Gaining Board Approval for Acquisitions
Particularly in a Tight Economy

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Abstract: During tough economic times, the Board of Directors, CEO, CFO and executives responsible for building the business are under increased pressure to ensure a respectable return on major corporate investments, including mergers and acquisitions. Interestingly, the most important aspects of ensuring success are often overlooked.

This article highlights seven areas – beyond the obvious financial requirements – that must be addressed to gain investment approval and set acquisitions up for success. A special emphasis is placed on the role of the business leader and corporate development team in driving measurable results.

As many executives experience the most significant downturn in the history of their industry, they face tough choices. With the recession well underway, it is becoming more difficult to sustain operations and make strategic investments.

Companies that have strong assets but lack the financial position to weather the recession will be motivated to exit through acquisition. This is the main alternative to remaining an independent company faced with tremendous cash constraints and a greater risk of failure.

Downturns create opportunities for leaders of cash-rich companies to acquire while benefitting from depressed valuations. The timing may be just right for an opportunistic acquisition, an expansion of capabilities within an existing division or product line (a “tuck-in” acquisition) or a strategic acquisition.

Executive teams that become acquirers need clear insights into the upside potential and the downside risks. This article outlines specific actions to maximize the investment and mitigate acquisition risk.

What the Board Needs to Know

All acquisitions start with a fundamental set of assumptions. These assumptions typically are presented to the Board by the business owner, who presents the business case developed with assistance from key executives in corporate development, strategy and finance.

Companies most adept at acquisitions, often serial acquirers, lead the process with a strategic assessment to align the company strategy with the merger and acquisition (M&A) strategy. These companies have built an M&A competency based on lessons learned during negotiation, due diligence and integration of prior acquisitions.

They are prepared to answer the following Board questions and adopt best practices to increase the likelihood of success.

#1. Who is the Business Leader and Champion? Executives successful in building companies through acquisition say failures began with a weakness in leadership and accountability.

Tips for the Business Leader

CEOs, GMs, business unit executives and other business leaders say acquisitions, whether a success or disappointment, are the most challenging and difficult experiences of their career.

One of the most important lessons learned by executives undertaking acquisitions is the need for a repertoire of soft skills to drive the acquisition and value creation forward at every juncture. The successful business leader

- **Demands a sense of urgency and clarity in finalizing the value drivers and targeted synergies, and in prioritizing resources and timeframes.**

  From due diligence to legal close, the integration team must gain confidence in the value drivers and targeted synergies. Simultaneously, they determine the resources and timeframes required to achieve these goals. The business leader must insist these are finalized as soon as possible. The longer it takes, the more likely decisions will be forced by political agendas, risk avoidance or other undesirable cultural characteristics that undermine the acquisition.

- **Is relentless in demanding a detailed plan after the Board plan is approved.**

  Setting value drivers and synergy targets means little if the responsible teams do not have a plan to achieve the goals. The opposite may also be true. A well-developed plan creates confidence and legitimacy although decisions are often difficult and sometimes unprecedented. Finalizing the plan reinforces that top management expects tough choices be evaluated, implications understood, decisions made and action taken. It is paramount that the plan be coordinated across functional areas – for example, finance, legal, IT, HR, sales, products, marketing and services. Once this happens, change becomes real to the integration team and the risks inherent in the plan become clear. It is absolutely essential that the business leader demand this level of rigor.

- **Is highly visible and willing to make the tough decisions.**

  Selling the acquisition to the Board requires absolute clarity. Selling it to the team responsible for pulling it off, in many ways, is even more challenging. Every day, the team will face dilemmas that seem insurmountable, yet they will be expected to come up with solutions. They need the business leader to provide vision and clarity, to continually reinforce the importance of building the business by integrating the acquisition, and to stand up for the team to acquire resources and facilitate decisions that enable the plan to be realized.

Designating a clear business leader to champion the acquisition is an absolutely critical aspect of making the case to the Board and holding the organization accountable for achieving measureable results. The business leader will lead most strategic decisions and deliver on the commitments made to the Board (called the Board plan).

#2. Why this Acquisition? The Board and executive team will expect even more rigorous analysis of an acquisition opportunity during tough times.

The CFO, CEO and Board must understand how the acquisition fits within the company's financial picture, the market, and various economic scenarios. A well thought out narrative backed by facts is needed whether the objective is to increase revenue, build the client base, acquire cash, increase market share or expand reach.

