

POST-ACQUISITION INTEGRATION AS A CRITICAL SUCCESS FACTOR TO EFFECTIVE M&A

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Abstract

Mergers and acquisitions (M&A) are ranked among the most important ways of company growth. Company growth through M&A is considered very flexible and reliably controllable and eventually the outcomes of M&A are easily measurable. Formalized and properly structured management practices aimed at M&A have been developed almost to perfection over past several decades. On the other hand prevailing part of M&A which have been executed over past years have not generated expected results. Such a contradiction gave rise to a research question which concerns causal analysis of M&A failures. One of key reasons for M&A failures is underestimating post-acquisition integration process (PAIP). Companies usually place emphasis on pre-acquisition stage of M&A when potential synergic effects are identified and financial benefits of M&A calculated. PAIP is usually believed to come into effect almost spontaneously without heavy interference of company management. The goal of this paper is making critical evaluation of theoretical findings which refer to PAIP, demonstration of effective PAIP management in industrial practice and preparation of the set of guidelines for effective running PAIP. As research methods questionnaire survey as well as controlled interviews with industry managers were conducted.

Key words: mergers, acquisitions, post-merger integration, integration planning.

JEL Code: L24, L25, M14.

Introduction

The goal of this paper is to provide the comparison of theoretical knowledge which were presented by various authors. In addition process mapping concerning post-acquisition integration which is a part of merger and acquisition (M&A) process was also performed. Theoretical background is supported by experts' opinion as well as by the case study taken from actual M&A practice. The reason for the exploration of this topic is especially high degree of failures of M&A regarding the achievement of synergies. Very important problem is the absence or low efficient post-merger integration and dysfunctional process integration upon the merger. That's why another goal is to look for the reasons of these inefficiencies as well as to propose specific management tool which would help either to cope with these

failures or prevent from these dysfunctionalities. The main benefit of this paper is the creation of the theoretical basis of the integration process for the further research and for the theoretical basis of the post-merger integration.

1 Scientific methods used

Thorough literature analysis aimed at the exploration of the principles of M&A was performed. Moreover, the emphasize was placed on determining factors which influence the quality of post-acquisition integration. As the main research method the qualitative research approach consisting in conducted interviews with company managers who bore responsibility for some parts or aspects of specific mergers or acquisitions. The part of integration process and activities mapping was a questionnaire survey to be focused on examination of employees' opinion of this change. The questionnaire was composed of 16 questions, the results being anonymous to serve the purpose of this paper. Total number of respondents was 102 and comprised all employees of the company.

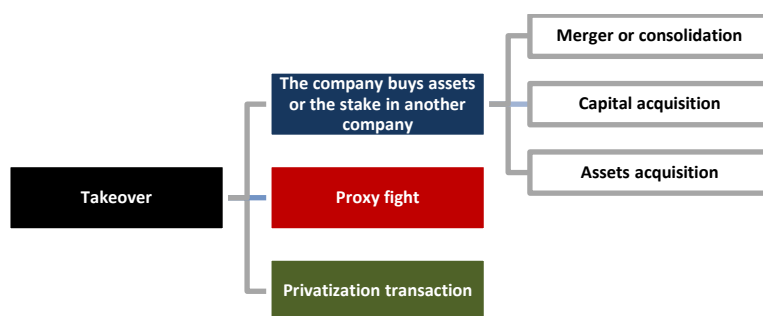
2 Mergers and acquisitions (M&A) as a form of the company growth

In conjunction with M&A the term *Market for Corporate Control* was coined. Kislingerová (2007, p. 619) supports the meaning of this term since it deals with the market where the commodities are represented by individual companies and the purchase of the company by another company results in closing the investment deal. This deal must observe the principle of *Shareholders' Value Engineering* which means that the purchase of the company must contribute to the increase in shareholders' wealth and value. The concepts of M&A can be further divided into individual forms like (Mařík and Dědič, 1995, p. 7):

