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M&A Today: Great challenges, but great opportunities

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INTRODUCTION

The volatility in today's financial markets creates challenges but also great opportunities for mergers and acquisitions (M&A). In uncertain times, there is a need to play it safe, but for some it is also the ideal time to seize opportunities to make great deals. As companies find distinctive ways to strategically navigate in these turbulent times, many continue to use a two-fold strategy: cut costs and stimulate growth through diversification, which includes M&A. Global M&A activity increased in 2010 and continues to increase in 2011. In this article, we report on Global M&A activity in the first half of 2011, review 2010, plus report on U.S. M&A activity with regards to private equity. We conclude with a discussion of best practices for successfully managing M&A integration.

M&A 2011 (Q1 and Q2)

Global M&A activity was up 41 percent with a total reported value of \$1.5 trillion in the first half of 2011 (Thompson Reuters, First half 2011). In Q1 and Q2 2010, worldwide M&A activity only increased 9 percent over 2009 with a total deal value of \$1.1 trillion. While total M&A activity and value increased, the number of deals decreased by 2.1 percent compared to the first half of 2010 to a total of 20,000 plus deals. The high value of M&A was largely a result of high profile players in the market, such as Google Inc., Time Warner Inc. and Duke Energy in the United States, making record deals in terms of size and value (combined deal value of \$39.6 billion alone), while middle-markets deals were slow. The big industry players are on a shopping spree due to their strong cash reserves. Large and small companies are driving revenues and growth through technology acquisitions and diversification so that they are ready when demand increases again.

For players in the middle market, deal pricing is a key factor that determines the number of deals in the market, especially at the lower end from \$5 to \$250 million (Spilka, 2011). Deal pricing has moderately improved since 2008, yet sellers are often still wary about settling on prices since substandard offers still seem to dominate in the market.

The first half of 2011 saw major M&A activity in the United States increase 71 percent compared to the same period the previous year (Thompson Reuters, First half 2011). The energy and power sector led the M&A market, and was responsible for 20.6 percent of total US M&A activity, totaling \$127.2 billion. This was an increase of 14.2 percent compared to Q1/Q2 2010.

The financial services and health care industries follow closely with deal volumes of \$110.7 and \$72.6 billion, respectively. The financial services sector ranks first in terms of number of deals, with 432 transactions, followed by the health care and energy and power sectors with a difference of only 6 and 3 deals, respectively. M&A activity outside of the United States also increased. For the first two quarters of 2011, emerging market M&As accounted for 24 percent of worldwide M&A value. M&A activity in the BRIC countries, Brazil, Russia, India, and China, was up by 84.3 percent in the first quarter of 2011, compared to the same period in 2010. (“Best start,”2011). This increase is in spite of a rise in financial regulation, financial market turbulence, and inflation risks. The M&A community continues to recognize the BRIC countries as lucrative investment targets.

Japan’s M&A activity grew 52.9 percent compared to 2010. Dollar volume was \$82 billion. European M&A activity increased 40 percent compared to 2010. Europe’s total M&A activity reached \$628.5 billion. The rest of Asia (ex-Japan) reported an increase of 11.2 percent and a total dollar volume of \$217.5 billion.

GLOBAL 2010 M&A ACTIVITY

As the world economy showed signs of recovery in 2010, M&A activity rebounded as well (Robert W. Baird, 2011). Global deal count increased by 15.7 percent, from 25,705 to

29,742 transactions, plus total dollar value of M&A increased from \$1.6 trillion in 2009 to \$2.16 trillion in 2010, an increase of 35 percent (see Exhibit 1). Most world regions had significant M&A growth. Central and South America experienced the most dramatic growth, almost tripling its total dollar M&A values from \$61.3 to \$172.2 billion, a 180.7 percentage increase. The number of deals for this region reached 966 in 2010. Africa and the Middle East follow with an increase of 90.6 percent from \$42.8 to \$81.7 billion and total number of deals of 835. Europe ranks third in terms of percentage increase, with 58.7 percent from \$480.6 to \$762.6 billion and total number of deals of 10,644. The Asia-Pacific region (ex-Japan), reached a total dollar deal value of \$329.9 billion, a 45.5 percent increase, with 5,371 deals. Japan, however, experienced a significant decrease in terms of total dollar deal values and number of deals, \$80.1 billion (32.4 percent) and 1,943, respectively.

