

Integrating with integrity: Latest news



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Introduction

Why are companies interested in mergers and acquisitions (M&As)?

Increasing shareholder value is the primary objective. However, research shows that most companies fall short capturing or creating value through their M&A deals. According to various independent sources, 70–80% of companies experience the opposite – a loss in shareholder value following a merger and acquisition deal.

Research of developed markets conducted by PricewaterhouseCoopers revealed that increasing the effectiveness of an M&A deal directly depends on fulfilling well defined and prioritised integration initiatives in a timely manner. The survey further indicated that the first 100 days after deal closure are critical to realising opportunities for profit growth, increased productivity and improved cash flow.

PricewaterhouseCoopers interviewed a number of top managers from companies operating in Russia on their latest deals both in the country and abroad, and about the integration process resulting from these deals. Among these managers were representatives from major Russian companies and local branches of international companies.

This paper presents observations on how a deal's effectiveness depends on the completion of integration objectives and is based on PricewaterhouseCoopers' international survey of developed markets and interviews conducted in Russia.

Observation 1.

Increased market share and expansion into other markets are the primary objectives of mergers and acquisitions



Executives in both Western and Russian markets said the primary objective of their latest deals was to increase market share.

In contrast, investors considering a potential target in developed markets typically tend to look for synergies, cost reduction opportunities and access to new technologies. They seek to increase operational effectiveness.

The survey revealed that the majority of Western respondents (64%) said that the aim of their latest deal was “to increase market share”. The second most common answer was “to access new markets” (55%). Responses related to increasing operational performance scored between 17% and 23%.

Interviews with Russian executives showed a similar trend. All representatives indicated “increasing market share” or “expanding into new markets” as the primary objective of their latest deals, noting that synergy and operational effectiveness were scarcely relevant in terms of selecting the target.

“The deal’s objective was to enter a new region. As for operations, we are not integrating acquired assets; however, we do consider banks that have a product line relatively similar to ours.”

Head of Asset Management
at a Russian financial group

“Entering a new market rarely presents synergy opportunities. It is not a factor for selecting a target.”

CFO of a Russian financial
and industrial holding company

Diagram 1

Percentage of companies who indicated the following factors as the main objective of their latest deals



Source: PricewaterhouseCoopers M&A Integration Survey Report 2008

Observation 2.

Strategic objectives are easier to achieve than operational or financial objectives



Mergers and acquisitions enable companies to achieve their strategic goals, but not necessarily meet their financial or operational objectives.

The PricewaterhouseCoopers survey of developed markets shows that, with their latest deals, 64% of the companies surveyed claimed significant strategic benefits. However, only 44% of respondents said they met expected financial targets. A smaller number of companies (38%) indicated that they achieved their operational objectives.

Interviews with representatives of companies operating in Russia showed that these companies do not carry out detailed assessments of the deal's financial or operational effectiveness.

This is a logical consequence of the first observation: companies' initial aim is to meet their strategic objectives. In other words, a deal motivated by strategic objectives is regarded as successful as soon as it is closed. However, even though the company considers the deal a success, it can still destroy shareholder value.

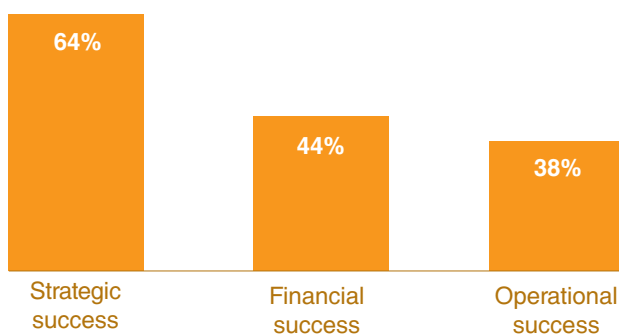
Implementing priorities to achieve financial and operational objectives is critical to increase deal effectiveness.

"An integration office was formality established, but nothing was done. Entire departments were leaving and taking their clients with them."

CFO of an investment group

Diagram 2

Percentage of companies who agree their most recent deal was successful strategically, financially and operationally



Source: PricewaterhouseCoopers M&A Integration Survey Report 2008

Observation 3.

Rapidly achieving integration objectives is essential to the desired financial and operational success of the deal



There was general agreement on issues related to the timelines for completing integration. Both the international survey and the interviews with Russian companies referred to the first 100 days following deal closure as the most critical period in terms of meeting the deal’s financial and operational objectives.

The international survey revealed that achieving targets for profit and cash flow depends directly on the timeline for integration.

91% of respondents said they achieved “very good” or “somewhat good” results for profit in deals where integration took less time than expected or than was initially planned. Only 62% of survey participants said they turned a “very good” or “somewhat good” profit for deals where integration took longer than usual or than was initially planned.

Moreover, the results revealed a correlation between profits and cash flow and the speed with which operational procedures were implemented.

Representatives of companies operating in Russia also mentioned that there is a very short period of time within which to realise substantial positive changes in the acquired company. People are most responsive to change and open to cooperation during the first 100 days following deal closure.

