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Making Mergers Work
The Critical Role
Of the CFO



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Making Mergers Work

The Critical Role of the CFO

Imagine for a moment that the closing date of a major acquisition is approaching, and as Chief Financial Officer (CFO) you are, of course, responsible for much of the process. Your finance team needs to complete the merger, stabilize the transactional processes of the two organizations, and sort out all the financial-control issues that will have to be dealt with beginning on day one of the newly merged company.

Yet, focusing only on the immediate tasks at hand comes at a cost. Your finance group's resources are stretched thin, and some tough, forward-looking issues are left behind. For example, incorporating the post-merger integration plan into your budget and building next year's plan will have to wait. Determining how to integrate forecasts to maintain an early warning system to protect against surprises will come later. Thinking about how to use the integration to increase the level

of hard-to-come-by finance talent also gets put behind immediate operational challenges.

With longer-term priorities on the back burner, trouble isn't far behind (see Exhibit 1). One of several things typically goes wrong:

- Merger integration plans that sounded great pre-close do not fit within the budget. One-time costs are much higher than originally estimated and the slippage cannot be reconciled.
- Inadequate forecasting causes the business to hit a major blind spot and the combined entity suffers.
- A competitor moves quickly to take advantage of your inability to respond as a cohesive well-controlled organization—and succeeds.
- Woefully overloaded, the best finance talent from the target company gets burned out by the integration and decides to quit.

None of this has to happen.

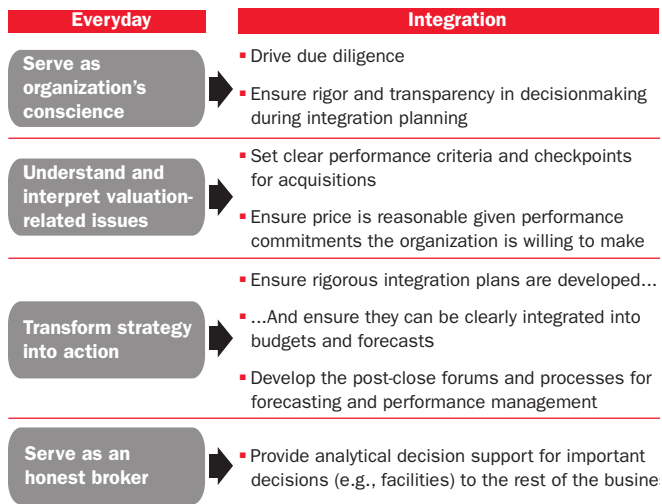
Exhibit 1
Merger Challenges Crop Up Quickly

What Tends to Happen
<ul style="list-style-type: none">▪ Finance resources rapidly become constrained across the company▪ Internal integration resources migrate toward immediate priorities<ul style="list-style-type: none">– Transaction processes– Controls– Organization—“lines and boxes”▪ “The rest” doesn't happen<ul style="list-style-type: none">– Designing new forecasting, planning, budgeting processes– Integrating synergies with budgets▪ As a result, overall performance tends to lag<ul style="list-style-type: none">– Synergies slip through the cracks– New organization gets bogged down and becomes less adaptive to change



What to Do About It
<ul style="list-style-type: none">▪ Shore up integration-related capabilities ahead of time▪ Start full integration planning immediately after deal is announced, and drive for early stake-in-the-ground solutions▪ Be explicit about which Finance resources will go where<ul style="list-style-type: none">– Running the business– Managing near-term issues– Looking ahead– Supporting other integration areas▪ Ensure that all integration teams are developing plans that will mesh with budgets and forecasts

Exhibit 2 Everyday Finance Roles Become More Important in a Merger



Source: Booz Allen Hamilton

In today's world, the CFO position is substantially more important than ever before. This evolution has occurred over the past 5 to 7 years, and it is a topic we have studied in great detail. Generally speaking, CFOs and their organizations have evolved well beyond their stereotypical roles—accountant and “organizational police”—and today are valued analysts and strategic business partners to senior management.

