Introduction to Integration & Separation: An essential step to capturing deal value

Date: 3 October 2024
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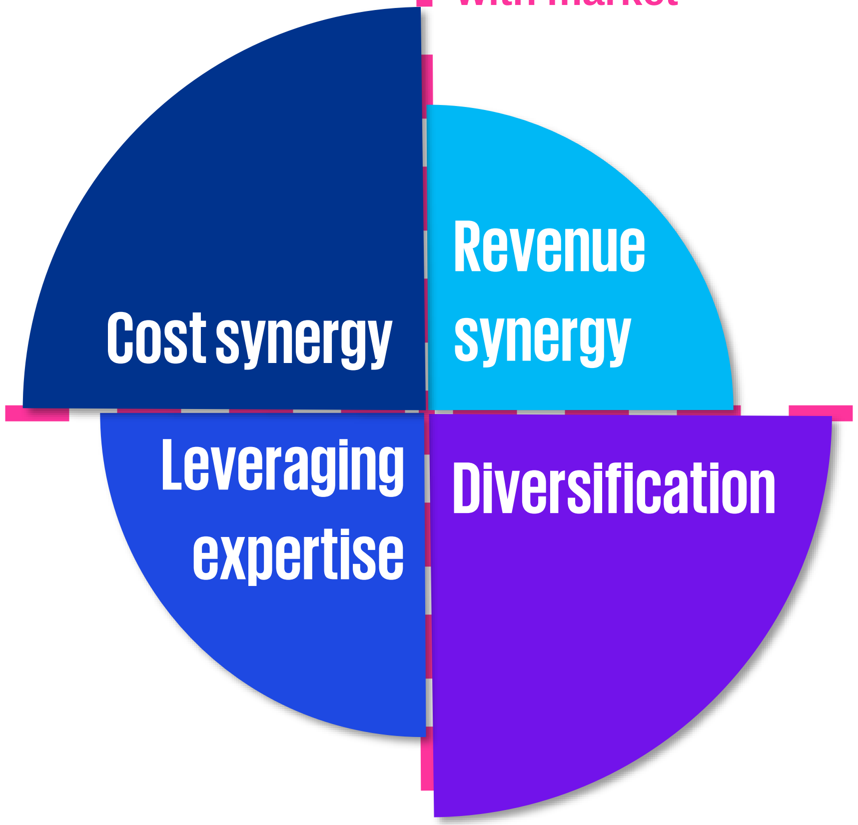
Deals can create value across four primary domains

Cost synergy is a common deal upside. Businesses can reduce costs by achieving **economies of scale**, streamlining **supply chain management**, leveraging tax benefits, consolidating **shared services**, and optimising production lines.

Interaction with market

Businesses often expect more sales from cross-selling by adding new products through acquisition. Acquiring a premium brand can also allow the acquirer to charge higher unit prices from an improved market position, leading more effectively to **greater market penetration** and **increased market share**.

Cost centre



Profit centre

Increased expertise can be achieved through the acquisition of **intellectual property** and key skilled personnel. By absorbing the target company, the acquirer gains control over **proprietary processes** and trade secrets. These valuable resources can be leveraged to benefit the acquirer.

By investing in or acquiring businesses across various markets, the acquirer reduces the risk of relying on any single sector or market. Acquiring a target with cyclical or counter-cyclical revenue streams stabilises income. In addition, it provides a **natural hedge to the bottom line**, where profits from one BU can offset seasonal losses from another, ensuring more consistent financial performance.

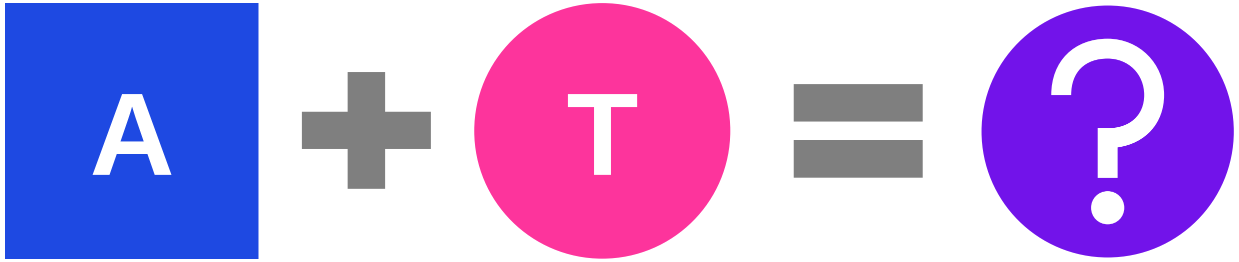
Interaction with internal parties

Why some M&A deals fail to deliver shareholder value

Based on our study, **83% of M&A deals fail due to poor integration**, which leads to **operating inefficiency, cultural clashes and strategic misalignments**.