- acquisition of the company or its part,
- selling off the company or its part,
- purchase of the company or its part,
- mergers,
- various forms of cooperation,
- joint venture,
- management-buy-out,
- management-buy-in,
- strategic alliances,

It can be deduced from aforementioned classification that it is perceived rather flexibly and includes such forms of collaboration as *joint ventures*, *branch-oriented cooperation* or *alliances* (Mařík, 1997, p. 8) while *takeover* is considered narrower. The *takeover bid* is the official announcement that during the certain period the purchaser will purchase definite number of target company shares for clearly defined price so called „*tender offer*“). *Takeover* in its larger context is shown in Fig. 1

Fig. 1: The processes included into the concept of takeover



Source: Mařík and Dědič, (1995)

Proxy fight is then understood as the effort of the shareholders to appoint people to top management position who will protect their interest. At privatisation transactions the stakes are purchased by a small group of investors mostly by the members of current management or external investors (Mařík, 1997, p. 9). The last form of the takeover, when the acquisition of the assets or the stake takes place, has three basic ways in which it can be applied as pointed below (Mařík a Dědič, 1995, p. 7):

I. Merger or consolidation

- In this point the merger is understood as joining two firms when one of them acquires assets and liabilities of the second company, retaining its identity while the second company terminates its existence.
- Consolidation is then joining two firms where both companies terminate their existence and new firm that acquires both assets and liabilities of preceding two firms is founded.
- The concept “mergers” includes both the merger and the consolidation.

II. Capital acquisition

- The principle is the purchase of the voting shares and it is executed by the takeover bid, purchase of the shares on the Bourse or OTC market.

III. Acquisition (the company purchase)

- All the main shareholders must yield consent with this transaction and then the transfer of legal rights to assets comes into force.

2.1 Various forms of mergers and acquisitions

The acquisition of the target company may be either “friendly” or “hostile”. In case of a hostile takeover the company management defy to intended takeover because of the fear of losing lucrative management position. It is usual that a new owner reckon on the replacement of the current company management. These so called “*corporate raiders*” contact directly the shareholders with the bid which must be advantageous for the current shareholders. (Synek, 2006, str. 86).

In practice two types of a *hostile takeover* can take place in two following ways (Kislingerová, 2007, p. 630):

- I. **Proxy fight**, when the raider gets the support of the shareholders in shareholders meeting and gets the right to vote instead of other shareholder,
- II. **Tender offer**, when the management of the target company may recommend or question the bid

There are also other forms of acquisitions like *Management Buy-out (MBO)* when target company is acquired by the current company management and the managers become the owners of the company. This way of the acquisition may even have the form of the hostile takeover. The similar way is *Management Buy-in (MBI)* when the company is acquired by an external management. The most usual aim is to improve company performance, acquit the debt and consequently sell the company off (Daniliuc et al., 2014; Kislingerová, 2007, p. 631). Bruner complement on Kislingerová (2007) and declares that in conjunction with MBO there exists *Leverage Buy-out (LBO)* which differs from the usual acquisition because the purchase of the stake is financed by the debt. In practice the acquisition deal is financed by the combination of the debt and financial resources provided by private investors (Bruner, 2004, p. 394). The success of such a transaction is contingent upon management's inclusion in the owners' structure and its motivation.

M&A can operate as a tool for company restructuring. In conjunction with M&A the term "divestment" was coined when the company gets rid of the property, stakes, securities etc. Among these practices *Equity Carve-Out* can be included when the company sells mostly minority stake in its subsidiary by means of *Initial Public Offering (IPO)* or by spin-off when the entire subsidiary is hived off and its shares are distributed to parent company shareholders as an equivalent of dividends (Kislingerová, 2007, str. 627). From the perspective of structure of business and environment M&A can be broken down into several types (Das et al., 2009, p. 71). Typically it deals with horizontal, vertical, conglomerate and congeneric mergers. Individual M&A specifically differentiate by means of company types which are entering the merger. Sometimes it is mentioned a reverse triangular merger which means the formation of a new company that comes into existence when an acquiring company establishes a subsidiary. Then the subsidiary purchases the target company and the subsidiary is then absorbed by the target company.