US 2010 M&A ACTIVITY

2010 was a bullish year for U.S. M&A activity (Robert W. Baird, 2011). The dollar value of U.S. deals increased by 28.8 percent, from \$765 billion in 2009 to \$986 billion in 2010. The number of deals also increased by 37.3 percent, from 7,883 to 10,827 transactions. The U.S. emerged once again as a dominant force in the M&A market, due to a stabilizing economy in 2010, improved confidence among buyers and stronger credit markets. M&A activity in 2010 was not led by public companies but by middle-market companies, many of which are privately

held. Out of 10,827 deal transactions, 9,221 were made by corporate buyers. Only 38.2 percent, however, were made by publicly traded companies. Exhibits 2 and 3 indicate most active industries in 2010 by number of deals and by dollar value, respectively. The technology, professional services and healthcare industries were among the top three sectors for total U.S. M&A activity by number of deals, contributing almost 50 percent, and 5,244 transactions, to total U.S. deals. The health care industry ranked first in dollar volume with \$143 billion, followed by oil and gas with \$112 billion and technology with \$98 billion.

US 2010 PRIVATE EQUITY M&A ACTIVITY

The private equity industry made positive strides in 2010, with support from a stabilizing credit market (Robert W. Baird, 2011). Total value of U.S. private equity M&A activity doubled from \$119 billion in 2009, to \$239 billion in 2010, with deals totaling 1,602 in 2010. The top three industries in the private equity sector are: technology, professional services, and healthcare, with a combined deal count of 843 transactions. Most transactions occurred in the middle-market with a total of 721 deals, and a dollar volume of \$93 billion.

M&A OUTLOOK

As of the time of this writing, M&A activity for Q3 and Q4 in 2011 are expected to decrease due to prolonged economic and structural challenges in the United States as well as in Europe. Specialists anticipate, however, that M&A activity will rebound again in 2012 (Partington, 2011). Despite a lack of certainty when it comes to the state of the US, and world economies, larger companies will continue to seek ways to drive growth and revenues in 2012. According to two KPMG (2011) surveys of banking and global manufacturing executives, the outlook for 2012 is positive. Almost 70 percent of top banking executives expect to be involved in M&A activities in 2012, with a M&A focus on new geographic markets and new technologies. Global manufacturing executives intend to drive growth via innovation and product diversification, using M&As, joint ventures (JVs) or strategic alliances. Deals in the healthcare, technology, energy and biotech sectors are predicted to be among the top contributors to M&A activity in 2012.

BEST PRACTICES IN M&A INTEGRATION

It takes time and finesse to identify the right target company and the “right fit,” in terms of product, financials, and people. Companies invest substantial resources in the M&A process, especially during the pre-merger and deal negotiating phases. Yet, perhaps, the most important step of the M&A process is often the most difficult, that is, to manage and govern the integration of an acquisition when the objective is absorption. Over half of all M&As fail (Homburg and Bucerius, 2005), because M&A integration is complex, and difficult at best. Acquirers often

spend a significant amount of time on legal and financial integration, yet not enough effort on integration for an absorption strategy. We discuss best practices in governance throughout all three stages of the M&A process: the pre-merger process, the closing of the deal and the actual integration. Special attention is given to the integration phase, which includes specific practices for integrating key functional areas of an organization, which will increase the likelihood of success.

The preliminary due diligence and bidding phases are critical in the M&A process. Time and resources must be allocated to these two phases. Yet, while acquirers spend time focusing on legal and financial aspects, they downplay the softer components that often make or break a M&A integration. During the pre-merger phase, acquirers often make assumptions that can cause a distorted view of the target (Lovallo, Viguerie, Uhlaner and Horn, 2007). Participants in the due diligence, bidding, and closing the deal steps often underestimate potential biases that can later prove fatal in the integration phase. These biases include overconfidence, conflict of interest, and underestimation of cultural differences (Lovallo et al., 2007). What acquirers often don't realize is that an integration strategy must be developed during the initial stages of the M&A process (Canina, Kim and Ma, 2010). Acquirers must create a concrete strategic plan for integration that has clear objectives, goals and synergies. As the M&A deal reaches the closing stage, the strategic plan must be fine-tuned with tangible implementation steps. This allows the M&A integration team to hit the ground running with a game plan that's been in place through

all three stages of the M&A process and will continue to be modified during integration. The extra time and resources invested will substantially increase the chance of successful integration. Exhibit 4 highlights best practices in the pre-merger, deal closing and integration phases of an acquisition.

CREATE A DEDICATED M&A TEAM

During the integration phase, effectively managing the merger requires a dedicated team of internal M&A experts. It is critical that this special M&A team blends expertise from both sides of the aisle. The team needs to share a common vision and have high level representatives from all key functional areas, including operations, IT, finance and accounting, HR, marketing, and corporate communication (Knillans, 2009). During the integration phase, employees of the target company are feeling the heaviness of the unknown. Keeping them engaged on what is happening and what is to come is not only best practice but also ethical.