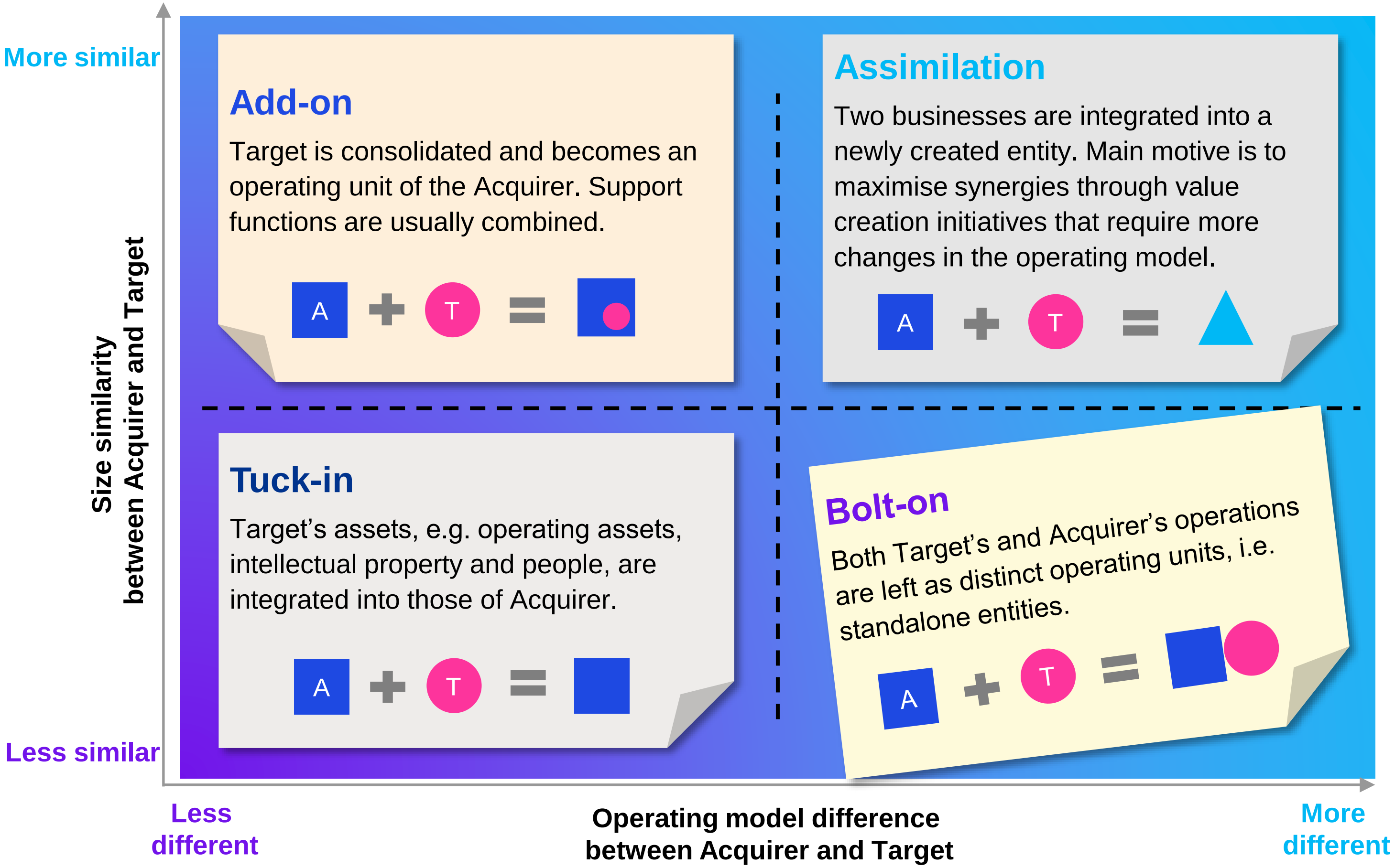
What is integration?

Integration refers to the process of **combining two or more entities** into a unified operating unit, regardless of whether the entities merge or form a new entity, known as **legal integration.** **Operational integration** will always occur as part of **synergy realisation**.

