



Realizing Value

The role of integration in M&A transactions

By Thomas M. Edens

The accounts receivable management industry continues its consolidation as companies are being acquired at a steady rate. In fact, many large companies consider a disciplined acquisition program to be an essential requirement for success today (in conjunction with strong organic growth). Many of the companies that learn to successfully acquire will gain a competitive advantage as they become industry leaders.

There are many valid business reasons for acquiring companies. Acquirers are usually executing one of two broad corporate initiatives in the form of strategic or financial goals. Acquisitions can fulfill strategic goals by:

- Diluting client concentration.
- Gaining access to new market niches.
- Entering into new geographic areas while implementing a national footprint.
- Increasing management depth or entering lower-cost job markets.

- Increasing the size of the organization in order to position itself as marketable to larger clients.

Acquisitions can also fulfill financial goals. These might encompass increasing scale to gain cost savings and efficiency, building critical mass to facilitate an exit strategy such as an IPO or earning an Ebitda (earnings before interest, taxes, depreciation and amortization) multiple expansion resulting in increased value. Regardless of the reason for the acquisition, it is almost always the intent of the acquirer that the target will bring more value than the resources utilized by the acquirer to purchase the target. Said simply, the value received is expected to be greater than the value paid.

Business literature well documents the fact that over 50 percent of acquisitions are a disappointment and fail to capture the expected value. Acquisitions, unfortunately, is an area where expectations often exceed the gains and where expected synergies can be illusory.

The most common reason cited for

disappointing acquisition results is too little effort expended toward integration. Accordingly, buying companies is easier than integrating them and capturing the promised value. The importance of post-sale integration has been gaining stature as evidenced by new corporate executive positions currently evolving, such as vice president of merger integration, chief integration officer and director of culture. There are no textbook solutions to merger and acquisition integration issues. However, there are some ground-rules that can provide useful guidance in delivering successful integration results.

Types of integration

There are two general types of integration approaches that result in different degrees of integration. Acquirers will usually either follow the "absorb" or the "autonomous" approach. When the absorb approach is used, the target company soon disappears after an acquisition. Usually the companies' top-level executives are replaced with

executives of the parent and back office functions are transferred to the parent's staff. The former company becomes an operating division with collection efforts and client support functions remaining with little change. The key to capturing the value from this integration approach is to realize cost savings as soon as possible.

The autonomous approach is utilized by acquirers who leave management in place and implement as little change as is practical. There is usually some joint branding indicating that the company is now a subsidiary of the parent and some noncore business functions are transferred to the parent, such as finance and accounting. A key to the success of the autonomous approach is allowing the existing executives to continue managing the business and the implementation of best practices.

Naturally, there are integration approaches that blend the two together. Regardless of the integration method used, acquirers must implement their plan quickly and decisively in order to capture the early wins so critical to the success of the acquisition.

Integration components

There are several discrete and important business areas that need to be addressed in order to achieve the desired integration result.

Communication: Communicating to the stakeholders of both companies (acquiree and acquirer) is critical during the integration process. Stakeholders would include employees, clients, vendors, shareholders and lenders. There will be a certain degree of destabilization that occurs during and after a merger. This destabilization can be energizing or highly distracting, depending on the clarity of communication and evidence of management executing the plan pursuant to the communication.

Some acquirers generate FAQs (frequently asked questions) with answers to be given to employees. This helps to promote a consistent message and should help clarify management's vision for the transaction. Other acquirers give each employee a

welcome packet explaining new benefits and company policies.

People: Future success of acquisitions will come from people. Therefore, addressing personnel issues early is critical. Service businesses, such as collection agencies, have personnel and clients as their primary assets. This human capital element must be nurtured and handled with the utmost care. Attrition during and after a merger can cause a loss of good employees. Marginal employees are typically the last to leave, primarily because their job outlook and opportunity elsewhere is less favorable.

A program of rapidly re-recruiting the good employees of the target company will help reduce this turnover. It is usually advantageous to have executives who are critical to the business execute written employment agreements. However, the announcement of the acquisition may be a good time to eliminate marginal employees.

