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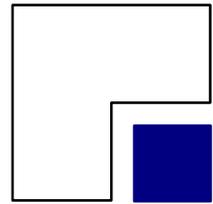
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## **Mergers & Acquisitions: A Systematic Procedure for Success**

von Kai Lucks



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# Arbeitsberichte Working Papers

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Heft Nr. 9 aus der Reihe  
"Arbeitsberichte - Working Papers"  
ISSN 1612-6483

Ingolstadt, im April 2005

## **Abstract**

The article first deals with misconceptions that typically end in failure and then compares them with major steps and determining factors that lead to success and need to be considered during each phase of a corporate merger. Taking a "mechanical", linear approach to the tasks and simply transferring responsibility from one discipline to another wastes time and distracts from the goal. The entire course of action should be worked out as early as the preparatory phase. Simulating various scenarios makes it possible to compare different choices along the way and identify dead-end decisions early on. All subsequent phases of the project can be handled according to this principle, placing all decision-making steps in a general context and working out the details gradually.

# **Mergers & Acquisitions: A Systematic Procedure for Success**

**In order to reach the desired goals, a mergers and acquisitions project must follow a clearly organized procedure.**

KAI LUCKS

Even after a firm agreement has been reached on a merger or joint venture, there is a lot that can go wrong during the course of subsequent integration. There are three main reasons why this happens: Lack of experience, insufficiently clear rules and inconsistent action. Later on, the people involved often lose the ability – and the total commitment – to make a success of their joint project. However, success comes about only when everyone involved is clear on the essential steps that must be taken and on the determining factors that need to be considered. Before this can be done, fundamental rules of procedure need to be established. The discussion below first deals with some of the misconceptions and false approaches that typically end in failure and then compares them with major steps and determining factors that lead to success and need to be considered by everyone involved during each phase of a corporate merger. The traditional linear deployment of individual specialist teams falls far short of solving all the problems that arise. Indeed, a project organization that is aimed at the overall process and solid knowledge management practices are the only ways to establish and transfer existing experience and thus ensure M&A success.

Complaints are often raised over the disappointments that occur following corporate mergers. While some major takeovers have even ended in very public disasters, numerous failures have also remained in obscurity. Anyone who has worked long and hard with corporate acquisitions and mergers knows that success has a lot to do with the way in which the merger process is organized and carried out.

After purchasing over 1,000 companies – and investing around € 25 billion – Siemens has systematically gained an enormous amount of experience over the past ten years, as reflected in the company's approach to a standard integration process involving binding programs and milestones, a center of competence for corporate mergers and a global network of experts. While some of the experience gained seems rather a matter of common sense in hindsight, actions in the past did not always fit the situation.

Any rules that can be derived from these experiences apply not only to large corporations, but to smaller businesses as well. The following questions are therefore essential: What serious errors have been, and are still being, made during mergers, and what steps can we take to avoid them?

## **Seven mistakes in corporate takeovers**

The skills involved in buying and then integrating a company come under a highly specialized field of expertise. It is wrong to assume that a successful business manager is necessarily equally skilled in buying and integrating companies; Siemens analyses have also come to this conclusion. You could look at a corporate takeover as a kind of external business reengineering project, which is why the ability to reorganize business is a decisive factor in M&A. Business processes that have undergone extensive reorganization can achieve above-average success in subsequent M&A projects.

Another wrong assumption is that every acquisition is so fundamentally different that the experience gained in other cases could not possibly apply to the one at hand. To the contrary, process-specific structures and skills must be worked out for company purchases and mergers and then transferred to the current project. Successful company buyers develop specific blueprints to be followed, including basic courses of action such as following a uniform strategy, acquiring companies belonging to a specific category (according to the "string-of-pearls" approach), integrating companies according to a certain pattern and adhering strictly to certain rules of procedure.

In the absence of rules and experience, on the other hand, company buyers can easily succumb to the temptation to follow cheap "patent recipes", deviate from

the initial basic concept and, in the end, yield to pressure to abandon necessary actions during the merger.

