Strategies for smooth sailing

How can private equity firms ensure that they integrate add-on acquisitions successfully? McGladrey's Jim Cashin and Daniel Wheadon explain

***Cashin:** resourse planning essential*

***Wheadon:** dollar targets are under-used*

Private equity groups are increasingly making strategic investments as the economy continues to improve. Often the private equity group is looking to grow existing investments through add-on acquisitions that complement a company or 'platform' in a particular segment or industry. This is often a great strategy, but one that requires integration and optimisation.

Recently McGladrey was engaged by a private equity group that employed such a strategy. The group had acquired a large international manufacturing company, which itself had grown through acquisition over several years. One of the challenges was that little investment had been made in technology. As a result, key business processes were highly manual and business information was not readily available or timely.

The private equity group developed both an acquisition and divestiture strategy to focus on its core operations and enhance efficiency. McGladrey performed an assessment of the organisation's structure within its finance and accounting and IT functions, and helped implement a project management office to coordinate activities among the various functional groups and locations. By implementing the 'road map' (integration and technology strategy), the organisation was able to enhance value. This value was realised by proactively managing performance through the implementation of consistent processes and metrics aligned to the business.

Some firms appoint operational executives directly to their portfolio companies to guide management teams through this process, or have executives at the fund level to provide assistance when necessary. Other firms rely on the platform company to drive the integration. Regardless of your firm's level of operational involvement, there are four key steps to mitigate the risk of a sub-optimal integration:

- **Assess** available resources (people, systems, processes) for integration planning and monitoring;
- **Design** an integration plan outlining specific goals, critical milestones and individual roles;
- **Monitor** progress and determine how effectively critical functions are operating; and
- **Communicate** plans across the combined company

A lower-than-expected return on an add-on acquisition can have far-reaching effects. The desire to close the deal quickly must be balanced against the need to ensure smooth operations and process improvements from day-one.

ASSESSING RESOURCES

A successful integration requires having the right people, systems and processes to develop and monitor the integration plan. McGladrey's 2012 Private Equity Survey, which focused on firms investing in the mid-market, found that an actively-involved integration leader and team is the most frequent requirement of add-on acquisition plans. The transition planning management team should be composed of key managers throughout the portfolio company. Additional transition teams prioritised by business area (finance, IT, HR, etc.) will enhance integration.

Many mid-market companies may not have sufficient internal resources to manage integration teams and establish critical milestones effectively. These companies might be unfamiliar with the integration process and could place unreasonable demands on employees, resulting in key »

» elements falling through the cracks or day-to-day work suffering.

Moreover, mid-market companies often have small IT departments that have difficulty managing the transition of IT systems during integration due to limited resources. More than 90 percent of private equity groups surveyed by McGladrey say that portfolio companies at least sometimes lack quality IT personnel and face infrastructure limitations (see chart 1, below). Without an IT department that has the expertise to perform the transition and implement necessary upgrades, the integration process can prove much more cumbersome and costly than originally envisioned.

Inadequate tools at the platform company can also cause challenges by making it difficult, if not impossible, to monitor integration plan progress accurately. Nearly 90 percent of private equity firms surveyed report that a lack of internal systems to measure results serves as an obstacle in implementing improvements.

It is critical to perform an accurate assessment of available resources early and, if necessary, enlist an advisor in the planning process upfront to save time and prevent costly errors.

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DETERMINING REALISTIC GOALS

Executives' primary goal with an add-on acquisition integration is to do it fast, with as few disruptions to the business as possible. This objective can only be accomplished by having an organised plan for managing the complex decisions involved.

According to McGladrey's survey, however (see chart 2, below), too few firms always require specific dollar targets and clear assignments (28 percent) and specific integration tactics (40 percent) in their add-on acquisition plans. Having a detailed understanding of integration assignments and targets is a best practice that firms should use to achieve their strategic goals for the deal — not to mention generate the expected return on investment.

Organisations must carefully plan all aspects of the business combination. This plan should incorporate several key milestones, including planning for day-one readiness and the first quarter of operations. Due to the financial implications and risk associated with an acquisition, a majority of attention is often focused on the financial aspects of the deal. However, companies shouldn't overlook process improvement opportunities, both short- and long-term.