“If you have failed to carry out changes within the first 100 days following deal closure, or at least properly initiate major changes, then later you will find that you are incapable of taking further action.”

CFO of a major Russian investment group

Diagram 3

Percentage of companies who agreed that they achieved “very good” or “somewhat good” results in terms of profit in their latest deal

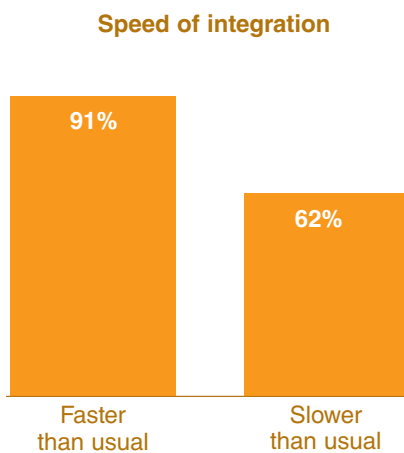
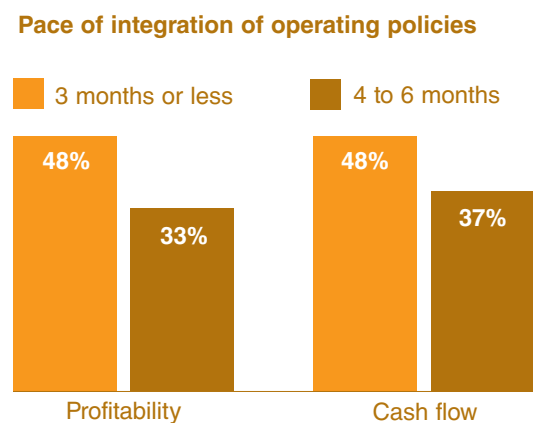


Diagram 4

Percentage who agree profitability and cash flow were “very favorable” based upon the pace of intergration of operation policies



Source: PricewaterhouseCoopers M&A Integration Survey Report 2008

Observation 4.

Integration-driven changes take a long time to implement, even when recongnized as critical and urgent



All participants, without exception, noted that it is critical to carry out integration changes early on after taking control. However, in practice this process requires many months or even years.

From the participants in the global survey, only 18% said they managed to implement fundamental operational policies and procedures in the newly acquired company within the first three months following deal closure. 39% of respondents reported that the entire process took seven months to complete.

Our experience in Russia shows that it takes from between 6 and 18 months to implement key operational policies and procedures in an acquired company.

During a discussion of integration timelines, the main difference between Western markets and Russia was revealed in terms of integrating companies as part of M&As.

In developed markets, integration is a standard (mandatory) stage of any transaction – as important as the preparation of legal documents or due diligence.

During our interviews with representatives of Russian companies, we noted that integration tasks are delegated at the functional management level. General integration management, the coordination of tasks between different departments and effective priority-based resource management are, in the main, absent.

Companies with a defined integration strategy, with a defined plan and executives accountable for its success were more successful in implementing integration-driven change in their new organisations.

“It is important for each department manager to decide what to do and how to do it. In the end, it is they who will be managing this asset.”

Project manager at a major Russian holding company

“We begin integration within the first week after deal closure. Our job is to appoint our executives to all key positions. All further management decisions are the responsibility of the relevant function management.”

Head of Corporate Finance at a Russian company

“When we submit our first bid, we already have a comprehensive draft integration plan.”

Member of the Board at a large international information services company planning an acquisition in Russia

Observation 5.

Major integration challenges include culture, information technology and finance process harmonisation



The majority of respondents identified people and cultural issues as the biggest challenges when integrating a company following an M&A deal.

60% of the global survey's respondents (the highest prevalence) said the biggest challenge in terms of company integration was cultural differences.

It was thus observed that large companies tend to see cultural differences as being the biggest challenge to carrying out integration. In our experience this is due to the fact that large companies are more likely to be involved in international deals, and therefore encounter intercultural problems more often. However, local companies also face corporate culture-related difficulties.

A clear example was presented in an interview with an official from a Russian telecoms company very active in M&A. The company has extensive experience with integration. However, when the company entered a new region outside Russia, it was confronted with serious cultural challenges.

Respondents identified IT-related issues as the second biggest challenge during integration. 58% of the global survey's respondents mentioned serious or moderately serious difficulties related to information systems integration. Moreover, 45% of respondents said IT-related issues caused delays in the overall integration rollout.

Many of the Russian companies' executives also ranked systems integration as number two in terms of complexity. However, in Russia, IT ties for second place with financial issues. The integration of financial procedures and methodologies often becomes the most urgent, if not the most complicated integration issue.

“People – this is the most difficult aspect of integration. To change habits, way of life, corporate culture is an extremely difficult task. And it takes much longer than, for example, IT integration.”

CFO of a Russian holding

Observation 6.