What is needed, therefore, is a strong and experienced hand capable of varying the solutions, while giving everyone involved on both sides a role to play in the merger. Using typical situations as examples, the hazards and ways to overcome them are explained below as a way to illustrate the fundamental steps to that must be taken in organizing and carrying out a merger.

### **Structure follows strategy – true, but not enough**

Danger threatens even before M&A projects begin, right when the strategists have the upper hand. Yet the old motto of "structure follows strategy" is not very helpful. An M&A project must, of course, follow a strict strategy that clearly answers the questions of why to buy a certain company, why to consider this particular candidate and how to generate enough business value to cover the purchase price and risks.

But those who leave the organizational work entirely up to the strategists – assuming that this completes the bulk of the work – are likely to ignore a large number of important factors, such as the partners' expectations, business processes and value-added levels, ways to organize the transition from the current activities to an integrated unit, the roles of the major players, the issue of fiscal optimization and other concerns. To take all these aspects into account, the project management team must have a lot of experience and be able to integrate the different disciplines, while assuming overall responsibility.

### **Big versus small – "who's paying and who's acquiring?"**

All too often, the business managers let their egos drive the M&A project, the ultimate goal being to expand personal power. As a result, they prefer to consider smaller takeover candidates who could be easily integrated into their own organizations or would make it possible to retain a majority in the event of a merger. What often fails to be considered is whether the objective to improve

one's own competitive position will indeed be achieved by the takeover and whether the balance of power within the organization would even make it possible to integrate the acquired company in the first place.

Major competitive upheavals are not the only things that require a broader approach in thought and action. Depending on the situation, it may indeed be necessary to form an alliance with a larger company, although this requires a careful comparison of the expertise offered by each company. It may turn out that the smaller firm is the one with better market expertise or a more competent management team. This is why it is important to enlist the "independent" opinion of the potential partner on issues of strategy and integration models and to systematically assess the executives as part of the due diligence test (known as a management audit), or to have this done by a personnel consultant (in the form of a management assessment).

Different models can help resolve structural conflicts, such as by "appending" a smaller takeover candidate to the organization of its larger buyer, while having a "sponsor" on the Management Board provide direct support for the acquired company beyond the formal reporting relationship; this helps maintain the self-confidence of the acquired company's management team, who held the top positions before the acquisition.

### **Small versus big – resistance to integration?**

If the company to be purchased has the larger volume, it makes sense to incorporate the buyer's business into acquired company's organization. However, this approach runs the risk of reversing the balance of power. A weak company and project management on the part of the buyer may nevertheless be inclined to accept the many arguments put forward by the representatives of the acquisition candidate. While the candidate's team may be presenting in-depth knowledge of their own business as the main argument, their actual goal may be to maintain existing structures and business definitions and avoid a necessary merger.

Considering the attention that a company management team's steering committee pays to the acquisition project in the early stages, it seems relatively certain that the established integration plans will be implemented. Once the joint

planning boards have been dissolved, however, the old business concepts are dusted off and agreements reached are often ignored or revoked. It is truly amazing to see just how long attitudes can persist which attempt to restore the status quo that existed before the merger decision, implementation and business reorganization took place. However, there are ways to avoid this mistake: mixed management configurations, joint working groups, rigorous pursuit of the correct course of action and staying power in the implementing the changes – all of this based on the idea that strategies and goals should be neither watered down nor altered over the course of time.

### **Merger of equals – a bad compromise?**

When two companies want to merge, but each party insists on retaining operational control, a "merger of equals" is often the solution to prevent the merger talks from breaking down. However, these apparently equal parties have different strengths and weaknesses, which achieve a sort of equality only in combination, with one party possibly making an extra contribution. Consequently, there are very few 50:50 joint ventures that manage to survive over the long term and be successful at the same time. Bosch Siemens-Hausgeräte (BSH) is one of the rare examples.