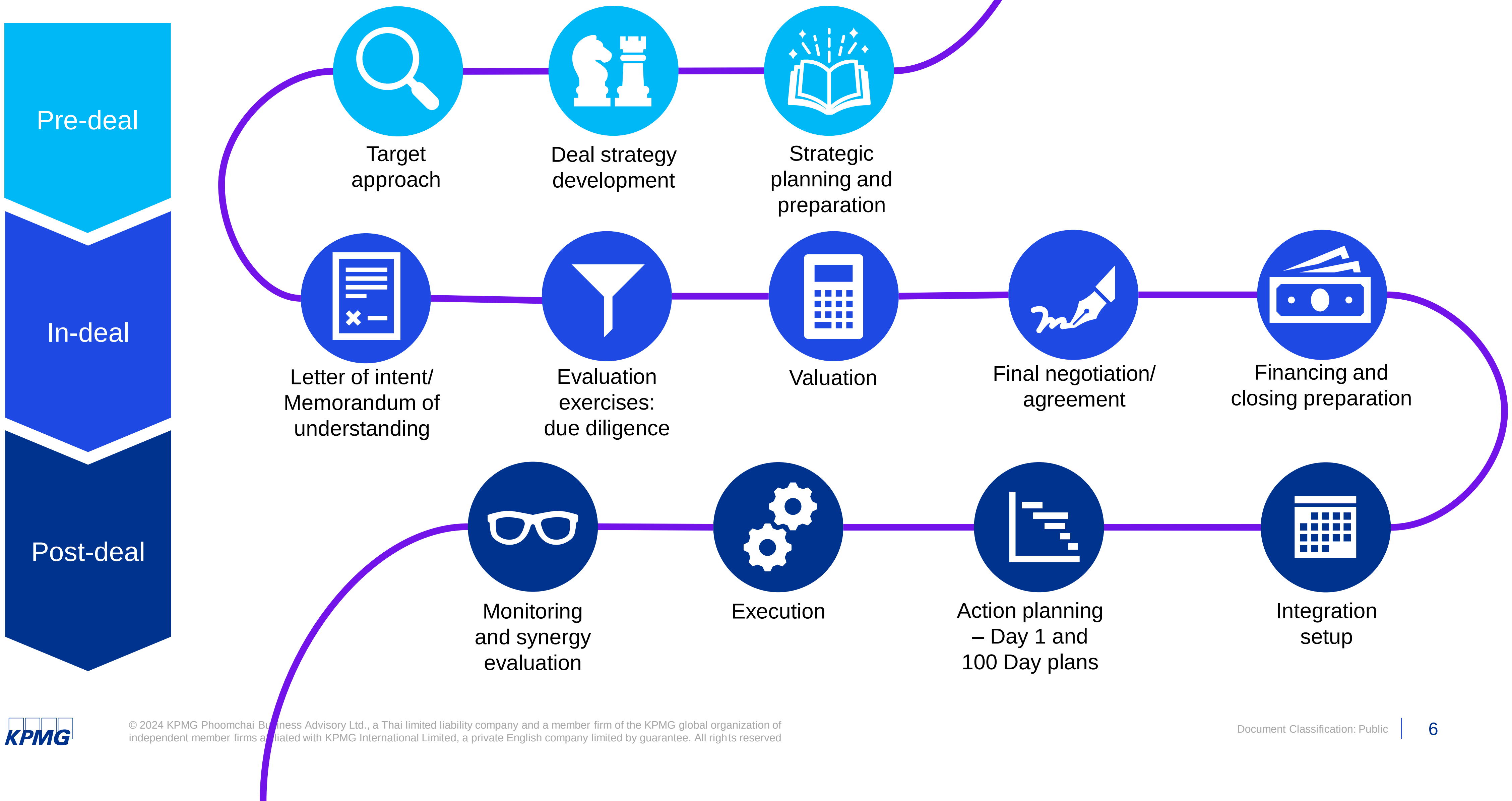


Deal rationale and expected **deal value** will determine the duration of the integration phase, depending on the **complexity** and **level of integration**.