The challenge of deferred integration –
higher cost, lower rate of success



Within recent years the Russian market has developed very rapidly. Such conditions have impeded the establishment of effective business processes or proper control procedures. Rapid growth for many has resulted in overlapping functions and unclear distribution of roles and responsibilities.

After a merger, these inefficiencies are exacerbated and lead to a considerable increase in operating and administrative costs.

A number of our clients mentioned a drastic increase in expenditure six to 12 months after deal closure. Only at this stage are companies beginning to take steps toward cost reduction, including a review of the company's overall business model and organisational structure, optimisation of selected business processes, creation of shared service centres, workload analysis and staff reduction, and increasing transparency in both the decision-making process and how authority is distributed. In fact, these companies end up implementing the integration process and developing the synergy that they should have commenced while completing the transaction and immediately upon deal closure.

The cost to implement later is much higher and the chances of implementation are much lower. The reason is that following the transaction people expect change, but soon they get accustomed to business as usual.

In good times many companies plainly ignore cost synergy. These opportunities are hidden by revenue growth. But those who take these measures are ahead during cycles of economic downturn, because their cost structure is better prepared for lower revenue.

“Why waste our time and resources trying to identify and develop synergy, which (if ever identified) will at best reduce our costs by 3–5%, while the market growth rate is 20% per year?”

CEO of Russian branch
at international company

Conclusion.

Transactions lose their value due to poorly timed planning and delayed implementation. Accelerating the transition significantly improves performance



The main reason for a decline in shareholder value from a deal is the incomplete planning and untimely realisation of the integration objectives. A drawn-out integration process increases costs, slows growth and reduces or delays the planned benefits of the deal.

When integration is planned, prioritized and executed in an appropriate, systemic manner, a business can potentially bring in considerably larger gains than originally anticipated:

- Deals can be a basis for increasing mobility of a company and its ability to quickly react to changes in the market and economy
- Deals create the opportunity to increase the effectiveness of operations through planned and steady changes and continuous improvement, which can completely transform the business

The key principles for a successful integration are simple. To increase the chances of achieving synergy and producing the maximum results from deals, it is necessary to accelerate the transformation process, on a foundation of timely planning and organisation of integration, and also concentrating on the changes that deliver the greatest impact on shareholder value.

PricewaterhouseCoopers' seven fundamentals for a successful integration



Today, increasing the economic effect of M&A transactions is a priority for companies seeking to achieve considerable growth.

We believe that the following seven principles facilitate successful integration and increase the economic effectiveness of transactions.

1. Accelerate the transition

Delays and a prolonged implementation of the transformation process after the deal will not lead to added value. Focus on the most fundamental and relevant changes, which will help increase shareholder value. A delayed transformation suppresses growth, reduces profit, lowers confidence, and results in lost opportunities and a decreased market share. While an accelerated transformation offers a faster return on investment, better capitalisation of new opportunities for growth helps to reduce uncertainties within the organisation.

2. Define the integration strategy

Integration is mainly a tactical process. However, tactics should be based on strategy. The ability to quickly convert strategic objectives into an integration strategy is critical to the economic outcome of a deal. Integration priorities and objectives can only be defined when strategic goals and expectations are clearly formulated and declared.

3. Focus on priority initiatives

Generally, implementing integration requires considerable human resources. Moreover, successfully meeting different objectives depends on whether or not the same people are involved. Resource allocation must be primarily aimed at increasing the effectiveness of the transaction. In other words, it is necessary to first identify potential sources for increasing effectiveness. Furthermore, the potential economic outcome of using each different source must be assessed, as well as the possibility of achieving this effect within the required time period: only then can the necessary resources be allocated.

4. Prepare for day one

To avoid any painful surprises on day one, all critical steps must be identified and planned, with less relevant tasks set aside for later. Be sure to have a plan for preparation through to day one, as well as a list of tasks to be completed immediately after deal closure. Planning for day one should be performed simultaneously with due diligence.

5. Communicate with all stakeholders

It is critical that stakeholders, including clients, employees, investors, suppliers, business partners and the general public are well-versed when it comes to issues that may be of interest to them. Be consistent in covering the planned steps, clearly communicate decisions and be open to areas of further improvement. Disseminate information in various formats so as to include all stakeholders. It is also important to have an effective mechanism in place for feedback.

6. Establish leadership at all levels

Appointing managers to all parts of the integration reduces uncertainties, increases responsibility and ensures timely decision-making. It is critical to define a transitional organisational structure and interim operational model, as well as ensure that all who are involved in the process have a clear understanding of their roles and are willing to cooperate.

That said, the integration management structure must meet the objectives for each transaction stage. During a transition to a different management structure it is essential to ensure continuity in terms of strategy, risk mitigation and achieving set targets.

7. Apply a systematic approach to integration management

M&A transactions rarely fail because of poor strategy. A more likely reason is that the strategy is not implemented in good time. A good integration requires speed and a systematic approach. The first 100 days are critical in terms of implementing essential changes and laying the groundwork for maximising the deal's synergies in the long term.

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