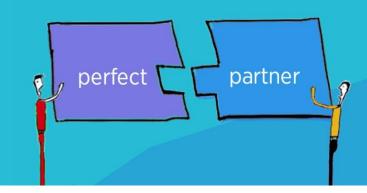


Why do M&As fail?

A view from the industry

Piran Partners LLP

December 2011





Why do mergers & acquisitions fail?

With the second anniversary approaching in March 2012 of the merger of T-Mobile UK and Orange creating Everything Everywhere, is the merger going according to plan? The departure of Tom Alexander in July 2011, reports of a substantial fall in customers and decline in earnings hints at difficulties. What does theory and practice have to say?

Background

Although mergers make headlines, it is not always than organic clear that they make economic sense. By some a competito measures half of all mergers and acquisitions are ultimately unsuccessful and fail to add value.

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Although often seen as offering opportunities for expansion and growth, more often than not they

are 'defensive' in nature and a reaction to contracting markets, or falling prices, or new technologies or excess capacity.

By definition an acquisition is where the acquiring company purchases the other company, whilst in a merger the two groups become joint owners of the combined entity. In the UK a 60:40 equity spilt is usually seen as the threshold beyond which a merger becomes an acquisition.

Regardless of how the merger or acquisition is framed, the common conclusion by the likes of JP Morgan, Mercer and others is that "the high hopes and good intentions which herald the merger announcement are frequently disappointed and denied once the hard work of integration begins" (ISR - TowersWatson)

Why then if so many mergers 'fail' do so many companies persist in contemplating mergers?

To M&A or not to M&A

Mergers and acquisitions are nearly always justified on economic grounds, emphasising shareholder wealth creation. For publicly-traded companies you'd hardly expect anything else. EE was no different, stating back in September 2009 that they expected to "generate estimated synergies with a net present value in excess of €4.0 billion (£3.5 billion)" [60% by 2012, 100% by 2014].

Orange and T-Mobile also said their deal would "bring substantial benefits to UK customers", promising expanded network coverage, better network quality and improved customer services.

An acquisition or merger can deliver quicker results than organic growth alone. Buying the market share of a competitor (market penetration), or integrating a

supplier or channel partner (vertical integration), or even diversifying are all reasonable strategic choices.

The problem as the Economist notes "doing the deal is easy" but post-deal when things go wrong, it is more

often than not the human dimension at fault. The cultural clash is often all too real: with differing visions and values, contrasting styles of (international) management and attitudes to risk and reward. Add in that immediately post-merger employees are understandably nervous about their jobs and it is amazing any merger succeeds.

But it's rare when things go wrong that these clashes are made public, rather the same economic arguments are used but in reverse, stating that "the potential economies of scale were not realised" or "an inflated purchase price was paid".

So what can be done?

ultimately unsuccessful

Companies such as Cisco or GE who depend on acquisitions to further growth start pre-deal with inhouse processes and managers tasked full time with overseeing all M&A activity. And post-deal these same managers are usually seconded to work with the merged company's employees to provide continuity.

But for many executives an acquisition may occur only once or twice in their career, so what are the tactics for success?



- Plan ahead: as with Cisco and GE, successful firms do not start the integration process when the deal is announced; experienced acquirers develop a plan for the entire integration before the deal closes, allowing execution to proceed without delay.
- Appoint a leader: typically no one in the acquisition team is assigned to manage the process. This often leaves the role to the new entity's boss, whose focus should be on strategic business goals such as customers and profits not the "the high

By acting as a facilitator an 'integration manager' creates structure, connects the cultures and allows focus on the critical objectives. Assisting the manager are the integration

integration.

teams. A rule of thumb states that only 10% of employees in any function should drive the integration – everyone else should stay focused on customers.

- Think customer: it's easy to become distracted and too internally focused, exposing the newly formed company to competitor attacks. Firms mustn't let customer satisfaction suffer while integrating. And where multiple brands are involved, customers need to have a clear value proposition and know what's going to happen to the brands they may love.
- Focus on strategy: according to Accenture, integration efforts should concentrate on capturing value toward the strategic objectives. This forces integration managers and leaders to prioritize activities according to the value they create. For example, if the strategic objective is is to expand product line and the purchased company has talented developers, an acquirer shouldn't automatically force their R&D departments to integrate.

Be sensitive to the culture & people: A relatively new approach is to conduct a 'cultural audit' prior to a deal's close so as to incorporate culture into the integration plan. It is crucial that cultural aspects are phased in – displaying little concern for the way business has been done in the past is a sure way to alienate key players at the target firm. Losing the people needed to run the business is crippling, so retaining these high-performers must top the integration plan.

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However it is likely jobs must be cut to achieve cost savings.

Treating those who leave with respect sends a powerful message to those who remain about what kind of company they are now working for.

Finally the new organisation's structure and reporting lines need

to be clear, else employees' attention won't be focused on the customer.

Actively Communicate: prompt, straight-forward communication is important as insecurity affects morale and productivity. Left without communication, employees form their own messages, and motivation decreases while resistance increases. Management also must show respect for the acquired firm's accomplishments, and stress how important the employees of that firm are to the new entity's success.

Not to be forgotten amidst the communication is the importance of outward communication to stakeholders: shareholders, customers, vendors, community, and media. All are affected by M&A, and all stakeholders will be curious as to how this new firm will impact their unique situations.

➤ **Go quicker:** Time is more valuable than money in integrating M&A. If an acquirer expects to capture €500 million in yearly cost savings, a month's



delay reduces the deal's NPV by over €150 million. There is also an indirect impact, caused by the delay. When a deal is made, change is expected but when it doesn't immediately happen, people become preoccupied with other things. Prudent acquirers take advantage of the window of opportunity provided to them by M&A, and rapidly introduce their integration plan.

Conclusion

The tactics are simple, the execution tough. But even where delays have occurred, internal debates and the bureaucracy have detracted from serving customers, it's never too late.

Whilst a basic principle of business says always avoid entering a 50:50 joint venture, EE has tremendous assets and has made progress in its first year of trading.

Looking again at the tactics above may pay dividends even though the pre-and immediate post-deal phases are long gone.

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