3 Post-acquisition integration process (PAIP)

The process of individual integration of all subjects in entire transaction process of M&A belongs to the most critical aspects of a current business. The concentration on the process of integration was remarkable in the last wave of M&A. Moeller and Brady (2014, p. 331) pointed at the importance to take into consideration that the transaction process is not ended up by closing the deal and signing the agreement. This might be apparent in some cases, especially in the inception of the development of a newly established company. As soon as the transaction is closed then PAIP is the remaining and terminal step which bears responsibility for the shareholders' value engineering which was planned at the beginning. It stands to reason then the success of all preceding phases (strategic planning, financial analysis, transaction structure and negotiation) would be typically contingent upon dynamic integration and successful implementation. KPMG study (KPMG, 2014) also confirms that

the most important factor for the success of the transaction mentioned by the experts was well elaborated integration plan. Moller and Brady (2014) further emphasized that M&A are the vehicles only not the end solution. Companies which based their growth on M&A and use this concept for the fulfilment of company strategic growth have to carry out the integration very cautiously so that the value planned can be achieved. Unfortunately in many cases the emphasis is placed on the finish of the transaction and there is little attention to be devoted to organizational problems and human resources. This fact contributes to a high level of failure in terms of reaching expected synergies. Many experts assume that the success should be ensured by the right selection of the goal and correct valuation (price) of the transaction. McKinsey & Company Study (McKinsey, 2010) shows that this level of failure achieves 66-75%. More conservative opinions mentioned the figure 50% in this respect. Schweizer and Patzelt (2012) emphasized the role of leadership in PAIP which affected the speed of the integration and facilitated commitment decisions of the employees to stay with acquired target firms during the integration process.

4 Case study on the post-acquisition integration between Logica and CGI Company.

Logica PLC company (“Logica”), UK based company, is one of the most renowned multinational providers of IT services and consultancy in Europe. Its shares are listed on London Stock Exchange and Netherlands Bourse Euronext. Logica was founded in 1969. Its scope of operation includes IT services including consultancy, SW development, systemic integration, product innovation for telecommunication, finance services, public services, product innovation. Logica customer portfolio includes such prestigious companies like Ford, Merrill Lynch, Exxon, IBM or Vodafone (Levi, 2000). Over past four years Logica manage to achieve sales round 1 M GBP. In addition to organic growth Logica closed several acquisitions in Europe. 91% of total sales was generated in Europe while remaining 9% was generated outside Europe (Logica, 2011).

CGI Group (CGI) is the fifth biggest multinational IT and BSP Company incorporated in Canada. CGI was founded by Serge Godin in 1976 who also holds the office of company CEO. The company is listed on Toronto Stock Exchange as well as on NYSE. In the past Logica made majority business in USA but later on moved its activities in larger extent to Europe. Application Management, IT and Business Consulting, IT Infrastructure, IT Outsourcing, Cloud computing and Business processes belong among the portfolio of services offered by CGI. The company provides its service namely to state administration, telecommunication, finance sector, healthcare sector, manufacturing sector, oil and gas industry.