BSH's secret to success is the fact that the interests of both parent companies and the things that each can contribute are more or less equal. Neither party sees the joint subsidiary as a "strategic vehicle" for its own interests, but instead gives the joint venture room to develop the actions needed to be competitive.

As a general rule, the more disparate the profiles of the combined units, and the further apart their expectations, the greater is the potential for tension between the partners. This is the reason for the greater frequency of asymmetrical solutions in which one company assumes the leadership role despite an equal division of shares. Let's take the example of a global player that has made a name for itself as a technology provider and wants to join forces with a regional company to gain access to a local market. A marriage of this type is likely to survive only for a short time, since the interests of each party and their will to continue committing funds will diverge over time. It is always better to recognize this circumstance and establish a way out of the relationship from the very

beginning than to pursue one of the countless "forced marriages" in which the partners stand in the way of each others' further growth.

Another example of a 50:50 joint venture is the long-lasting optical fiber cable marriage between Siemens and Corning. The original idea behind the merger was to make complementary technologies available to both parties, with Corning contributing fiber expertise and Siemens its cable-manufacturing experience. Yet the spread of globalization gave rise to a new risk: that the partial joint ventures, which had been operating on a continental level, would now become competitors. To avoid this, Siemens yielded its stake in the joint venture to Corning.

One general rule in fighting the pressures of a 50:50 alliance is to avoid entering into such liaisons altogether. While the idea of a merger of equals can indeed open doors to negotiation, the leadership struggle by both parties can slam them shut again. This was one of the concerns that arose when Siemens entered into negotiations with Westinghouse on the possibility of combining their business activities in the area of fossil-fuel-based power plants.

To examine the economic and technical suitability of such a project without the added burden of deciding who would be the leader, the two parties first went with a "neutral" model of a 50:50 joint venture. Only later did they bring up the question of which parent would be the better choice for guiding the joint venture. In the end, the decision went in favor of Siemens AG, due to its orientation toward infrastructure business. The "new" Westinghouse subsequently sold its industrial projects and power plant business and has since conducted business under the name of CBS, which it acquired to gain access to the TV studio business.

### **Power plays rarely benefit anyone**

Another reason for failure has to do with the lack of clear role assignments during the M&A process. If the development of future business structures is left up to Management, it should surprise no one to see them being organized "around the strongest executives" without any restructuring taking place. This is why it is best to separate the project management and business management functions. The project team should take responsibility for planning corporate

restructuring – known as "discontinuity management" – with line management continuing to handle "continuity management" for day-to-day business; individual employees can assume dual roles, albeit under different management teams.

The joint project team formed for the transitional period should transfer its activities to the new staff as quickly as possible, following a schedule to be established by all parties and controlled by the project management. Ideally there should also be a project review team that is independent of the project team and steps in when results deviate from the target. This team routinely jumps into action after the closing, that is, the green light to conclude the takeover agreements, and compares the information provided by the acquisition candidate with the books and business procedures that are now accessible (post-closing due diligence).

### **Relying on external specialists?**

The question of whether to use external consultants arises in every M&A project. The reasons for doing this range from expertise and achieving objectivity to determining capacity – or simply because it is required by law. Only a few large corporations can afford a team of in-house specialists.

When external players are brought in, it is, of course, important to remember that these people have interests of their own. For example, an investment banker is paid for the success of a deal, which gives him a strong motivation to complete the transaction. A corporate consultant, on the other hand, has a stake in the amount of analysis work involved, which will reflect on the size of his fee. If the investment banker gains the upper hand, therefore, the merger-driven process aimed at generating value within the company turns into a transaction-driven process whose main risk is an excessively high purchase price. If the scales tip in the consultant's favor, not only does this cost time and money, but there is the danger of the people in charge becoming overwhelmed by the volume of data and individual issues and getting lost in the complexity of the situation.

When using an external consultant, it is worthwhile to insist on balance and a guarantee that all knowledge obtained by the consultant remains with the

company and continues to be updated there. It is therefore a good idea to assign several internal employees to each consultant (ordinarily 1:3), focus strongly on the job at hand (ordinarily 80:20, or 20 percent of the issues targeting 80 percent of the value) and transferring the function as quickly as possible to the internal project team or the new organization. The message is simply this: Always retain control, give everyone involved a job to do and adhere strictly to the distribution of work.