A key issue for acquirers is to protect the productivity of the collection and sales staff. People will not concern themselves with the company's survival until they are assured of their own survival. You want to minimize employees' energy being diverted from work to personal issues. People can deal much better with change than they can with uncertainty. Clarity in the communication to your employees will attract support and help stabilize the target company's employees. Some companies initiate post-acquisition specific incentive programs to insure the sustainability of production levels immediately after an acquisition. Be sure to make use of the time value of early employee enthusiasm.

Sales, marketing and the client service: Immediately after the closing, initiatives should be implemented which communicate to the clients the benefits of the acquisition. Oftentimes, the clients will now be served by a larger organization with greater resources and a broader range of accounts receivable products, such as outsourcing and early-out services, and with greater geographic coverage.

It is important is to inform and educate your clients before your competition delivers a negative message. Your market position can

be undermined by competitors indicating to your clients that they will now receive poor service because of confusion caused by the acquisition, or that your company is now "too large" to give them good service. This is a time to personally contact your clients more often than before and resell them on the benefits of using your company's services. Shortly after the transaction announcement could also be a good time to adjust fees charged any clients of the target company that are not generating adequate profitability margins. Be sure to enlist the support of the target company sales' staff when formulating a strategy for dealing with unprofitable clients.

Systems: System integration is a key element in the success of acquisitions. The collection industry has become very dependent on technology to remain competitive, service their clients' demanding needs and provide the tools for profitable recoveries within a declining commission environment. Hopefully, by the time the transaction closes, a technical system integration plan is in place and has been communicated clearly. There are numerous issues to consider, including determining whether a system conversion of the target is warranted. If a conversion is to be implemented, it is critical that data integrity be maintained and agency/client data transfers continue without interruption.

Accounting and financial: Most acquirers will immediately gain control of the cash, treasury and accounting functions after an acquisition. Internal controls will be put in place to ensure that cash is managed efficiently, not only at the subsidiary level but at the corporate level as well. All acquirers, along with their investors and lenders, will require consolidated financial reporting. Oftentimes, internal financial statements that used to be prepared several months after the end of a fiscal month must now be prepared within weeks (or days) after a month-end closing.

Culture: Company cultures are never identical. Some companies' cultures are client focused—even down to the receptionist. Others are inward focused toward employee empowerment and

benefits. Some companies handhold their clients and may deliver the clients' checks each month, while other companies would terminate that practice immediately. There are organizations where the mantra is year-to-year growth, while others are satisfied with maintaining a marginal growth trend. These are but a few of the culture issues that can exist, resulting in differences in customer service approaches, selling tactics and employee relations that can, in turn, cause post-closing tension between the acquirer and acquiree's staff.

The major differences in culture should be identified early in the due diligence phase prior to closing. I see very few due diligence questionnaires that have a section dealing with culture. This issue should not be deferred to an after-closing discovery. Do not underestimate the importance of culture. Culture is difficult to change. If the

companies' philosophies and cultures are too widely different—resulting in probable significant integration conflicts—you should consider terminating acquisition discussions.

Principles leading to valuation capture

It is one thing to execute the mechanics of the acquisition integration plan, and another to understand the principles that will help realize the value promised by the transaction. Key integration principles utilized by successful acquirers include many of the following:

- Understand and preserve the factors that have historically driven the financial performance of the target company.
- Integrate with a sense of urgency. A prolonged integration process rarely

results in value creation. Do not delay in generating early momentum toward value capturing.

- Protect the bottom line. Focus on activities that will have the most impact on sustainable earnings. Do not pursue activities that have a low probability of success.
- Understand that system integration is a cornerstone to the success of the other valuation drivers.
- Do not be afraid to make mistakes. You will probably not make any more mistakes taking swift action than you would taking a prolonged approach to acquisition integration.
- Focus on the 20 percent of the actions that result in 80 percent of the benefits for valuation creation in the subsidiary.
- Communicate often and with clarity to the stakeholders of the company. Encourage two-way communication.
- Empower a strong executive to lead the integration and provide the resources of an integration team.
- Initiate clear operating targets with accountability and performance incentives.

Conclusion

Acquisitions can be a very effective means of increasing shareholder value. However, acquisition integration is challenging and a misguided integration plan is unforgiving. The primary determinant of an acquisition's success is creating, delivering, and measuring shareholder gains resulting from the transaction. CM

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