Dangerous Liaisons: Maximizing leadership in Mergers & Acquisition environment

Claude Dion, M&A Global Director
Michał Skup, Business Unit Manager
Hay Group is a global consulting firm that works with leaders to transform strategy into reality and to help people and organizations realize their potential.
What is reality? What is potential?

800,000 PLN ?

299,000 PLN ?

5,500 PLN ?

1,999 PLN ?

JIMMY CHOO
The reality and potential of the Warsaw Stock Market

Change: -62%
M&A deals

September 23, 2008:  October 6, 2008:

NOMURA  BNP PARIBAS

LEHMAN BROTHERS  FORTIS
May 05, 2008:

Vistula & Wólczanka
5% of shares
30 mln PLN

Grupa W. Kruk
66% of shares
300 mln PLN

June 24, 2008:
Dangerous Liaisons: Maximizing leadership in Mergers & Acquisition environment

Claude Dion, M&A Global Director
WARSAW November 2008
1. Dangerous liaisons: M&A a fast track for growth despite the risks

2. Leadership capability review during due diligence
   - Strategic objectives and “dangerous animals”
   - Critical roles, critical situations, critical competencies
   - Assessing risks associated with leadership competencies
   - Establishing a top management team – quickly

3. Research findings – voice from the field

4. Finally what’s matter
Dangerous liaisons: M&A a fast track for growth despite the risks
50 to 70% (*) of deals STILL do not meet expectations and FAIL to enhance shareholder value

A high portion of acquiring firms have, on average, lower growth than industry rivals for 3 years following the merger

(*) Source: Hay Group 2008 research
M&A does not create the expected value

Deals - %

10

Outstanding
met most short, medium and long term objectives

30

Worthy
created shareholder value

50

Even
resulted in balance between value created and value destroyed

10

Failure
destroyed value
### Domination of intangible assets

#### % Intangible assets of market value in 1975...

<table>
<thead>
<tr>
<th>Sector</th>
<th>1975 Intangible Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare</td>
<td>73%</td>
</tr>
<tr>
<td>IT</td>
<td>63%</td>
</tr>
<tr>
<td>FMCG</td>
<td>51%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>13%</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>~0%</td>
</tr>
<tr>
<td>Utilities</td>
<td>~0%</td>
</tr>
<tr>
<td>Telecom</td>
<td>~0%</td>
</tr>
<tr>
<td>Banks</td>
<td>~0%</td>
</tr>
</tbody>
</table>

#### ...and in 2005

<table>
<thead>
<tr>
<th>Sector</th>
<th>2005 Intangible Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthcare</td>
<td>89%</td>
</tr>
<tr>
<td>IT</td>
<td>82%</td>
</tr>
<tr>
<td>FMCG</td>
<td>94%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>87%</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>69%</td>
</tr>
<tr>
<td>Utilities</td>
<td>62%</td>
</tr>
<tr>
<td>Telecom</td>
<td>79%</td>
</tr>
<tr>
<td>Banks</td>
<td>64%</td>
</tr>
</tbody>
</table>

Source: S&P 2005 Survey, Hay Group Analysis
### Defining intangible assets

#### Hay Group’s intangible assets model

<table>
<thead>
<tr>
<th>Organizational capital</th>
<th>Relational capital</th>
<th>Human capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Culture and market convergence</td>
<td>Brand</td>
<td>Leadership</td>
</tr>
<tr>
<td>Governance</td>
<td>Client intimacy</td>
<td>Employees</td>
</tr>
<tr>
<td>Agility</td>
<td>Client loyalty</td>
<td>Development and management</td>
</tr>
<tr>
<td>Communication and teaming</td>
<td>External networks</td>
<td>Engagement</td>
</tr>
<tr>
<td>Energy and clarity</td>
<td>Internal networks</td>
<td>Productivity</td>
</tr>
<tr>
<td>Organizational structure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tacit ‘know-how’ and innovation</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Mergers & Acquisitions
The reality: It’s not a fast journey

Integration complete within 2 years

Target Actual
85%* 32%

Operations not disrupted by more than 2 years

Target Actual
93% 50%

(*% of respondents)
The M&A Building blocks & Specific modules

1. Conduct Due Diligence
2. Conduct Pre-Closing activities
3. Frame the merger
4. Alignment Office
5. Manage the Intangible Assets