During discussions with the executive team and Board, the business leader must demand what is needed from the organization. This is key to setting the acquisition up for success since resources will undoubtedly be tight and acquisition integration must be a top priority.

#3. How will Value be Derived? A key element of communicating an acquisition's value is defining and quantifying metrics, called value drivers, to reflect the acquisition's contribution to the combined company. Every acquisition is judged by value created – such as increased revenue, reduced costs, enhanced market share, expanded capabilities, accelerated product strategy or advanced knowledge.

Value drivers need to address two equally important dimensions:

- The benefits of the acquisition, including realization of synergies.
- The material risks to the business as a result of the acquisition.

Value drivers are essential for communicating the compelling story of the acquisition. It is just as important to show the thinking behind attaining the benefits and managing the risks as it is to quantify them whenever possible for tracking purposes.

It can be a challenge to obtain enough data prior to due diligence to identify and quantify drivers that accurately reflect potential value and synergies. The most successful acquirers take a coordinated approach to due diligence to increase their knowledge of the business realities, including the strengths and weaknesses of the company being acquired. This information is then used to adjust the value drivers and reflect a more realistic perspective in the business case.

#4. What Due Diligence Information will Build Confidence? To expedite an acquisition during an economic downturn, the executive team of a company seeking to be acquired may be more willing to provide important information to the due diligence team. This can work to the advantage of the acquiring team in understanding risks and formulating plans for integration.

Corporate development most often leads due diligence and deal negotiations with the goal of identifying showstoppers and major issues that may impact valuation.

A few areas requiring investigation during due diligence are highlighted in Table I.

Showstoppers & Valuation Risks *Owner: Corporate Development*	**Business-Building Challenges** *Owner: Business Leader*
• Distribution contracts with conflicting terms and conditions • Unpaid legal settlements and pending lawsuits • Open source software embedded in customer offerings • Material employee and long-term procurement contracts	• Differing product quality and customer satisfaction standards • Material differences in cost structures • Unique customer capabilities that do not integrate • Key talent retention challenges

Table I. Sample Areas to Investigate during Due Diligence

Simultaneously, the business leader must
- assess short and long-term business risks,
- ask questions to determine the timing of synergies,
- further quantify value drivers, and
- begin to formulate the plan for building the business.

This expedites short and long-term value realization and avoids major gaps between forecasted and actual value.

Case In Point – *Business Model Conflicts*

Major differences in an acquired company's business model may substantially impact the timing and risks of realizing deal value.

A company, acquired by a global software firm, invested in a specialized order and fulfillment process that enabled it to configure software for each client prior to shipment. The acquirer's own systems and processes did not provide the flexibility to integrate this specialized capability.

During due diligence, these differences were not identified. When they were identified, management attention was already focused elsewhere and priorities were not changed to address the issue.

Over a year later, when the processes were integrated, a key differentiator of the acquired company was lost. This resulted in thousands of frustrated customers, low morale within the acquired team and lost time as the integration team reacted.

Had the specialized process been identified up front, the company would have moved far more quickly, accommodated an interim fulfillment process and managed customer expectations to prepare them for the ultimate change.

Not only was the impact felt through lost time and frustrated customers, but the morale of the acquired team never recovered. Turnover reached 30%, eliminating the goodwill created by key staff retention bonuses.

#5. How will the Companies be Integrated? A strategic decision must be made as to the timing and depth of integration. Business leaders are accountable for integration and business building so they must have a key role in this decision.

It is important to determine whether the acquired company will be left to operate independently for a period of time or be fully integrated immediately. There are significant tradeoffs to be made between

- full integration, with its long term cost efficiency and flexibility, and
- operating as a separate business, which initially may maintain momentum but longer term creates unwanted complexities for the company.

This strategic decision is critical. If it runs at odds with the company norms then it will inevitably be revisited time and again. Whatever the decision, sticking to it and being absolutely clear about what is negotiable and what is not is essential.

Once the decision regarding the level of integration is made, a clear, coordinated plan for integration can be developed.

#6. Who is Accountable for Integrating the Companies? The business leader, supported by functional teams focused on ensuring all aspects of the integration are handled, is accountable for the long-term success of the business.

To assist the business leader and functional teams, an integration lead is typically designated. The integration lead is responsible for driving the cross-functional integration team after deal approval.