### **Neglecting day-to-day business**

When Management gets involved in an M&A project, attention is diverted from day-to-day business. Competitors may use this phase of uncertainty to launch an offensive – against customers, suppliers and the employees of the acquisition candidate. The situation can become critical when candidates are placed on hold, for example, while antitrust issues are being resolved. Until the green light to complete the deal is given, the two companies involved must treat each other as competitors. However, if customers do not find this very convincing during public tenders, they will strike one or another of the perspective merger partners from their lists when issuing an invitation to bid.

This results in lost opportunities on both sides as well as a typical belt-tightening response for the duration of the game of merger poker. Continuity management can help counteract this effect. The dual responsibility of conducting day-to-day business and dealing with the M&A project is a special challenge for the management team and can be mastered only by taking precautionary measures, such as adding internal or external consultants to the integration team to share some of the burden.

### **The need for a set of fundamental rules**

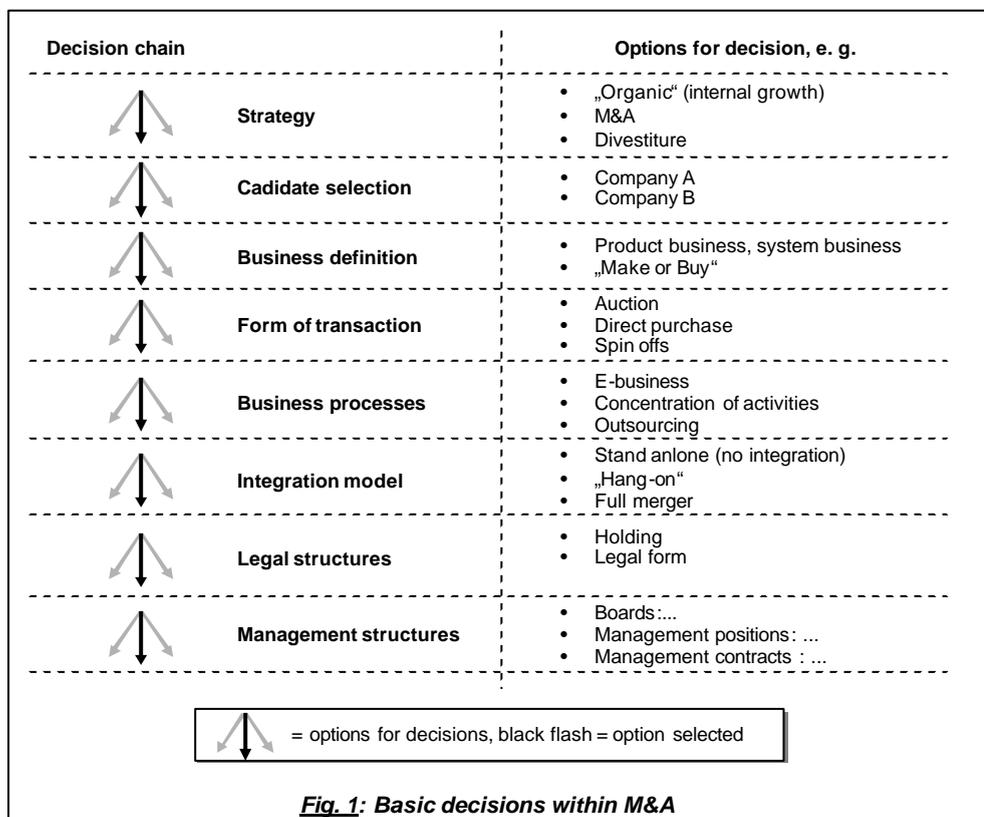
The above examples provide a more or less accurate picture of the typical challenges posed by corporate acquisitions and mergers. This is why safety measures must be established to prevent unwanted situations from arising. These precautions include a number of well known rules of conduct, such as

the principle of "set your price limit early on and stick to it" (see the article by Robert G. Eccles et al. in Harvard Business Manager 2/2000) or "don't build any synergies into the purchase price" or "limit yourself to 100-percent acquisitions and transfer your business system to the acquired company".

