

Post-Merger Indigestion

Incomplete integrations can be hazardous to your company's health

Spectrum

Spanning the realm of business issues and solutions

Post-merger indigestion (n.): an insidious malady common among serial acquirers that fail to fully absorb their acquisitions. Initial symptoms include rising costs, unclear reporting relationships, technological inefficiency, and marketplace confusion. The sufferer experiences shrinking margins and lower revenue gains with each additional transaction. If left untreated, the syndrome can lead to a spectacular loss of profitability and revenue, usually after the patient makes one acquisition too many. As with most systemic ailments, prevention is highly preferable to often difficult, costly, and uncertain attempts to cure.

What's worse than the complicated, expensive, resource-intensive, stress-filled process of integrating a newly merged or acquired company seamlessly into your own? A multi-layered, enormously complex behemoth of a business in which costs keep rising, margins keep shrinking, and everything keeps taking longer and longer to do. Unfortunately, that's just what can happen to acquisitive companies that don't stay ahead of their post-transaction integration needs.

Not every acquisition needs to be completely integrated, of course. Depending on your acquisition strategy, you may choose to integrate a company to a greater or lesser degree based on the reasons you acquired it and your company's business model. The problems arise when a company makes the strategic decision to integrate as completely as possible – say, to realize economies of scale or maximize operating synergies – but, for one reason or another, doesn't quite achieve that goal.

It's not that companies deliberately set out to leave integrations undone. But even the most far-sighted integration projects can fall prey to powerful external and internal pressures that prioritize speed, risk avoidance, and immediate cost synergies over the need to make long-term business investments. Wall Street wants speed. Investors want savings. Customers want uninterrupted service of pre-transaction quality or better. Under the circumstances, it's understandable that cheaper, faster solutions that are good enough to meet immediate needs often get the nod over more time-consuming, expensive, though ultimately more robust approaches.

But companies that persist in this pattern are living on borrowed time. With each new acquisition, the business becomes more complex and more difficult to navigate. Undigested remnants of legacy processes, systems, products, and functions hamper efficiency and create unexpected problems. Eventually, the business becomes so complex that almost every process and initiative costs more, takes longer, and yields worse results than they would at most other companies of similar size and scope. That's when alert competitors, unhappy customers, and frustrated investors can nudge an already weakened organization toward a significant tipping point.

The downward spiral isn't inevitable, though. As an executive, you can help your company escape it in the same way you'd address any other ongoing business challenge: by taking the issue seriously, evaluating your situation, and taking steps to fix current problems and minimize future ones.

One Company's Approach

One company's aggressive growth-through-acquisition strategy made it one of its industry's largest players in just a few years – but also left it with hundreds of accounting locations around the world using hundreds of different financial systems.

This situation created two significant problems. First, the long-term operating cost of maintaining all of the different locations and IT platforms was clearly not sustainable. Moreover, the variability in the company's accounting processes and platforms would have made compliance with the Sarbanes-Oxley Act of 2002 a crushing cost and resource burden.

Fortunately, management recognized the issue in time to launch a worldwide initiative to standardize the company's financial processes and systems. The company is now consolidating its accounting locations and systems into a network of country and regional shared service centers that will use a common software platform. When completed, the project is expected to cut ongoing administrative costs in half and to significantly improve the company's Sarbanes-Oxley compliance capabilities. In addition, the company expects the greater process standardization and increased operational visibility to improve its overall business performance.

Performing the Checkup

One reason business leaders may overlook the dangers of excessive complexity is the "stealth" nature of both the problem and its consequences. Because no single acquisition is usually to blame, and because growing complexity does most of its damage through an overall dampening effect instead of through obvious emergencies, executives may not even recognize the danger until they suddenly face an unavoidably huge operating expense or realize that the latest transaction is destroying value instead of creating it.

Fortunately, catastrophic failures rarely happen without some kind of warning. Here are some of the signs and symptoms of acquisition-driven complexity that can alert you to the need for action.

Symptom 1: A highly matrixed organizational structure

There are several good reasons to have a matrixed organizational structure. However, trying to satisfy every stakeholder in a post-transaction integration isn't one of them. If your company is cross-cut by multiple

organizational classifications that don't have a clear business rationale – especially if those categories reflect the way prior acquisitions were structured – that's a strong tip-off that your business may not have integrated those acquisitions to an optimal degree.