Market Screening → Due Diligence → Pre-Closing → Alignment → Integration

- 1.1 Conduct Due Diligence
- 1.2 Conduct Pre-Closing activities
- 2.1 Align & engage
- 2.2 Synergies and Organization
- 2.3 Communication and Engagement
- 2.4 Human Resources
- 2.5 Finance

Intangible Asset Management

5.1 Manage the Intangible Assets

© 2008 Hay Group. All rights reserved
Leadership capability review during due diligence
Old habits die hard – the wrong focus

Due diligence priorities

Source: Hay Group 2008 research
The balance between tangible and intangible assets

58% confess that over-prioritizing systems integration resulted in insufficient focus on intangible assets and cultural integration.

54% of business leaders confess that failure to audit intangible assets enhances the risk of a poor acquisition.

70% of companies failed to prioritise intangible assets.
Companies that conducted a formal **leadership capability review** during due diligence are **four times more successful** in delivering on the deal objectives.

Hay Group “Dangerous Liaisons” report 07
You can make a difference with an early leadership capability review

The impact of leadership on attitudes to merger: Percentage of people that support the M&A depending on their level in the organisation and on the priority given to LCR

- **Leadership**: 81% (High priority), 46% (Not carried out)
- **Senior Management**: 76% (High priority), 46% (Not carried out)
- **Middle Management**: 68% (High priority), 32% (Not carried out)
- **Frontline**: 44% (High priority), 20% (Not carried out)
Companies that conducted a formal leadership capability review reported an improvement in motivation levels of more than 10%.

Hay Group “Dangerous Liaisons” report 07
Conducting a leadership capability review – at due diligence stage

Five key actions to take at due diligence stage:

1. Clarify the strategic objectives for the deal and identify “dangerous animals”

2. Identify implications for critical roles and critical situations the leaders holding those roles will face

3. Determine the few critical competencies necessary for success in those roles

4. Decide on the best method to use to assess target company leaders for those competencies considering the specific due diligence context (hi/lo stakes, hi/lo risks)

5. Conduct the leadership capability review during due diligence using the chosen methodology

Mitigate risks associated with leadership and increase probability of a successful integration
Strategic objectives and “dangerous animals”
Defining strategic objectives for the deal
Why do you want to acquire this company?

M&A intangible gearing

High Intangible and tangible business case related to similar size/competitive target/unknown territory

- Dimension change (size factor, Client and stakeholder management)
- Performance enhancement (Target strengths and weaknesses)
- Continuous improvement
- Standardization
- Brand rationalization
- Intra-country "trench war"

- Restructuring (IT)
- Property/Facilities plan
- Equipment optimization
- Purchase / Economy of scale
- Finance integration

- Revenue synergies
- New management model
- New product/show launches
- Client satisfaction model

- New leadership model
- New cooperation work culture
- Client relationship transformation

Mostly tangible business case associated with smaller size, less performance target and well mastered environment

- Short-term cost synergies
  - Stand-alone cost improvements
  - Cross-selling existing products
  - Building new customer relationship

- Complementarity
  - Building new products
  - Integration of systems and processes

- New value model
  - Financial model
  - Revenue recognition
  - Outsourcing and new options

- Long-term revenue synergies

Merger context (political, economic, social, environmental, regulation, etc.)
Case Example 1 (1/2)

Sales & marketing

Gain leverage from new Nuclear medicine and Ultrasound product
Gain access to the US market and develop our brand image
Gain leverage from the new field force in Europe
Accelerate the multi-channel distribution model
Seize new Business Development opportunity (ultrasound)

M&A leverage

High Intangible and tangible business case related to similar size/competitive target/unknown territory
 Mostly tangible business case associated with smaller size, less performance target and well mastered environment

Merger context (political, economic, social, environmental, regulation, etc.)

Consolidation  Complementarity  New value model

Sales & marketing
Case Example 1 (2/2)

M&A leverage

High Intangible and tangible business case related to similar size/competitive target/ unknown territory

Low leverage

Complementary growth zone
The acquisition will provide synergies through the alignment of assets of a different nature which will require careful monitoring.

High Value/high Risk zone
An organizational transformation which will be accelerated by the Acquisition and will have implications for its culture, leadership capability and stakeholder management.