Because of the many different factors involved, a number of useful rules also exist, some of which are mutually exclusive in specific situations or lead to one-sided solutions. There is no one-size-fits-all model, but every company must establish its own set of actions. The organizational steps to be taken are closely linked to additional problems, which leads to the question of how a company can develop its own suitable set of actions.

### Basic steps to be taken

Figure 1 provides an overview of the main organizational steps that smooth the way toward the successful conclusion of a takeover project. The first step is planning.



**The strategic plan.** This plan determines the procedure to be followed once it has been established that the competitive goal can be achieved only through an external solution, whether this be cooperation, founding a joint venture or purchasing another company. There is no going back at this point, and all subsequent steps can be worked out on the basis of the existing chain of decisions.

**Choosing the candidates.** This step establishes a number of additional conditions. It is unlikely that any one candidate will meet all strategic and structural goals (for example, in terms of the majority ratio) exactly as desired. With one candidate, there will be only a limited range of conceivable models on which to base a merger of both parties' businesses, while another candidate may allow entirely different models. The candidates themselves will also have their own requirements and conditions. From their point of view, it is also useful to examine the chain of possible consequences from the very beginning and work out a requirements profile for a merger.

**Business definition.** It is of the utmost importance to define the business early on, a step that is frequently neglected. The deliberations on this should be neither rudimentary nor shaped by opportunistic factors. Let's take the case of a regional company that is up for sale. Although sales factors may seem to be the only reasons for reaching out to this company, the parties should take the opportunity to broaden the scope of the deliberations. Perhaps this candidate defines his business in a different way, or maybe his product range would be a nice way to expand the buyer's own business to other regions of the global market.

Consequently, it is advisable to examine potential for improvement throughout the value-added chain even if there seems at first glance to be only a slight overlap between the products and services of both parties. Frequently enough, parties first plan to pursue only a "limited" merger, but then discover unexpected shortcomings later on, making it necessary to organize a major streamlining and reorganization project one year later. This can be avoided by taking a broader

approach to the project from the very beginning. In addition, improvements can help enhance value if the project scope was more broadly defined.

**Form of the transaction:** Dealing with this issue at an early stage leaves room to focus attention on other steps to be taken. For example, a determination should be made early on as to whether the joint venture can achieve a leadership position on the market. If legal problems are not identified before they come to the attention of the antitrust authorities, the project is likely to be delayed or, in a worst-case scenario, even derailed entirely under antitrust laws, as happened when General Electric tried to take over Honeywell. Taking the time for careful advance consideration internally can help anticipate problems, for example, by defining business from the very beginning in a way that meets merger legal requirements or by abandoning a project before the company sustains any damage.

**Auctions:** The rules of a bidding contest controlled by investment bankers must also be considered. For example, if the potential buyer must conform to the conditions of an auction, he will be limited in his ability to find out more about the object of the acquisition. In certain business situations, it is even advisable to turn away from a purchase, for example, if a candidate is attractive mainly because it seems to possess new technology or is about to launch a new product generation. In any case, information "controlled" by the seller cannot be relied on. An interested buyer should essentially pursue the deal only if suitable information can be obtained from third parties (such as customer surveys or technical analyses).

**Spin-offs:** These are necessary if a joint venture is to be founded by merging corporate divisions. If several proprietary companies have a stake in the joint venture – which is the case in international business – this can easily take half a year to complete. However, such spin-offs can be arranged even before a merger begins, provided that everyone involved is willing and a need has been identified. The actual merger can then also begin at an earlier point.