4.1 The presentation of the acquisition of Logica Plc and CGI Group

CGI announced the recommendation for the acquisition of Logica on May, 31, 2011. The negotiations on the acquisition understandably proceeded even before this date. The bid consisted in cash settlement amounting 2.8 bill. CAD (1.7 bill. GBP). It accounted for 105 pennies per share which represents 60% premium above closing price. This transaction combined assets of two companies which were ranked among 50 biggest companies in IT

sector. In fact the transaction was executed by the purchase of so called *ultimate parent company* which was in this particular case Logica Plc. The situation was a bit unusual since the smaller company acquired the bigger company. By this acquisition CGI was ranked among the top 10 IT service providers in the world. 99.5% of shareholders voted in favour of this acquisition. It was the largest acquisition in company history since its foundation. The goal for the synergy was set at 375M USD for 2014 and it was eventually exceeded. Within the framework of the acquisition net debt of Logica amounting 0.9 bill. USD was also purchased by CGI. CGI financed the transaction by means of both equity and shares' swap. The combination of corporate cultures of both companies was a great challenge because of multicultural environment in Logica that was developed through various acquisitions in the past. CGI and Logica indicated two main synergies:

- Complementary geographic coverage when CGI covers 94% sales in USA and Canada and Logica 91% of selected European countries.
- Similar focus on industry which enables services cross-selling in a public sector, health sector, banking, telecommunication and insurance.

The next synergies can be expected especially in operation processes which are integrated according to CGI Management Foundation and should be more effective. In conjunction with Angwin and Meadows (2015) recommendation CGI places emphasis on the growth strategy expressed in terms „build and buy“ which is aimed at both organic growth and acquisition.

4.2 The mapping and evaluation of post-integration process between Logica and CGI based on management interview.

The interview was used to map and describe the PAIP, examine the specifics of these transaction and make the comparison with the best practices. The analysis of the PAIP was made on the sample of the staff working in the Czech subsidiary of CGI. The entire integration proceeded in all European subsidiaries simultaneously and each of them was assigned the integration leader. Limited factor to this research was the access to information about the integration planning and integration management because of the control of these activities from the central office of CGI. Czech local subsidiary was a subordinate entity which executed the directions given by the headquarters. Moreover the Czech subsidiary operated under internal information sharing constraints which disabled the researchers to go into details of the mapping PAIP. Based on internal company documents the primary goal was to integrate Logica into strategic framework of CGI in all *Strategic Business Units (SBU)*. Duration of the PAIP was scheduled to 3 years, nevertheless during the integration period some changes to existing schedule were made and the integration period was shortened by one year. Integration strategy was affected by the nature of the transaction where the goal was to take over Logica and its European territory. At the very beginning the whole PAIP was focused on the integration of all activities and adjusted Logica to standardized processes of CGI. Needless to emphasize that the whole integration was managed and monitored by the central office of CGI. Local subsidiaries assumed coordination roles only.

The acquisition of Logica was oriented on growth synergies when the extension of a “geographic trace” took place. The integration proceeded very fast and as mentioned before it

was shortened from three to two years. Integration planning began long before the kick-off of the PAIP. The team structure consisted of the central integration team controlled all the activities in subsidiaries. Local team exerted coordination of integration activities. Key decisions and change management steps were properly formalized. Despite high quality communication on the stepwise PAIP detailed steps to meet the milestones were not specified. In general there were not significant differences between companies. Both companies were active in the same sector, with the same product portfolio and business model. Diagnosis of a corporate culture pointed at some differences, especially in the way of management of the company. Although from reporting and monitoring point of view newly established company centralized the control of individual subsidiaries under one office in the North America, nevertheless it was indicated during the interviews with company representatives that there were changes in the autonomy of individual subsidiaries. Currently the subsidiaries are enabled to have higher level of autonomy in the way how to tackle individual areas of „CGI management framework“. It corroborated the opinion of Zhu et al. (2015) who stressed that the autonomy is highly important in the value creation. This approach can be simply described in the following way: “it is given *what* and *why* to do but there no direction which way should it be accomplished. The evaluation of the effects of the merger between Logica and CGI was performed by means of conducted interview. The aim of this interview was to results of which are presented below.