Relative size and similarity of operating model are two key building blocks of integration strategy



Snapshot of the deal process



Businesses should start integration planning as early as possible to avoid deal failure

Benefits of early integration process

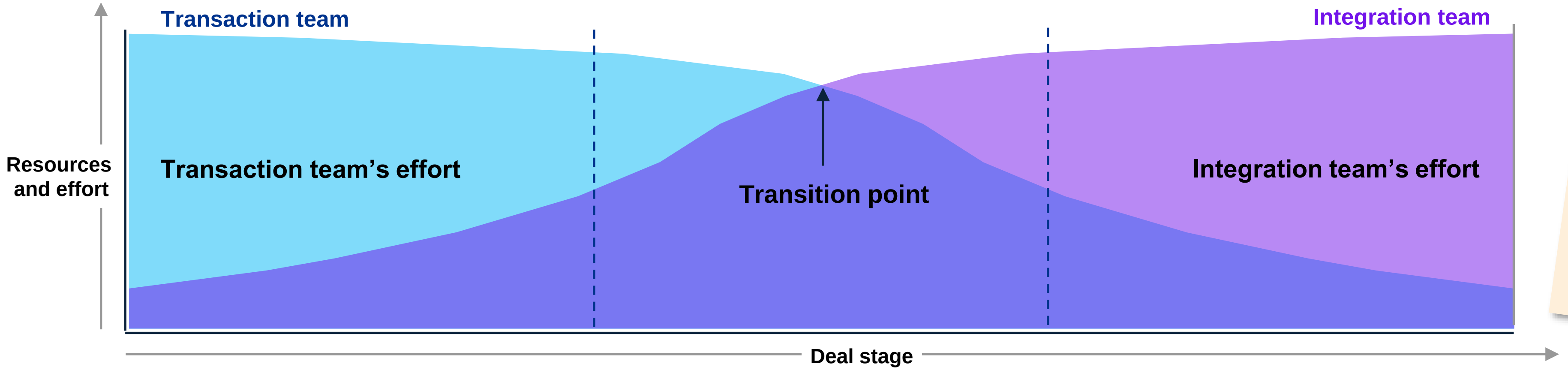
- ☑ Smooths the process by clearing integration-specific obstacles before handing over to the in-house team
- ☑ Ensures the deal value is captured
- ☑ Allows operations teams to carry on with their daily tasks and minimise extra work from integration
- ☑ The earlier the integration team is engaged, the better the planning and the more deal value is captured.

Integration enables the focussed capture of deal value during implementation, **accelerating the achievement** of synergies. **Proper integration** reduces the post-deal risks of the following:

- Operational inefficiencies
- Employee morale
- Internal and external miscommunication
- Unclear vision
- Strategic misalignment
- Missed synergies
- Mispricing
- Growth limitations
- Suboptimal financial results

Early integration planning enables businesses to capture expected deal value

Pre-deal: Deal strategy → In-deal: Transaction evaluation → Post-deal: Integration → Business as usual



. Deal evaluation exercises and post-merger integration should be viewed as joint exercises along the deal stages

Transaction team's responsibilities

- Team focusses on M&A initiatives, target screening, target approach and negotiation, not post-merger integration.
- **RISK**: failure to execute the deal

