as a temporary gig. To address this, managers of one global diversified food company assigned a midlevel manager to run a multibillion-dollar integration, hoping it would prove his potential to be a business-unit leader. Eighteen months later, they elevated him to the leadership of a business unit. The visible career trajectory of this individual helped elevate the perception of integration roles for subsequent acquisitions. Integration is increasingly perceived as a career accelerator, which is attracting more talent within the organization to integration. In another example, a major technology company takes this even further and makes rotations through material integrations a prerequisite to becoming a company officer.



High-performing acquirers understand the complexity and importance of getting all aspects of integration right. Companies that apply best practices tailored to deal objectives have the best chance of delivering on the full potential of the deal. ■

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<sup>1</sup> An annual barometer of more than 700 integration managers attending Conference Board's Merger Integration Conference since 2010 identifies similar needs year after year.

<sup>2</sup> Rebecca Doherty, Spring Liu, and Andy West, "How M&A practitioners enable their success: McKinsey Global Survey results," *McKinsey on Finance*, October 2015, mckinsey.com. The online Global M&A Capabilities survey was in the field from May 19 to May 29, 2015, and garnered 1,841 responses from C-level and senior executives representing the full range of regions, industries, company sizes, and functional specialties.

<sup>3</sup> "High performers" are defined as companies where respondents to the Global M&A Capabilities survey report that their companies have met or surpassed cost- and revenue-synergy targets in transactions (n = 464). "Low performers" are defined as companies where respondents report that their companies have achieved neither cost- nor revenue-synergy targets in transactions (n = 302).

<sup>4</sup> Oliver Engert, Neel Gandhi, William Schaninger, and Jocelyn So, "Assessing cultural compatibility: A McKinsey perspective on getting practical about culture in M&A," in *Perspectives on merger integration*, McKinsey & Company, June 2010, mckinsey.com.

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