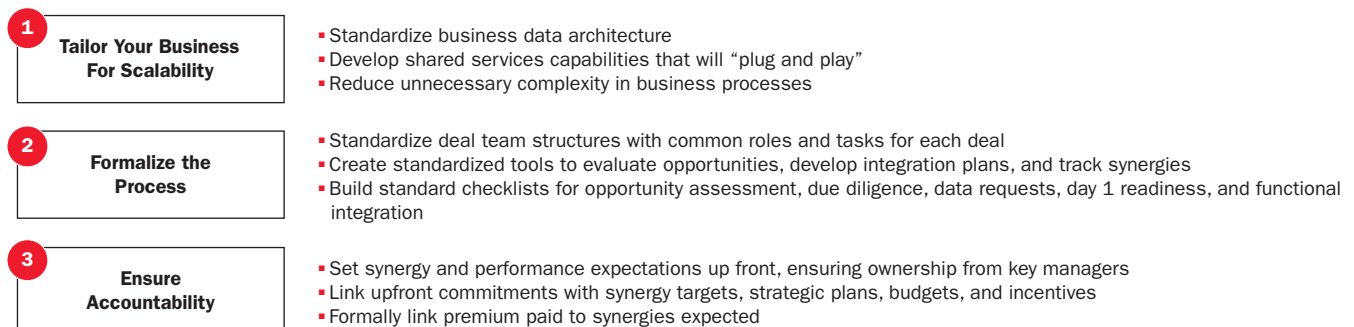
Many elements of the CFO's expanded, everyday role become more crucial in a merger (see Exhibit 2), and success in these areas can help beat the odds and create a transaction that delivers. Widely cited research, including a 2001 Booz Allen Hamilton study, shows that mergers typically are unsuccessful in

meeting their goals. However, CFOs have the ability to fly against this trend. Why? The modern CFO and his or her organization are involved in all aspects of the proposed transaction, from concept and selection of merger partners to tracking the last penny of synergy. Indeed, the CFO's work begins early. A great deal needs to take place before the transaction is announced—some before it is even envisioned.

First, it is critical that the CFO and the finance organization prepare for merger activity by immediately shoring up basic everyday capabilities. For example, developing strong planning and performance-management capabilities will invariably lead to improved discipline in capturing merger synergies. Companies anticipating several acquisitions should develop standard processes and checkpoints for integration teams. Establishing structured processes and roles ensures all transactions are handled in the same, rigorous manner (see Exhibit 3). Within finance, CFOs should consider developing a standard, scalable structure and deploying shared services support capabilities. In our experience, companies that complete these steps are able to integrate faster and capture more of the expected merger benefits.

Second, finance resources need to be deployed intelligently in a merger, and this process begins by anticipating all roles the group needs to play. An overall blueprint that lays out what decisions need to be made in a clear timeline is critical. The long-term integration model for transactional processes should be developed early in the merger process, with specific decisions about merger-integration philosophy (e.g., rapid

Exhibit 3 Building an Internal Integration Engine



Source: Booz Allen Hamilton

absorption or capturing the best of both companies), priorities for systems integration, and the degree of integration for key business processes. Attention must be paid to details, and the speed and stability of finance integration can set the pace and tone for the entire company.

Last, the regulatory environment has become far more challenging with the adoption of Sarbanes-Oxley, and compliance issues can become more complex—and sometimes need to be entirely reworked—in a merger. Target companies come with their own set of controls, policies, and procedures that need to be harmonized with the acquirer. If the target company is privately held or ill-prepared for Sarbanes-Oxley, implementing and documenting the right set of controls could increase the time and effort required to close the transaction. Due diligence must include a deeper look into controls and compliance. In addition, Sarbanes-Oxley has pushed Boards to demand more information on acquisitions, which often leads to more structured reviews and more Board involvement in approving even relatively small mergers. Exhibit 4 presents the merger dos and don'ts for CFOs.

Once the organization is well into the merger process, the CFO and his or her organization are forced to operate in a challenging environment. But having taken the right steps beforehand, the CFO is ready to meet these new challenges in a disciplined way. Success requires a deep understanding of the specific roles that

finance must play and the ability to deploy resources to them appropriately.