The reason unnecessary matrices are so common among poorly integrated companies is that they're a seductively convenient way to minimize the political hassle of combining two differently structured organizations. But an organizational structure driven by convenience instead of by strategy is likely to do a company more harm than good. So when you integrate acquisitions, do the extra work to figure out the most appropriate structure for the combined entity. You may need to have some uncomfortable conversations, but you'll save yourself potential problems downstream.

Symptom 2: Multiple disparate technologies, and/or multiple instances of the same technology, without a compelling business reason for the variety

The thought of spending massive amounts of time and money to standardize your company's IT systems is never a pleasant one. But if you don't do it at some point, you could end up with dozens or hundreds of mutually incompatible systems. Papering them over with middleware may let you view adequate summary data, but middleware doesn't allow for the detailed analyses needed to inform business decisions. What's more, the need to maintain multiple systems and upgrade multiple instances can be a huge drain on the company.

To be fair, most people realize that unnecessarily disparate technologies spawn all sorts of inefficiencies and data-

management issues. The problem is how to balance the company's post-transaction need for speed and cost containment against its long-term need for IT interoperability and efficiency. One approach might be to use a "down" period between acquisitions to develop an enterprise-wide IT governance structure that continually monitors current and future standards. This governance process can then be invoked to help develop a strategy for integrating each new acquisition's IT systems in a way that supports the consolidated entity's direction.

Symptom 3: Products or services that duplicate each other in the marketplace, and/or parallel development of duplicative products or services

A business should compete with itself only by choice, not by accident. Knowing this, companies make product/service rationalization a central part of every full-blown integration project. But just because your integration teams report that everything's rationalized doesn't mean that you've necessarily arrived at an appropriate product/service mix.

Consider what can happen when two essentially identical products, one made by the acquirer and the other by the acquiree, each live in one of those virtual "fiefdoms" that crop up from time to time in any organization. The walls of the fiefdoms can be so high and so hard to break down that the integration team gives up trying to merge them. Each side offers a host of reasons for not discontinuing its own product: the company would lose market share, the product targets a niche that the other product doesn't, and so on. Because many of these reasons are factually true, integration teams can easily overlook the possibility that maintaining both products may not work for the business as a whole.

Getting past this kind of territoriality takes two things: an enterprise-wide view of the combined company's strategic goals, and the power to make and enforce potentially unpopular decisions. Therefore, it's important for the integration leader to be a senior executive with enough authority to negotiate among and, if necessary, overrule warring factions.

Symptom 4: Overlapping and/or suspiciously numerous vendor/supplier relationships

If your company has a reasonably well-enforced vendor/supplier policy but still has many more vendors and suppliers than you'd like, the culprit may be a long history of less-than-optimal post-transaction rationalization efforts. Even though your business units may comply with all of your company's procurement guidelines, the guidelines by themselves can't always tell you which relationships are truly necessary and which you'd be better off consolidating.

To address the issue, you may need to dig deeper into your business processes to see where and why the duplications arise. If incomplete integration is a source of the problem, you'll probably uncover some unnecessary process variations driving the use of multiple vendors. You may also find that the integration project missed some opportunities for vendor/supplier consolidation. Sometimes, fractured IT systems may keep different business units from knowing who's supplying what and taking advantage of economies of scale.

The same sort of territorial dynamic that arises during product/service rationalization can also interfere with effective vendor/supplier rationalization. Here, too, the integration leader plays a vital role in settling conflicts of interest, personal

discomfort notwithstanding. If there isn't a legitimate business reason for a group or unit to have a unique supplier, don't let it happen, no matter how many arms you have to twist.

Symptom 5: Increase in the use of temporary help

It's not unusual for companies to have a certain baseline percentage of temporary employees in a variety of roles. But if temps are starting to appear in unusually large numbers, it could be a sign that your company is getting too complicated for its own good. Why? Because the more complex a business becomes, the more work it takes to keep it running smoothly – and most of that extra work tends to fall between the cracks of the company's "official" job descriptions and organizational roles.

Compounding the problem, the cost pressures experienced by overly complex companies often lead to strict caps on departmental headcount, whether or not the allotted number of employees is enough to do the work. Hiring managers may turn to temporary employees simply to avoid leaving important tasks undone. Depending on the way the company is organized, a hiring manager may not even need to pay for the temporary worker out of his or her own departmental budget – which gives him or her an easy way to address the department's staffing problem, but only at the expense of the rest of the business.

