Post-Merger Integration: Doing the Right Deal and Doing the Deal Right

The business environment for the utilities industry has changed. New players are entering the marketplace as technological and regulatory barriers are overcome. Many energy companies are looking to mergers and acquisitions to thrive in the new marketplace. Finding the right merger or acquisition target is only half the battle – fully integrating all business processes into a combined, efficient organization will determine success.

The energy industry is in the midst of its most challenging period in more than three decades. The rapid convergence of the power industry, telecom-like deregulation, the confluence of the Internet and improved energy technologies have set the stage for massive industry changes and allowed space for new players in the marketplace. Energy companies are looking to mergers and acquisitions to obtain critical mass, exploit economies of scale, enter new markets, and/or diversify in an environment that is increasingly competitive.

While changes in technology and deregulation have lowered the barriers to entry, they have also increased the number of mergers and acquisitions as companies seek to increase anticipated synergies. “Synergy” is popularly cited as a prime reason for planning mergers. It is implied that “efficiencies” and “growth” will naturally occur when two companies merge to create a new entity. Merger results, however, continue to be disappointing. Most often, the anticipated synergies fail to materialize.

Analysis conducted by PricewaterhouseCoopers shows that over half of the announced utility mergers since 1997 have failed to increase shareholder value post-merger. Other industry surveys have resulted in similar observations; 58 percent of mergers failed to reach goals set by top management and 78 percent of mergers were mistakenly driven by fit instead of vision.

The reasons for these disappointing results include: poorly defined strategic motivations for doing the deal, regulatory issues that do not receive enough attention, overpaying, inadequate transition planning in pre-closing, and integration problems after the deal is done. Based on our extensive experience in mergers and acquisitions and post-merger integration, PwC has developed a five-phase approach to the merger lifecycle – strategy through implementation and monitoring. We have identified ten potential pitfalls to avoid in these merger-lifecycle phases – the source of the majority of M&A failures. This article will focus on these pitfalls and what can be done to avoid them.

Real success in energy M&A demands a value-creating approach to activities throughout the M&A lifecycle. As mentioned, we have organized this lifecycle into five phases:

1. **Strategy Development** – Involves developing your company strategy and understanding the role of M&A to help realize it. The focus here is on “Doing the Right Deal.”

2. **Transaction Support** – Focuses on target evaluation, due diligence, pricing, and the beginning of integration planning activities. It is the concluding phase to determine if you are doing the right deal and the beginning phase of “Doing the Deal Right.”

3. **Integration Planning** – Entails forming an integration program-management office and integration transition teams. It also entails developing the merger “blueprint” and business model, 100-day plans, and detailed work plans that address expected benefits associated with timing, responsibilities, savings, costs, and identifying risk mitigation.

4. **Implementation** – Implements the actions developed in the planning phase to merge the companies and realize benefits.

5. **Monitoring** – Uses key performance indicators (KPIs) for risk/performance management. Monitoring programs address the status of the integration program actions to determine whether they are on track and if the strategic intent is being realized. KPIs also include business measures (EBITDA, ROCE, customer service performance, reliability, inventory turns, safety, etc.) to help manage ongoing performance for the combined company.

However, the merger team may encounter numerous risks along this lifecycle. We discuss 10 of the more common pitfalls that occur in M&A transactions and categorize them roughly under

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the lifecycle phase where they are likely to be experienced.

**Strategy Development**

**Poorly Defined Vision, Strategy, and Goals**
M&A is a tool to help energy companies implement their strategy—it is not a strategy in itself. The corporate vision and strategy should be clear to ensure that M&A is one of the right means to reach the goals. The leadership should be prepared to answer why they are using an M&A deal to reach its objectives and why this particular deal will enable it to do that. As the company proceeds through the merger lifecycle, a clearly-articulated vision, strategy, and specific goals will serve as the critical framework for merger-integration planning. As the goals are set, care should be taken to develop an appropriate incentive plan that rewards the desired behavior in the new company for supporting the strategy.

**Poor or Incomplete Regulatory Review**
Understanding the regulatory process for a particular deal and developing an appropriate strategy is another key component of the process, especially in the fast-changing utility regulatory environment. Without the appropriate approvals, most deals will not get far. Witness the recent GE-Honeywell deal, the failure of which many attribute to GE’s underestimation of the regulatory review process and the requirements to get the regulators on their side. This is especially important, because the increasingly global scope of energy deals require a deep understanding of regulatory agencies in multiple jurisdictions.

**Transaction Support**

**Incomplete Definition of Business Model**
There is no cookie-cutter answer to the business model for the planned combined company, but the model will define the blueprint as to how the corporate strategy will be operationalized. The following questions need consideration and will require clear answers from the merger integration teams:
- What is the vision for the combined company’s operations?
- What will be the role and responsibilities of Corporate?
- Will there be a holding company model or will Corporate be actively involved in business unit operations?
- What will be the specific roles and responsibilities of the business units? How will they be measured? Who/who will be the decision-making authority?
- How will business services be provided—individually or through shared services?
- Which operations will be integrated and, most importantly, which will be left alone?
- What will be the business processes through which the company will operate?
- What will be the organization and legal structure?
- How will performance be measured?