**Business processes.** In the current age of e-business, it is simply impossible to avoid dealing with the business processes. Over the course of the merger, all business processes must be analyzed and harmonized. It can turn out that merging the business processes is simply too time-consuming and expensive, in some cases possible only through years of migration work and temporary auxiliary solutions. IT specialists and e-business experts on both sides can get together at an early stage to roughly compare the existing technical solutions and estimate the time and money involved. Surprises go with the territory: Thus, some companies maintain numerous partially or entirely incompatible SAP solutions side-by-side in which harmonization programs have been in progress for years.

**Legal structures.** If two (or more) organizations are expected to be combined during the course of a takeover, it can be extremely helpful to consider this circumstance sufficiently in advance. A decision needs to be made early on as to which form of organization will be given priority and how the temporary solutions following "day 1" will be shaped.

**Management structures.** The question of how to resolve staffing problems is a major consideration. For example, the parties must determine the extent to which the key players are compatible in their expectations and relationships with one another. A strong executive team can be laid down in draft employment contracts even before closing so that they can sign the acquisition or joint-venture agreement as soon as the deal goes through.

## **Organizational models for project management**

All that's left is to determine the ways in which the essential steps mentioned above can be worked out and implemented. The model in Figure 1 provides a way to establish basic rules for setting the course for all investment projects. A classic approach is one in which the individual steps are worked out gradually. The teams to be formed for this purpose, usually have a functional orientation, with the strategists springing into action first (preliminary analysis, candidate

selection, etc.), followed by the financial specialists (due diligence) and the legal experts (contract preparation, resolving antitrust problems). However, taking a "mechanical", linear approach to the tasks and simply transferring responsibility from one discipline to another wastes time and distracts from the goal. Earlier decisions can lead to dead ends, requiring revision, while the delegation of responsibility can dilute overall responsibility for a project.

A better choice is to interconnect the "steps" from the very beginning and deal with them with input from all disciplines. For example, the entire course of action should be worked out as early as the preparatory phase. Simulating various scenarios makes it possible to compare different choices along the way and identify dead-end decisions early on. All subsequent phases of the project can be handled according to this principle, placing all decision-making steps in a general context and working out the details gradually.

For example, once talks with a takeover candidate have led to a general consensus on the practicality of merging business activities, a joint "explorative team" can re-examine the entire chain of decisions and give the management teams on both sides a clearer picture of the opportunities, risks and necessary steps to be taken. Even the subsequent due diligence analysis and management audit should involve all steps in the planned decision-making process (business definition, integration model, management structures, etc.) and not only an examination of past business figures, as is typically the case.

A similar approach is used to prepare the merger prior to closing and to plan implementation during the first 100 days, when all value enhancement levers along the value-added chain must be identified and the restructuring activities mapped out.