COMMUNICATE WITH PEOPLE

Corporate communication should deliver critical updates and information in a timely and consistent manner (Lloyd, 2009). This is especially important when human resources (HR) policies must be shared with employees. The communication of staffing and HR issues should happen sooner rather than later. It is recommended that key HR integration representatives work closely with the communications professionals. For example, employees should receive updates

on merger and staffing issues. Employees will feel valued and appreciated if they are told about changes in HR policies and potential career prospects in the newly merged company. This allows for a smoother transition and reduced corporate culture issues that can cause a merger to fail. Other best practices include face-to-face meetings, video conferences and a culture audit in both organizations. Direct supervisors are important conduits in this process to keep employees focused and engaged.

INTEGRATE ALL FUNCTIONAL AREAS

A well-developed strategic plan is essential for integrating functional areas. The plan's strategic objectives will guide the internal M&A team in identifying which of the functional areas need to be integrated first (De Haldevang, 2009). The IT and operations functions may be the most complex integration. Individuals in charge of the IT and operations function should identify key risks, ensure that proper controls are in place, and develop a process oriented integration plan with a realistic time line, benchmarks, and tools on how to safeguard assets (Tarasovich, Lyons and Gerlach, 2008). Independent consultants with special expertise in business process and IT systems integrations might be needed to move this process forward.

The effective integration of the marketing function is often not a top priority in the M&A process, yet research has shown that this can result in negative performance outcomes of the merger. Homburg and Buceris (2005) suggest that "the focus of integrating marketing functions should not be on reducing costs, but should focus on market-related performance, which means

special attention should be paid to the needs of the merged firm's customers.” Just as employees are guarded during the merger process, so are customers of the merged firm. Staying on top of customers' needs and satisfaction during the merger process safeguards market performance. It is also vital that the newly merged company communicates and responds to customer concerns in a timely manner.

For the integration of the finance and accounting functions some essential ground work should have already been completed in the due diligence phase, which allows the internal M&A team to move ahead more quickly (Tarasovich et al., 2008). Yet the team will soon realize that the integration of the two accounting functions, requires much cross functional work. The M&A team needs to work closely with IT, the financial controllers in respective departments, as well as operations, to integrate effectively. Teaming up with the target firm's internal audit team early on may prove to be beneficial to ensure safeguarding of financial assets, to evaluate existing controls, and to identify high risk areas. Implementing additional controls may be necessary as needed.

CONCLUDING COMMENT

M&A integration is complex, and challenging, yet also rewarding. Acquirers often focus on legal and financial matters and minimize effort on developing and executing an integration strategy. Careful development and management of an integration strategy through the pre-merger, closing and actual integration phases of an acquisition is critical to success.

Exhibit 1

Global M&A Activity Years 2010 and 2009

Region	M&A Value of Deals (in Billions, US Dollar)			M&A Number of Deals		
	2010	2009	% Change	2010	2009	% Change
North America	\$1,068.3	\$861.4	24.0%	12,552	9,048	38.7%
U.S.	\$986	\$765.7	28.8%	10,827	7,883	37.3%
Central/South America	\$172.2	\$61.3	180.7%	966	645	49.8%
Japan	\$80.1	\$118.5	-32.4%	1,943	2,142	-9.3%
Asia Pacific (ex Japan)	\$329.9	\$226.7	45.5%	5,371	4,720	13.8%
Europe	\$762.6	\$480.6	58.7%	10,644	10,279	3.6%
Africa/Middle East	\$81.7	\$42.8	90.6%	835	639	30.7%
<i>Global Total</i>	\$2,160.2	\$1,581.3	36.6%	29,742	25,705	15.7%

Source: Robert W. Baird & Co. Incorporated (2011, January). 2011 middle-market M&A outlook. Retrieved from <http://www.rwbaird.com/research-insights/insight/ma-market-analysis.aspx>.

Exhibit 2 U.S. Most Active Industries in 2010 (by Number of Deals)	
1. Technology	
2. Professional Services	
3. Healthcare	
4. Finance	
5. Real Estate/Property	
6. Oil and gas	
7. Telecommunications	
8. Utility and energy	
9. Construction/Building	
10. Mining	
<i>Source: Robert W. Baird & Co. Incorporated (2011, January). 2011 middle-market M&A outlook. Retrieved from http://www.rwbaird.com/research-insights/insight/ma-market-analysis.aspx.</i>	

Exhibit 3 U.S. Most Active Industries in 2010 (by Dollar Value)	
1. Healthcare	
2. Oil and gas	
3. Technology	
4. Utility and energy	
5. Insurance	
6. Telecommunications	
7. Real Estate/Property	
8. Finance	
9. Food and beverage	
10. Professional services	
<i>Source: Robert W. Baird & Co. Incorporated (2011, January). 2011 middle-market M&A outlook. Retrieved from http://www.rwbaird.com/research-insights/insight/ma-market-analysis.aspx.</i>	

Exhibit 4

Best practices for Integration through the M&A Process

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