**Insufficient Due Diligence**
Companies should invest in due diligence to avoid this pitfall. The due diligence teams should be instructed to uncover all the proverbial skeletons in the closet. Once identified, the acquirer may consider linking price and contract terms to key areas for protection and proper pricing. The key focus in this area should be to ensure the right price is proposed and to eliminate surprises so that management can make go/no-go decisions based on verifiable facts. Due diligence should go beyond just the basic financial analyses of cash flows, earnings, etc. and include—but not be limited to—reviews of tax structures, IT framework, process-related costs, regulatory and environmental issues, trading risks, and contract liabilities, to name a few.

**Integration Planning**

**Organization and Integration Plans not Aligned with the Business**
Establish a strong, central program management office and a merger checklist early-on to help manage the integration process. This group should be responsible for coordinating and consolidating integration team results and can help identify inconsistencies with the strategy and business model. The Program Management Office and integration teams should have a point of view that will drive the combined business to new levels of performance through the application of best practices. Simply put, the teams should go beyond merely facilitating the process and seek to apply a fresh approach to empowering the new combined company.

Furthermore, the leadership should be as specific as possible when defining the planned synergies, the timing, and the expected benefits. Ownership should be defined clearly and delivery should be built into the responsible executive’s performance plan. Since the old adage “you get what you measure” applies, we suggest a solid tracking program that uses a balanced scorecard to measure and monitor progress and results through the CFO’s organization and the program management office.

**Insufficient Focus on Speed of Integration**
Strike while the fire is hot. Increasingly, the marketplace expects to see improved performance in shorter and shorter timeframes, and thus speed of integration is important in creating shareholder value after the merger. The team should move rapidly while the momentum of the merger is fresh in order to drive changes in the organization. The farther one gets from the merger date, the more difficult change typically becomes. A good rule-of-thumb is that the new entity will make most of its progress in achieving merger-related synergies during the first year of the merger.

Change management and the cultural aspects of a merger are critical as well. The desired behaviors for the new company should be clearly defined and backed up with a solid performance management system, which include measures, rewards and incentives that support the desired strategy and results. The human resource dimension and cultural differences of two companies, which are often overlooked, should be assessed and a plan developed and implemented to support the business strategy.

**Cherry Picking Systems**
The information systems strategy needs to be driven by the business and operations strategy. Systems need to be selected based on meeting business needs and through a business case. The time and expense of integrating IT systems after a merger are often vastly underestimated. The merger team must not address IT and process issues late in the process, but rather up front so that there will be a realistic view of what IT integration means. IT should not develop the plan in a silo. Rather, the IT strategy and plan should

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be developed with cross-functional teams drawing resources from across the business to ensure business needs are met. Success in IT integration can be a significant source of value creation, or if done wrong, a source of value destruction.

### Implementation and Monitoring

**Unfocused and Incomplete Efforts to Mitigate Risks and Track Performance**

The governance and decision-making structure for implementation must be clearly defined as the team proceeds through integration planning into implementation. The integration teams will need to identify potential risks, and most importantly, how they will be mitigated. The focus should be on finding a solution and the Program Management Office should monitor and manage these as part of the merger integration process.

**Poor Communication**

“Poor communication” is the phrase one does not want to hear during the course of a merger. Communication is one of the most critical components of the change-management process. Lack of employee commitment and understanding has been shown to be a barrier to integration. A robust communication plan and strategy for the merger lifecycle that is targeted to stakeholder groups – shareholders, employees, regulators, customers, and communities – must be developed. The right resources must be dedicated to this effort and all communications should be managed through the Program Management Office. Messages that need to be conveyed, as well as when and how they are conveyed, are among the key components of a solid communications strategy and the beginning of the change management strategy. It is especially important to have key messages communicated from the top, including for example, strategic rationale, vision for the merged companies, and expected benefits and synergies.

**Don’t Lose Focus on the Business and the Customer**

Depending on the size of the merger, the process will likely require significant top management attention. But, this is the same senior management team that is also needed to run the business and serve the customers. It’s easy to lose sight of this basic fact while planning and implementing a merger. Depending on the size of the merger, the process will likely require significant top management attention. But, this is the same senior management team that is also needed to run the business and serve the customers. It’s easy to lose sight of this basic fact while planning and implementing a merger. Assigning a trustworthy executive to lead the integration effort through the Program Management Office full-time, who is supported by full- and part-time merger integration teams, will enable senior management to do both. It will be their responsibility to develop a merger integration plan that aligns with the strategy. Furthermore, the selected executive will be responsible for ensuring the involvement, input, and approval of the line executives who are responsible for day-to-day business operations. Otherwise, it will be impossible to manage properly and merge at the same time.

Within the next five to 10 years, energy companies in the United States and Europe will consolidate as deregulation and competition for greater growth continue. The ultimate outcome of these mergers will depend on the success of the merger integration team. This will be even more critical in the case of cross-border deals, where cultural, financial, technological, and regulatory issues will pose an even more complex challenge than in same-country mergers. For a merger to be truly successful, growth – and complementary cost savings – must be demonstrable. It should follow from a long-term, growth-oriented unified business vision. The companies that best apply the time-tested strategy development and post-merger integration techniques, which will methodologically avoid the highlighted pitfalls, will be the ones that achieve the synergies and growth that they originally anticipated. The others will simply become tomorrow’s textbook case studies of failed mergers.