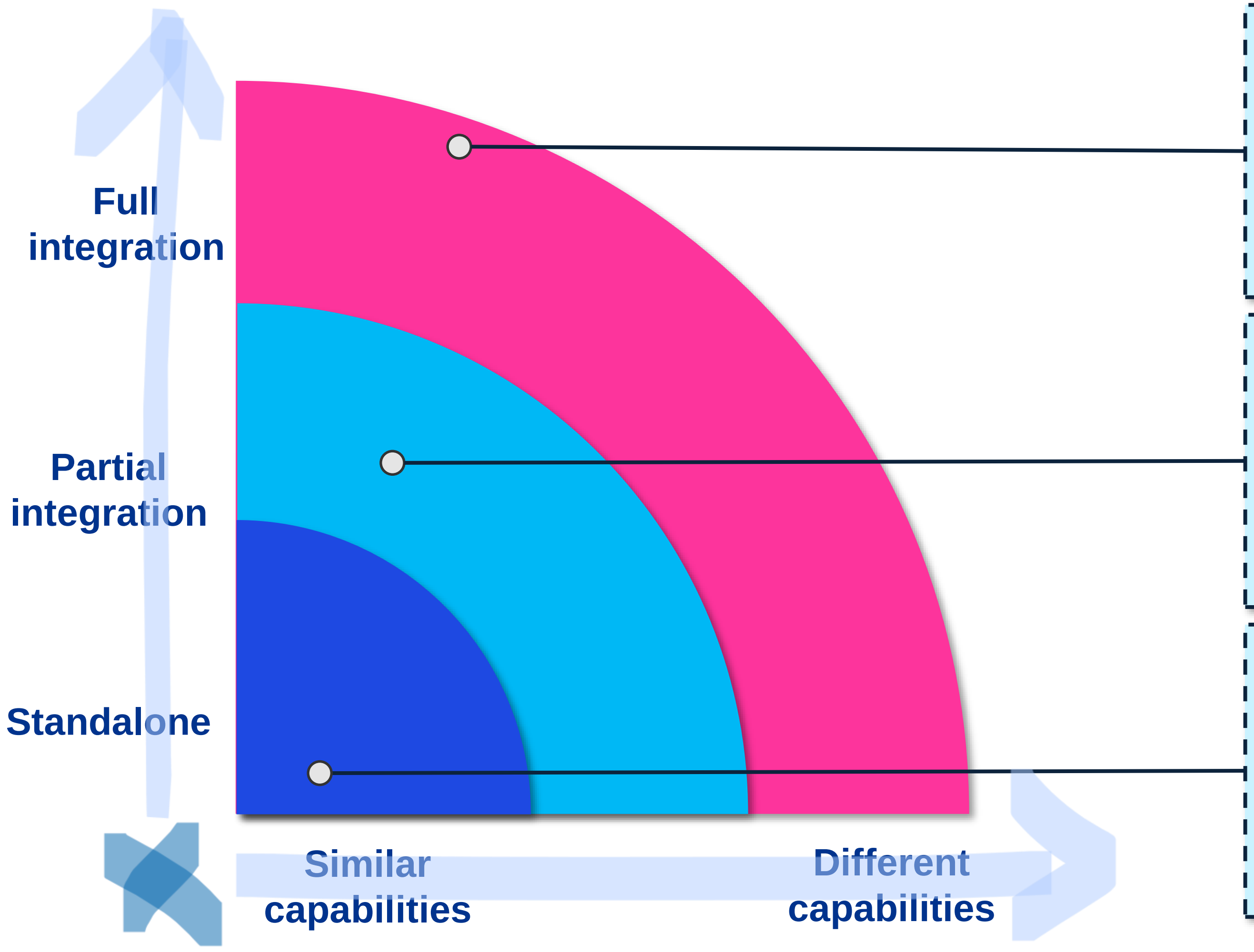
Transition point

- Team focusses on negotiations to acquire target at desired price but may fail to identify and capture sources of additional value.
- **RISK:** integration challenges and opportunities not identified

Integration team's responsibilities

- Team typically receives handovers from the transaction team and begins integration work without adequate knowledge transfer, leading to potential discrepancies between the integration and transaction teams' perspectives.
- **RISK**: failure to achieve the expected synergies and value upside

Deal objectives should consider the degree of integration, and where the post-deal value is



Transformational integration

In most cases, integration requires changes to processes for both the acquirer and target.

Typical deal value levers include**:** Product diversification, cross-selling

Group consolidation

Businesses allow a level of autonomy, balanced with consolidation of some functions, e.g., support functions

Typical deal value levers include**:** Operational efficiency, leveraging technology

Holding company

Collecting sub-optimal businesses and letting them operate as standalone businesses with shared services from the holding company

Typical deal value levers include: Cost saving, building a portfolio

Key integration steps

	1. Set up of programme	2. Day 1 planning	3. Day 1 execution	4. End-state planning	5. End-state execution
	1 – 2 weeks	***3 – 4 months***	***1 – 2 months***	***1 – 2 months***	***1 – 2 months***
			Operation Day 1		
Objective	To set roles and responsibilities of each stakeholder, goals and milestones	To complete list of activities necessary for Day 1.	To ensure necessary task completion, minimising disruption and maintaining business continuity	To ramp down to normal integration governance and reporting	To transition to "business as usual" ("BAU") by phasing out integration management office, workstream structure
Key activities	• Teams appointment • Alignment of goals and milestones to the timeline	• Identify deal value • Create detailed plan from operating models	• Implement changes according to Day 1 detailed plan • Log issues found	• Convert remaining tasks to BAU initiatives/ projects.	• Continue project/ initiative status reporting.
Output	• Stakeholders' awareness of roles and responsibilities • Milestones and timeline	• Readiness checklist • Day 1 detailed plan	• Changes applied to Day 1 operational model • Risk and issue log	• End-state plan • Synergy initiative assignment to relevant functions	• Synergy cost and benefit summary • Integration management office closure

Integration management office approach: in-house team or external consultant?