The best fit for this role is an executive with strong leadership skills, a solid understanding of corporate and acquisition strategy, significant operational experience, and specialized skills leading cross-functional teams through change.

Most often, the integration lead reports to corporate development to ensure that general and administrative (G&A) integration is handled to meet close date requirements. This creates a strong focus on near-term integration but typically does little to provide the business focus for short and long-term value creation.

Alternative reporting structures that reinforce a more holistic view of integration should be considered. In some companies, the integration lead reports either

- directly to the business leader with dotted line responsibility to the corporate development executive who is accountable for all G&A aspects of integration, or
- directly to the CEO or COO to whom all functional areas and business units report.

Once an integration lead is designated and the reporting structure clear, drilling down and understanding the value drivers in depth allows the executive team to identify where specific accountability resides. For example, with

- Sales to increases revenue, with the help of the teams who deliver new products.
- Manufacturing to reduce costs by consolidating facilities and purchasing.
- Product management to reduce cost and raise productivity by combining products.
- Engineering to accelerate product delivery by integrating acquired technologies.

#7. How will Progress be Tracked? Acquisitions, like other large cross-functional initiatives, can be very complex and seem unmanageable. Therefore, it is critical that there is excellent communication and reporting up and down the levels of the company on a regular basis.

- The Board, the executive team and business leader need to know the status and progress of closing the acquisition and attaining the expected value.
- The integration lead and functional leads need information from above as context to make better decisions.
- Integration project teams need to report progress and challenges upwards, with confidence that help is available, if needed, to remove bottlenecks.
- Employees in both companies need to know how the acquisition impacts their current jobs and future careers.

Critically important is tracking value drivers and synergy objectives for Board presentations. This provides the Board and the executive team evidence of results and identifies early any areas falling below expectations. It also helps to frame discussions regarding tradeoffs that need to be made.

Case In Point – *Balanced Scorecard*

A high technology company used a balanced scorecard following a technology acquisition to ensure tradeoffs were made between operational efficiency and the needs of shareholders, customers and employees. The scorecard focused on the following short and long-term goals outlined in the Board plan.

Shareholder

- Meet or exceed revenue and cost synergies in the business case
- Exceed quarterly sales funnel targets based on synergy commitments

Customer

- Meet or exceed customer satisfaction objectives based on surveys
- Meet product roadmap commitments

Employee

- 90% retention of top talent during the first year following acquisition close
- Improve employee satisfaction based on quarterly pulse checks

Operational

- Meet financial, IT and HR process and system integration commitments

When creating reports to track value drivers and synergies, each metric needs a clear definition, quantifiable results, a process for tracking changes and an owner responsible for reporting. Typically these measures are reported monthly or quarterly to the Board.

Equally important is tracking integration progress at a detailed level and rolling it up into a summary report for management. This method of reporting identifies if integration is gaining traction, serves as a vehicle to surface issues early and provides the opportunity to remove bottlenecks and resolve issues promptly. Typically this reporting is done weekly or bi-weekly.

By monitoring acquisition progress on a regular basis, the Board and executive team will gain confidence in doing deals.

Conclusion

Acquisitions are often evaluated and approved based solely on financial plans or the enthusiasm of key executives. Once momentum starts, little stands in the way of doing the deal.

This article touched on a few areas often overlooked when approving and tracking the success of acquisitions:

- Placing accountability in the hands of a business leader to drive the acquisition.
- Creating a well thought out strategy, solid rationale and value drivers for the acquisition.
- Developing a detailed plan and maintaining a laser focus on execution.
- Establishing a consistent method of tracking and reporting measureable results.

All are absolutely essential to realize value, mitigate risks and enable long-term success.

By taking action now to shore up existing approval and integration processes, acquirers will substantially increase their acquisition success rate and minimize costly divestitures.

Felix Consulting Group *partners with high technology executives to accelerate corporate growth. Through management consulting and interim leadership services, Felix Consulting helps drive companies up the growth curve and overcome obstacles that hold them back from success.*

Susan C. Felix, CEO of Felix Consulting, works with middle market and billion dollar companies to *fast track corporate initiatives from strategy to measureable results*™. As a business unit executive, she built rapid growth businesses through mergers, acquisitions and organic growth. Susan can be reached at www.felixconsulting.com/contact.html.

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