Temporary help, in short, can be an attractive band-aid for a wide range of underlying process inefficiencies and unnecessary redundancies. If your company uses a great many temporary workers to fill "ad hoc" positions, or if the number of temporary

workers has been rising for no apparent reason, it's a good idea to peel off the band-aids to see what problems might lie underneath.

Symptom 6: An exodus of acquired executives

Have you ever spent huge sums of money to keep an acquired company's key executives on board with the combined entity, only to have them leave within a year or two of the deal? A repeated pattern of acquired executive flight could mean that their proper "care and feeding" at the new entity is being sabotaged by an overly hasty integration approach. A careless corporate buyer may invest substantial time and effort in getting acquired executives to stay with the company – but then, distracted by the next acquisition, fail to help them adjust well enough to the new environment to do a good job. Feeling that they've been shunted into meaningless roles, even those who don't quit outright are unlikely to add as much value as anticipated.

One way to guard against this problem is to set up a buddy system that pairs each acquired executive with a designated mentor at his or her peer level. The mentor would be expected to guide the acquired executive through his or her initial steps at the combined entity, and would be held partly responsible for the acquired executive's eventual performance.

Symptom 7: Widespread confusion about the company's corporate identity, mission, and goals

Communicating a clear corporate vision is hard under the best of circumstances.

Cruelly, it gets even harder just when it's most important – when you want to bring a newly acquired company fully into the fold. The acquired company's employees may be slow to understand or accept the larger organization's strategy and goals, while the buyer's employees may be uncertain about how the acquisition will affect the company's future direction. Left unaddressed, the mounting confusion from multiple acquisitions can erode morale and hinder effective decision-making, especially if the lack of consensus extends into upper management.

A rushed or incomplete integration can exacerbate the post-acquisition identity crisis in several ways. The company may have been so intent on executing the deal that it didn't formulate a clear rationale for the acquisition, or keep its employees in the loop if it did. The integration team may shortchange communications in favor of other, more tangible elements of the project. And even experienced acquirers sometimes forget that it takes time and many repetitions to truly drive a message home.

Treatment and Prevention

So much for the symptoms of acquisition-related complexity. What about keeping the problem from getting out of hand in the first place? Our advice:

Take the issue seriously. If you've read this far, you probably don't need any more convincing that excessive complexity is a significant business risk. It's vital, if you want to stay ahead of the problem, that at least a quorum of your fellow corporate leaders

feel the same way. Many of the integration roadblocks mentioned above – convenience-driven matrix structures, product/service fiefdoms, lack of funds for IT standardization – can be mitigated, if not completely avoided, by appropriate executive intervention. And strong leadership is even more important when you're addressing issues left over from past acquisitions. No large-scale initiative, which is what it usually takes to whittle down a company after a long series of incompletely integrated acquisitions, can be effective without top-level commitment to providing the money, resources, and time to see it through.

Tie the integration leader's rewards to long-term integration quality as well as to acquisition-related revenue gains and synergies. The typical integration project leader receives incentives based on time to completion, revenue gains, and cost synergies. What's missing from this set of incentives is the enterprise view – the responsibility to conduct the project in a way that produces the tightest, most effective integration needed to support the entire company's long-term goals. If you reward the integration leader solely on cost, time, and synergy metrics, he or she will have every reason to maximize those metrics even if it means creating or ignoring complexities that put the company's future at risk.

Integrate in batches. It's not always practical to perform every integration as completely and as thoroughly as you'd like.

To prevent incremental complexity from creeping up on you, consider taking a break after every few transactions to take stock of your company's overall integration level and to simplify areas that need it. That way, you can concentrate on achieving your immediate goals during each transaction without allowing complexity to accumulate to a dangerous level. Integrating in batches can also offer you economies of scale in areas such as IT and real estate, as well as give you a better perspective on what your combined organization should look like.

Pick your battles wisely, but aim to win each one. Every acquisition, and every integration, has its own strategic purpose. It's up to you to decide how much integration is appropriate for the company and how much progress is satisfactory. But by the same token, don't let lack of planning, preparation, and focus make those decisions for you. Understand the integration needs of each area of the business and determine realistic goals ahead of time – and then put enough resources behind the effort to make it work.

Excessive acquisition-driven complexity only gets harder to cure the longer you let it go. Don't let your company ignore the risk. If you're planning or pursuing an aggressive acquisition strategy, the time to take complexity in hand is now, before it's too late.

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