Although not an exhaustive checklist, here are the central areas of responsibility for CFOs as a transaction moves through deal close and post-merger integration:

- *Executing the transaction.* Finance has primary responsibilities for deal-related accounting (e.g., purchase accounting), the structuring and execution of merger-related agreements, cash and financing requirements, and details necessary for operation of the new entity on day 1, such as insurance and bank-account transfers.
- *Creating a strong, stable control environment.* Finance must drive the rapid harmonization of accounting policies to prevent the first reporting period following the merger from becoming a nightmare. Again, detail is critical and the challenges are many. They include ensuring adequate controls for not only the merged entity but also for transitional processes (e.g., limits of authority, capital-expenditure approval processes), training the organization on new policies, and ensuring Sarbanes-Oxley 404 compliance from deal close onward.
- *Integrating the two organizations.* Finance must ensure that the right management information exists in a way that allows managers to effectively run and report on the new entity—and it needs to be in place on the first day. For example, will customer

Exhibit 4
Merger Dos and Don'ts for CFOs

Do
<ul style="list-style-type: none"> ▪ Ensure a strong process is in place to measure and capture the synergies from any deal—big or small ▪ Insist on top-level accountability for synergies from the organization before signing the agreement ▪ Set expectations for the business to build integration plans that will link to budgets and forecasts ▪ Invest sufficient finance resources in the integration, commensurate with the importance and magnitude of the expected synergies ▪ Have finance play a lead role in building the transition plan for systems and processes ▪ Maintain the right tone at the top during planning integration—lead by example in the finance organization, focus communications on the deal

Don't
<ul style="list-style-type: none"> ▪ Focus solely on deal close and day 1 issues within finance ▪ Wait for other areas to determine when and how systems and processes will come together before planning ▪ Wait to close the deal before beginning integration planning—change is easiest in the early days following the merger ▪ Let the organization oversimplify the complexity of integration during the planning, only to get trapped in the details after the deal is closed ▪ Ignore the people aspects of the deal—use the merger as an opportunity to woo high quality, experienced talent

profitability data be available in a manner that allows managers to compare performance from both pre-merger entities on an apples-to-apples basis? This integration imperative is also applicable within the finance group—processes like vendor payments, placing orders, credit analysis, and accounts receivable need to be running seamlessly at close and throughout the organization.

- *Designing the post-merger management architecture.* It is important for finance to understand how key management processes will be run in the post-merger environment. Many a merger has been stifled when two management teams sit across the table from each other after the close but do not understand how their reports, plans, and processes fit together. Rethinking these processes involves considerations such as information management and the method by which strategic and operational plans will be integrated.
- *Providing financial support to the integration teams.* Other post-merger integration teams will need objective resources to make fact-based, objective management decisions as they move through the process. They will need help in planning and quantifying synergies so they can be incorporated in future budgets and, later, concrete commitments.
- *Providing guidance to investors on when to expect synergies.* This is a CFO role, often in partnership with

the Chief Executive Officer (CEO), and requires that commitments to achieving synergy targets be clear and that relevant parties be fully accountable. CFOs have often been foiled by losing track of merger-related costs and synergies and not harmonizing integration planning with financial forecasts. It is critical not to under-deliver to Wall Street right out of the box.

Without a doubt, a merger can be a hair-raising experience for the unprepared CFO—pushing his or her finance organization beyond the breaking point. However, CFOs who get their groups in shape before the merger and who anticipate the challenges ahead can find themselves in a position to drive their transactions to completion with minimal disruption and fewer surprises.

We have worked with CFOs and companies that have done it right, and their experience provides a positive counter to the generally dismal results mergers produce. Finance, as we have said, has a critical and central role to play, not only in selecting the merger partner but also in ensuring that the expected value of the transaction to the organization is realized. It is not easy, but it is possible—a fact that should be heartening for CFOs interested in looking to business combinations as one way to help achieve their company's long-term goals.

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