Merger context (political, economic, social, environmental, regulation, etc.)

Consolidation

Complementarity

New value model

Acquisition Business case

© 2008 Hay Group. All rights reserved
Identifying “dangerous animals”

Strategic Goals and External Context

Strengths & Weaknesses
Buy Side

M&A Dangerous Animals

Strengths & Weaknesses
Sell-Side

Data gathering Strategy

Consider Tangible and Intangible Assets

Including LCR
### Organizational Capital

- Governance and operating model principles (level of centralization)
- Decision making process
- New production technology and outsourcing
- Cultural convergence (investment vs. cost optimization)
- Factories dismantling
- Mitigating typical impairment due to hot product stop and financial impacts to clean the industrial site
- European commercial operations and Mitigating typical HR risks due to redundant European implementations
- Mitigating carve out risks, especially supporting IT and pharmacology activities will remain with the vendor.
- Check insurance plans

### Relational Capital

- **Product portfolio**
  - Arrival of generic competitor
  - Black box warning on a key product
- New target clients
- Banks
- Environmental regulation

### Human Capital

- Assess Leadership capability
- Assess talent losses (past and on going due to longer time uncertainty – 12 months – for that business unit in the holding portfolio)
- Assess unfulfilled mission critical jobs / difficult to recruit
- Retention
- Expected drop in the people engagement (Productivity)
- Acquired by a French Family-owned mid-size company
- R&D nuclear medicine and Ultrasound capacity
- Assess and capitalize on the strengths of acquired company (Development in the US)

### Intangible assets

- Property, plants
- Equipment
- Cash, taxes
- Patents
- Inventory
- Investment

### Tangible assets
Critical roles, critical situations, critical competencies
Identifying critical leadership roles
Which roles will be critical in our context?

<table>
<thead>
<tr>
<th>Strategy Formulation</th>
<th>Planning &amp; Advice</th>
<th>Matrix</th>
<th>Delivery &amp; Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Corporate CFO</td>
<td></td>
<td>President, BU</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Strategic Alignment</td>
<td>Corporate Head of Technology</td>
<td>Chief Investment Officer</td>
<td></td>
</tr>
<tr>
<td></td>
<td>BU Finance BU Head of Technology BU Head of HR</td>
<td>Head of Quantitative Analysis</td>
<td></td>
</tr>
<tr>
<td>Strategic Implementation</td>
<td>BU Finance BU Head of Technology BU Head of HR</td>
<td>Head of Fixed Income Head of US Equity Head of International</td>
<td></td>
</tr>
<tr>
<td>Tactical Implementation</td>
<td>Head of Systems Architecture Head of Compliance</td>
<td>Head of Trading</td>
<td>Director, Research Head of Sales and Marketing</td>
</tr>
</tbody>
</table>

- Assumptions to validate regarding those leaders
  - Engagement: What is his intention (stay or not) and his personal aspiration?
  - Capability: Can he stand in the same job?
  - Potential: Can he move to another Executive positions within the company?
The critical roles identified were:
- CEO
- COO
- CFO

The situations the newly adopted leaders would have to manage successfully in their roles within the given operating model varied according to the leadership role but included:
- Making the numbers
- Integrating processes
- Creating synergies
- Working collaboratively across functions
Case Example 2
Competency grid w/ risk assessment

<table>
<thead>
<tr>
<th></th>
<th>ACH</th>
<th>TL</th>
<th>SCF</th>
<th>INF</th>
<th>INT</th>
<th>OA</th>
<th>IMP</th>
<th>ING</th>
<th>FLEX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Managing Director (CEO)</td>
<td>4/5</td>
<td>3/4/5</td>
<td>2/3</td>
<td>3/4</td>
<td>3/4</td>
<td></td>
<td></td>
<td></td>
<td>2</td>
</tr>
<tr>
<td>Supply Chain Director (COO)</td>
<td>3</td>
<td>3/4</td>
<td></td>
<td>2</td>
<td>3</td>
<td></td>
<td>2</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>Financial Director (CFO)</td>
<td>3/4</td>
<td>3/4</td>
<td>3</td>
<td></td>
<td></td>
<td>3/4</td>
<td>2</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>
Assessing risks associated with leadership competencies
A competency is scored based on **observed evidence**