Prior to the deal closing, firms should prepare for day-one readiness and perform a full process review to determine how the combined organisation can be improved going forward.

The day-one readiness plan should focus on key regulatory and organisational components that will allow the combined company to operate effectively. It is important to prioritise the key initiatives for this plan including: financial reporting, key controls

CHART 1: TECHNICAL ISSUES

How often do firms encounter the following IT deficiencies at portfolio companies?

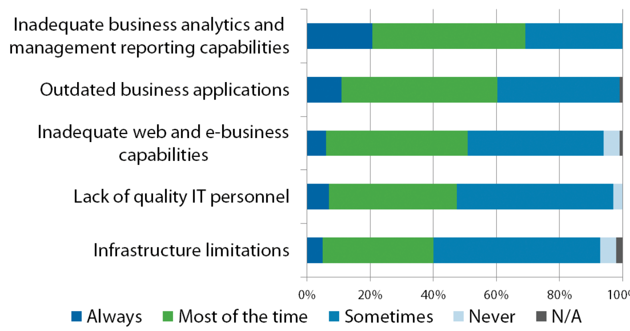
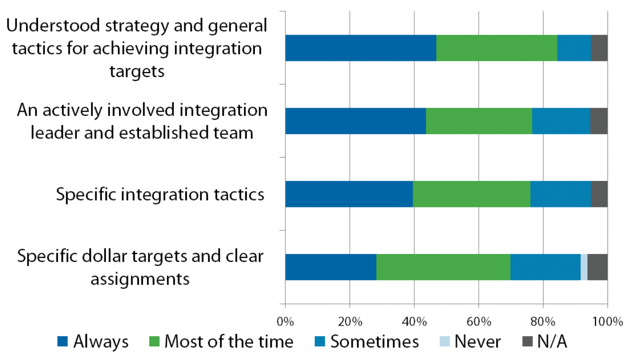


CHART 2: INTEGRATION TACTICS

What do integration plans for add-on acquisitions to portfolio companies typically contain?



Too few firms always require specific dollar targets and specific integration tactics in their add-on acquisition plans

such as cash management, customer and vendor communications, as well as cultural considerations.

The next step is to develop a 100-day plan that specifies integration milestones, determines how process improvements are identified and specifies the roles of various transition team members. The overall integration plan should align the vision of the combined organisation with individual operating goals.

It is important to keep in mind that when developing plans for day-one, day-100 and beyond, the desired goals must be realistic and attainable — otherwise, you might face pushback from overburdened employees, and unforeseen delays/expenses can arise.

MEASURING PROGRESS

Organisations should implement a tracking mechanism to determine how effectively critical functions are operating during the first 100 days and whether enhancements and/or additional controls are needed. This monitoring can be incorporated into an existing process-improvement plan for the platform company for greater efficiency.

Companies must develop a process to monitor improvement and the success of the integration, as well as to determine when the integration process is complete. Mid-market companies are often unable to accurately report whether an acquisition met its strategic goals — information that general partners and limited partners require. A best practice is to establish a mechanism where synergies are articulated to individual project teams, and a process for measuring their success as time goes on is established. This might necessitate upgrading IT systems to ensure that results can be accurately measured.

COMMUNICATING EFFECTIVELY

During the integration process, companies often fail to fully consider the impact of combining two different cultures. Firms should consider how employees and management teams across the combined company will respond to changes in strategic goals, processes, policies, vendors, etc. Effective communication is key: by ensuring that business objectives and the impact of operational synergies are clearly communicated, firms decrease the likelihood of management pushback, and the acquisition will be more likely to deliver on its expected value.

More than 85 percent of private equity groups report facing pushback or obstruction from portfolio company management teams at times, and the stress involved in an acquisition makes it all the more likely that difficulties will emerge if lines of communication are not kept open.

CONCLUSION

Common issues that cause challenges in the integration process include lack of and/or inadequate planning, underestimating the scope of the initiative and lack of communication through the entire process. These problems can be avoided if resources are properly assessed (and obtained, if necessary) prior to the deal closing; if integration plans are specific and outline reasonable goals; if plan progress is effectively monitored; and if the importance of clear communication is recognised. ■

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