	In-house team	Hybrid	Consultant
○	• Operational understanding • Cost-saving • Full ownership	• Combination of consultant's expertise and in-house understanding	• Experienced in integration • Integration perspective • Able to provide expert integration resources, e.g. industry-specific
✕	• Business-as-usual familiarity • Resource constraint	• Different points of view between internal and external teams could prolong decision-making process • Requires more internal-external alignment meetings	• Technical perspective • Resource mobility could be challenging and requires additional approval

Operational separation and divestiture options

Separation exercise refers to operational separation involving planning- and execution-related tasks to ensure successful standalone operation. A **Transition Service Agreement (TSA)** is used to smoothen the transition process by granting necessary support from the parent company.

Separation rationale

- **Strengthen balance sheet**

Partial sale can unload burdens from the balance sheet, and also give more liquidity from the sale proceeds.

- **Maximise shareholder value**

A popular option, such as taking a carved-out business to IPO, could monetise a part of the business at a market price.

- **Focus on a new strategic goal**

Selling unprofitable or non-core business units allows entities to concentrate on new businesses which are more aligned to their strategic goals.

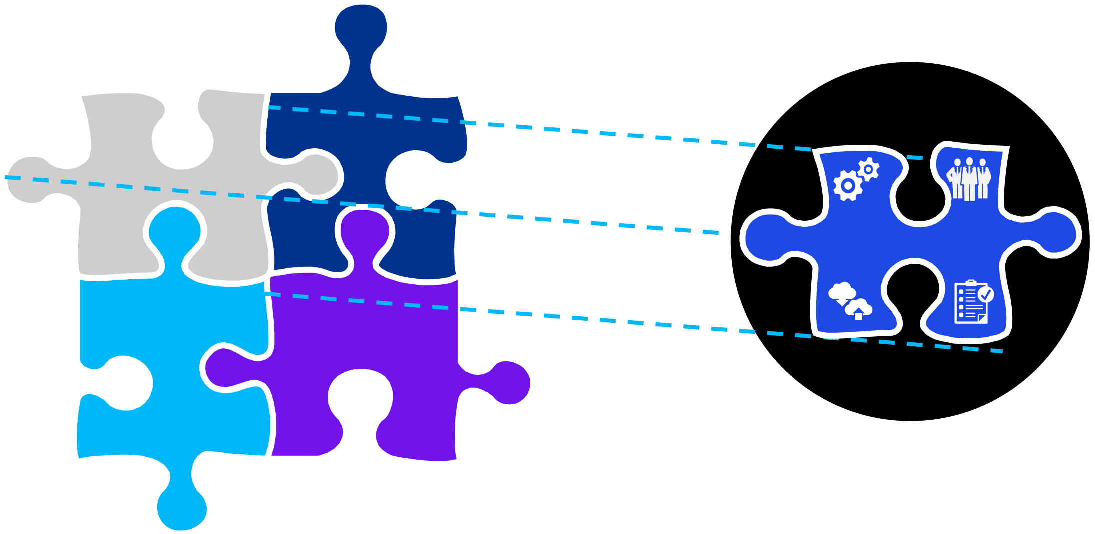
Divestiture options

- **Carve-out:** disposal of a business unit by selling a minority share.
- **Spin-off:** disposal of a business unit by issuing new shares. In many cases, spun-off companies are as large as the remaining companies.
- **Sell-off:** sale of assets, groups of assets, or business units, including liquidation, which requires a minimal level of operational separation.

Separation exercise ensures standalone operation of carved-out businesses through an operating model framework

Understanding of business operation through analysis of the operating model, which outlines the components of processes, people, systems and assets, helps to identify potential actions and key activities required for standalone operation.

After the **separation perimeter** is set, existing support from the group is gradually phased out. → The exercise begins with identifying **key considerations** and then suggests **required actions**. → Below are considerations to be addressed in the separation exercise to ensure a **smooth transition to standalone operation** and **successful separation**.



Functional process Identify and summarise key functions, key processes, and interconnections among them.	**People** Identify key people issues, critical positions, and alignment with strategic statements.
Systems Summarise key systems used to support the functional processes.	**Assets** Identify key assets, including data, reports, and contracts involved in the operation.

How we can help ease your integration journey

Deal value confirmation: reconfirm your pre-identified value drivers and suggest other value creation initiatives.

Integration readiness: evaluate integration readiness by investigating operational issues and drafting a firm-level target operating model to help you better understand the current state of the target.

Planning support: assist you in developing an integration blueprint and preparing a detailed plan.

Execution support: coordinate and monitor integration activity execution, and escalate risks and issues to expedite resolutions, including hypercare support during Day 1 execution, when any disruptions should be resolved as soon as possible.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

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