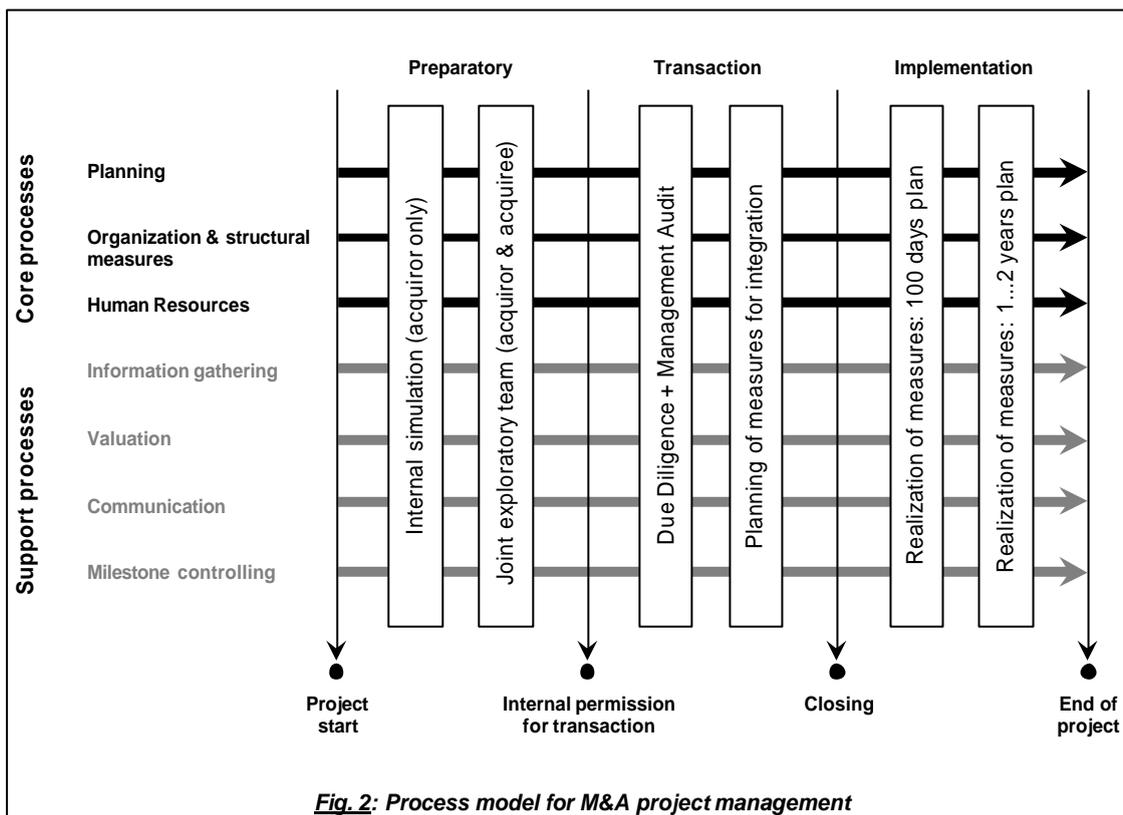
All of the above-mentioned steps along the way are thus discussed according to this organizational management concept. However, if this takes place gradually, with different people assuming responsibility, nobody is ultimately responsible for the overall result. This is a serious procedural shortcoming, which demonstrates the need for a continuous project approach.

## Process-oriented project organization

This alternative involves a process-oriented project management approach (see Figure 2), whose main features are as follows:

- A merger or investment project is viewed as a universal process, from the time the initiative begins until it is implemented.
- The overall process is divided into sub-processes.
- A project or module manager assumes full personal responsibility for the overall process as well as the sub-processes.

In the case of the sub-processes, a distinction can be made between direct management tasks (or core processes) and typical specialist functions (or support processes).



There are three core processes: Planning (from strategic planning to profit-loss and balance sheet accounting and even operating cost and revenue accounting), organization (from structural development to implementation) and

personnel activities. The support processes include information gathering (competition, market, due diligence, etc.), business appraisal (from initial determination of value enhancement potential to tracking the degree to which actions can be implemented), communications (press releases, stock market announcements, staff meetings, publicity, road shows for customers and suppliers, coordination with social partners, etc.) as well as project controlling (including third-party reviews).

The overall process can be organized into three phases: Preparation, transaction and implementation. The preparatory phase ends with internal approval of the acquisition project by the Management Board, while implementation can begin once official approvals – especially those by the antitrust authorities – have been granted.