- Evidence can be observed in different ways:
  - In “real time” (actual interactions with people, presentations, meetings, etc)
  - In “deferred time” (narrative form, video/film, …)
  - Through simulations (business simulations, case studies, role plays, etc)

- Conducting a risk assessment through a leadership capability review during due diligence may include some or all of the techniques described depending on the context
Assessment process and options during due diligence (1/2)

1. Critical review of sell-side top leadership resumes (CV’s) : identify key competencies to preserve, detect potential individual ambitions, etc…

2. Management presentations
   - Observation for evidence of competencies
   - Q&A (semi-structured)

3. Round-table sessions
   - Observations for evidence of competencies
   - Q&A (semi-structured)

4. Soft-time observation (breaks, meals, …)

5. One-to-one meetings
   - Semi-structured interview
   - Structured interview (BEI)
Assessment process and options during due diligence (2/2)

6. Optional full assessment center
   - Structured interviews (BEI’s)
   - Business simulations
   - Case studies
   - Cognitive / psychometric / personality tests
   - Role plays
Critically reviewing leadership resumes (CV’s)

Collectively discuss the answers to the following questions for each critical leader using the data available on individual CV’s (and any prior knowledge of the persons):

- What are this person’s foreseeable aspirations based on their past experience and career path?
- What do they currently have in mind? What are their feelings about this potential acquisition?
- Does this person have a core competency that must be retained?
- What are this person’s potential strengths and weaknesses, motivation level?
- What implications for the LCR and risk assessment?
- What implications for how we want to manage our relationship with this person?
Behavioral event interview

- In-depth interview utilizing an Interview Protocol tailored to confirm and analyze the targeted competencies
- The BEI is a unique derived technique, which helps us to get beneath the surface to uncover behavioral characteristics necessary for superior performance
- This is a highly effective method both in terms of predictive accuracy and cost effectiveness
- Covers key experiences in the interviewee's career
- Focuses on significant events from the last 24 months
- Probes for details on the candidate’s involvement in these events
- Produces a profile of the most characteristic behaviors (or competencies) the candidate uses to get work done
Establishing a top management team -quickly
Companies are taking too long to get a new leadership team in place, on average 74 days – two and half months of leaderless operations.

Hay Group “Dangerous Liaisons” report 07
Companies appointing a new management team as early as the due diligence stage are more than twice as likely to reach full integration within a year.
Unleashing the full value of M&A through intangible assets
A lack of focus of many senior leaders’ during merger on the intangible assets

<table>
<thead>
<tr>
<th>Intangibles</th>
<th>Synergies</th>
<th>Integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Brand value assessment</td>
<td>▪ Strategy review</td>
<td>▪ Financial audits</td>
</tr>
<tr>
<td></td>
<td>▪ Cost assessment</td>
<td>▪ IT systems audit</td>
</tr>
<tr>
<td></td>
<td>▪ Deal negotiation</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Systems integration</td>
</tr>
<tr>
<td></td>
<td>▪ Talent retention</td>
<td>▪ Systems integration</td>
</tr>
<tr>
<td></td>
<td>▪ Elimination of redundancies</td>
<td>▪ Functions integration</td>
</tr>
<tr>
<td></td>
<td>▪ Communication</td>
<td>▪ New structure</td>
</tr>
<tr>
<td></td>
<td></td>
<td>▪ Business as usual, stability</td>
</tr>
<tr>
<td></td>
<td>▪ Top team composition</td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Stakeholders management</td>
<td></td>
</tr>
<tr>
<td></td>
<td>▪ Brand management</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Before</th>
<th>During (60-120 days)</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Focus of “Best in Class” leaders during the merger