5 Results and discussion

Questionnaire survey performed among the employees of former Logica pointed at several highly interesting aspects of M&A in the Czech Republic. The conclusion are apparently more commonplace. The researchers submitted 16 questions with complete CGI staff (102 persons) in the Czech Republic. They succeeded to collect more than 90% of the responses. Due to uneven scale to be used for the evaluation of individual questions, the evaluation is focused on the calculation of a percentage of the modus and the most favourable or important answer.

Tab. 1: The results of the questionnaire survey

No.	The question	Modus	Frequency of the most favourable/important answer
1	CGI as the place for the work	Above average (60%)	One of the best (20%)
2	CGI assessment in various areas: <ul style="list-style-type: none"> - opportunity for the growth - hierarchical relationships - fellow workers - job certainty 	Good (54%) Excellent (44%) Excellent (64%) Good (56%)	Excellent (14%) Excellent (44%) Excellent (64%) Excellent (21%)
3	Acquisition from motivation, organization and results point of view	Good (36%)	Very well executed (2%)
4	Satisfaction with taking over by CGI	Neutral (57%)	Very satisfied (4%)

5	Communication of the acquisition	Neutral (43%)	Very satisfied (7%)
6	Sharing information about the fundamental changes concerning the merger	Rather YES but temporarily not completely (50%)	All the changes were properly communicated (30%)
7	Having trust in company future	High (46%)	Very high (9%)
8	Changes in workload due to the merger	None (56%)	Significant changes (10%)
9	Organization of PAIP	Good (44%)	Very good (12%)
10	Interference of PAIP with routine company operation	Rather NOT (48%)	NO (13%)
11	Changes in internal legislation and guidelines	Partial changes only (49%)	Important changes (38%)
12	The most challenging part of the PAIP	IT (52%)	Sales and marketing as the least important (12%)
13	Perception of cultural differences among both companies	Commonplace cultural differences (40%)	Big cultural difference (10%)
14	Problems with merging both corporate cultures	Rather NOT (52%)	NO (17%)
15	Synergy creation	Rather YES (31%)	NO (14%)
16	Level of autonomy in newly established merger	The same as before (27%)	More autonomy (4%)

Source: Own research

The survey proved that M&A brought new problems to the newly formed company and all the consequences of the merger are not usually accepted by the majority of the staff. The modus (the value with the highest frequency) showed that employees were a bit hesitant to accept new establishment without any reservation. In general roughly 50% of the company staff was not fully convinced about the benefits of the merger. It is apparent that the employees have the highest affection towards fellow workers which represents rather personal standpoint than an institutional support. It supports the opinion of Moilanen (2016) that emotional parts of employees' character play important role during M&A. The main benefit is that the research disclosed the weak points in the perception of the merger by the employees. The company management should address these deficiencies so as to facilitate PAIP.

Conclusion.

According to experts' opinion the most important factor contributing to the success of the transaction is well elaborated integration plan. Companies which make use of M&A for the fulfilment of strategic goals must carry out the integration very cautiously so that the value planned can be achieved. The importance of PAIP is evident from the high level of failures of M&A which is indicated as 50-60%. One of the main reasons of this failure is that the companies are not able to benefit from planned synergic effects or fulfilment of the goals. Among the failures of PAIP can be ranked the absence of the integration plan or its ineffective fulfilment, underestimating integration budget, insufficiently flexible or slow

fulfilment of key areas at the beginning of the integration like the integration of organizational structure or future business model, quitting key persons for the reason of uncertainty or insufficient communication within the course of integration, wrongly defined goals and strategy of the integration, poor operation performance for the reason of flooding by activities, enhanced probability of attracting customers by competitors or insufficient reflection of cultural differences which can imply fragmentation of both companies. Important part of the entire PAIP is the change management on all company levels and regular and transparent communication which is inevitable to surmounting entire uncertainty in the company.

Acknowledgment

This paper was published with the support of internal grant agency program IGA2 IP 304015 at Faculty of Business Administration, University of Economics in Prague.

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The 10th International Days of Statistics and Economics, Prague, September 8-10, 2016

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