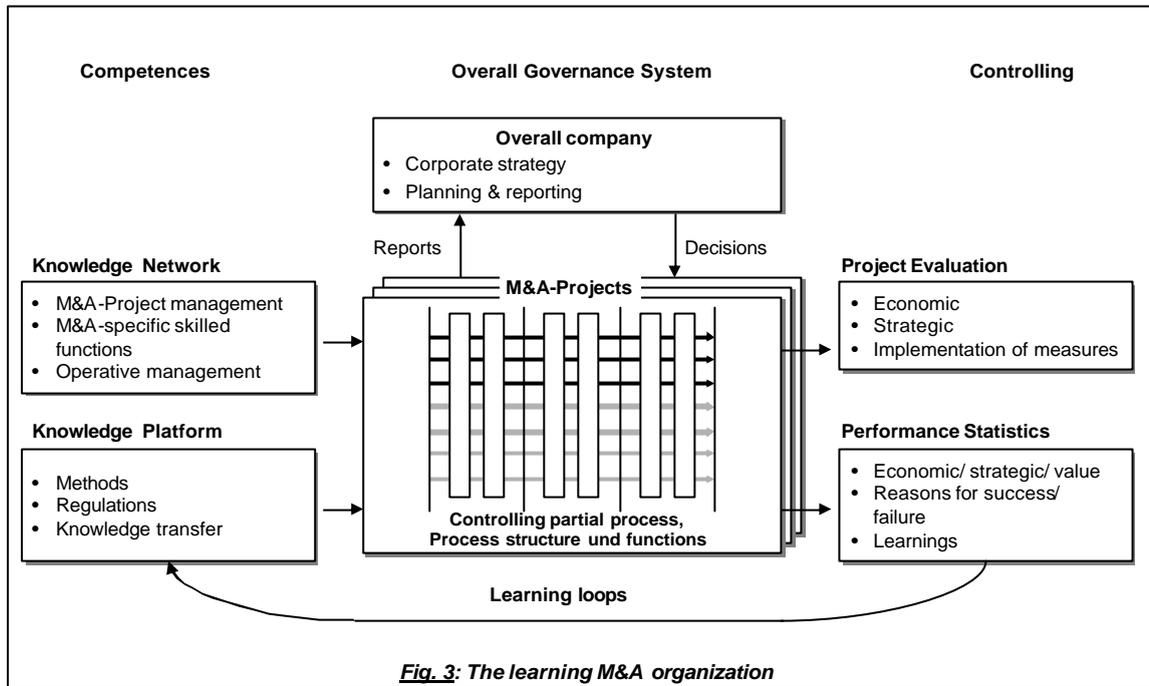
The job packages listed above can be treated as cross-sectional assignments between the process teams. Each team ensures process continuity and thus the consistency between one job package and the next. Primary attention should be paid to establishing a comprehensive approach and focusing on the overall goal being pursued by the project at hand.

## **Experience transfer and knowledge management**

Organizing these processes and forming process teams requires a certain amount of experience in the management of M&A projects as well as general process management skills. However, because organization depends on M&A-specific factors, it is especially important to transfer experience from one project to another; to encourage this, it can be useful to develop an M&A knowledge management system which can be accessed by all company employees involved in M&A work. This includes the top management team, representatives of M&A-oriented departments and the people responsible for the current M&A projects (see Figure 3).

The knowledge base to be established for this system should cover all relevant areas: Operative functions along the value-added chain (R&D, manufacturing, sales, etc.), functions involved in managing the M&A project (strategy,

negotiations, contracts, etc.) and the general cross-sectional functions needed for business purposes (reporting, IT human resources, communications, etc.).



## Assessment and outlook

Corporate acquisitions and mergers are becoming routine, which has resulted in more and more professional specialization. This is the only way to ensure that the course of action is no longer set according to random circumstances, but instead is actively controlled – from the time a project begins until it is completed - making it possible to improve the present unsatisfactory merger success rate and generate real company value. There must be stricter standards of professionalism when economic conditions get tough, without abandoning the commitment to business globalization. The system described above can be especially helpful in institutionalizing continuous learning on M&A project management.



Kai Lucks has a 30 years worldwide professional experience in managing infrastructure projects, mainly in the hospital / university building and power generation area. Having participated in more than 1.000 M&A projects he developed the Siemens Standard Framework for M&A integration. He is the Head of Group Strategies Department in Siemens Headquarters in Munich, comprising the Center of Competence for M&A Integration. He is President of the German Federal M&A Association and a lecturer for International Project Management at the University of Applied Sciences in Ingolstadt.

The article on systematic M&A procedures was first published 2002 in the German "Harvard Business Manager". When 2005 the article was selected for an M&A training program at INSEAD the author decided for the first public printing of the English version in the FHI Working Papers.

## **Impressum**

### **Herausgeber**

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Hausdruck

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**ISSN 1612-6483**