<table>
<thead>
<tr>
<th>Intangibles</th>
<th>Synergies</th>
<th>Integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>- <strong>Leadership</strong></td>
<td>- <strong>People</strong></td>
<td>- <strong>IT systems</strong></td>
</tr>
<tr>
<td>capability review</td>
<td>audit</td>
<td>audit</td>
</tr>
<tr>
<td>- <strong>Culture</strong></td>
<td>- <strong>Strategy</strong></td>
<td>- Financial</td>
</tr>
<tr>
<td>audit</td>
<td>review</td>
<td>audits</td>
</tr>
<tr>
<td>- Brand value</td>
<td>- <strong>Cost</strong></td>
<td></td>
</tr>
<tr>
<td>assessment</td>
<td>assessment</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Integration</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>“Business as</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>usual”</strong>,</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>stability</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Before</th>
<th>During (60-120 days)</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Organization</strong></td>
<td><strong>People</strong></td>
</tr>
<tr>
<td></td>
<td>design fit</td>
<td>engagement</td>
</tr>
<tr>
<td></td>
<td>to strategy</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Top team composition</td>
<td></td>
</tr>
<tr>
<td></td>
<td>and alignment</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Stakeholders</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>mgmt</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Talent</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>retention</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Elimination</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>of redundancies</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Communication</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Product, market</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>strategies</td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Cost, process</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>optimizations</td>
<td></td>
</tr>
</tbody>
</table>

**Before**: Focus on leadership capability review, culture audit, and brand value assessment.

**During (60-120 days)**: Focus on organization design fit to strategy, top team composition and alignment, stakeholders management, talent retention, elimination of redundancies, communication, product, market strategies, and cost, process optimizations.

**After**: Focus on “business as usual”, stability.
Frequent leaders’ involvement during a merger

Before | During | After

Intangibles

Synergies

Integration

Senior leaders

Delegate

Corporate finance team

Integration team
Leaders’ role to unleash the full value of the merger

Intangibles

Synergies

Integration

Before | During | After

Senior leaders

Delegation

Corporate finance team

Integration team

Lead capture of intangible value

© 2008 Hay Group. All rights reserved
Research findings – voice from the field
Two underlying factors for superior performance

Short-term autonomy

Long-term cultural differences
A strong opposition from the beginning

- Almost half of the leadership teams opposed the mergers they experienced
- This opposition of the leaders to the merger has a negative impact on managers’ and employees’ attitudes towards the merger

Attitudes towards the merger depending on the level in the organisation
Cracking the stress-code

- Problem-solving coping strategies
- Uncertainty regarding job
- Emotion focused coping strategies
- Work / Private life unbalance
- Managerial sources of pressure
- Professional sources of pressure
- Psychological stress
- Physical Stress

- Positive correlations in blue
- Negative correlations in orange
Cracking the employee engagement model in M&A situations

- Normative commitment
- Affective commitment
- Attachment to the new company
- Social control
- Global job satisfaction
- Recognition at work after the M&A
Social controls, that is actions aiming at creating cohesion in the new working teams, tend to increase attachment to the new organization.
Finally What’s matter
The biggest challenge in M&A is to find the best balance between Alignment and Integration in each step of the process.

**Alignment**
- Culture alignment
- Executive team effectiveness
- Empowerment
- Commitment

**Integration**
- Synergy creation
- Cost reduction
- Organization
- Common policies
- Governance...
Post Merger Integration: the First 90 Days
Steps to manage the integration

- **Install the Structure and Fix Priorities**
  - 30 days
  - Emphasis on establishing new governance and structure,

- **Plan the Merger**
  - 60 days
  - Emphasis on defining work plans for various integration areas

- **Initiate the execution Implement priorities**
  - 90 days
  - Refining plans and preparing for rollout

- **Alignment Program**
  - Program Office Execution
  - We balance integration & alignment to maintain performance, motivation and morale

- **Consolidation & Growth**
  - We help you create systems and processes and transfer what we know
Addressing the key issues

Deal with context
- The strategic objectives and “dangerous animals”
- Implications for critical roles and situations
- Critical competencies for success in roles
- Conduct the leadership capability review

Merger control
- Short term autonomy
- Install an internal dialogue focused on tasks
- Program office scheduling
- Alignment office in place new teams

Balanced alignment
- Align leadership
- Align governance
- Fit for purpose of the leadership/operating model
- Operating model and leadership alignment
The ‘must-do’ Common knowledge conditions for mergers to work well

- Retain the main focus of the firm
- Mergers of different-sized firms often work better
- Early planning for the integration
- Fast-paced integration
- Designate an integration team
- Retain the talent that resides in the acquired firm
- Minimization of customer and sales force attrition
What is a merger like in an ideal world?
What is a merger really like in 50 to 70% of cases?
What can we expect in the best scenario?