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THE STATE OF M&A

Fred Hencke leads Segal's mergers and acquisitions solutions group. We asked him what the first six months of 2020 tells organizations about M&A today.

Has Covid-19 effectively put mergers or acquisitions on hold?

We normally see M&A activity rise and fall on a five- to seven-year cycle, and we began to see activity slowing down during the second half of 2019—even before Covid's full effect hit. Covid-19 then accelerated the drop off in activity, but it has not brought all activity to a halt. Think of it more as a plateau in the cycle's wave, with a number of organizations now in "wait-and-see" mode rather than completely walking away.

Is that the case for the majority of organizations?

Not at all, and, in fact, some have actually sped up their plans or at least their inquiries. Buyers may be seeing some opportunities in terms of pricing or as a way to diversify, become more resilient or consolidate their supply chains. On the one hand, some sectors are heating up, but many remain in a wait-and-see mode. Some sellers that have been hit hard by Covid-19 are seeing sales or mergers as their best chance to survival. There is no question that the pandemic has affected pricing, with valuations declining and valuation methods adjusted to account for the short- and long-term impact. Covid-19 has decelerated and re-focused traditional M&A activity, and, because of that, we will likely see a spike in divestitures and financially distressed sales, especially in the industrials sector. On the positive note, we are witnessing technology and technology-heavy organizations leading the way in the recovery.

Price aside, would integration of operations of two companies be any harder now?

It can be harder in some situations. The first place I would look would be at the current operations of the two organizations. Are they operating at pre-Covid capacity and with pre-Covid staffing? Or are they still adjusting to a business-continuity-plan reality? If stability was only recently achieved, news of a major change can again cause disruption and make employees anxious. In that situation, a longer-term and staged integration plan may be wise.

Can you give an example?

There are primarily three ways to bring two organizations together:

- The lead organization can impose its culture and processes on the other organization,
- There can be a blending of the culture and processes (which may include an opportunity for improvements that are new to both), or
- The two organizations can operate as they had for a time or even permanently (like a portfolio company under a private-equity firm).

The situations at the companies involved should be used to determine the best course of action. Good and frequent communication from the leader is important because people become disengaged from their work when they fear the unknown and do not know what tomorrow will bring. A goal should include managing the risk inherent in the deal. Risk often can be mitigated by ensuring the "fit" of the organizations through examining the cultures and workforce and then planning their optimal integration.

How important is culture to success?

In our view, which has been borne out repeatedly, that is one of the three key internal factors: people, culture and leadership. Organizations can make adjustments for external factors, which is what we are seeing now, but getting people, culture and leadership right goes a long way to achieving initial success and sustaining it. A successful M&A deal should not be judged as a snapshot in time. Rather, how is the combined organization doing a year or two or five later? If you get people, culture and leadership right, and you made a smart decision in choosing the other organization, the results should stay positive or, better yet, grow year after year.

Supporting all three is communication—what's coming, why, when and how will it affect me (including what will I need to stop, start and continue doing). Think of it this way: culture sets expectations and a common denominator by which people prepare for and respond to the changes a merger or acquisition brings. Then, in the midst of organizational change, culture and workforce differences drive new challenges in employee engagement and commitment, which need to be anticipated and addressed.

So, people, culture and leadership need to be integral in all planning. What else?

We always advise that organizations looking to buy, sell or merge should have a clear understanding of their readiness before the first conversation with an intended suitor or target. We take our clients through a readiness assessment diagnostic—a series of questions that go beyond the balance sheet, that start with people, culture and leadership and go a bit deeper into how these categories play out in terms of products or services, sales and customers, governance and organizational operations. This includes workforce planning, forecasting and management processes.

What is the practical benefit of the readiness assessment?

What we are really doing here is documenting the factors that lead to sustainable synergy so that the integration planning can focus on business optimization. Before you can judge how well you will integrate with another, you have to understand yourself, including your motivations for considering a deal. Think of it this way: if you can document and, to some degree, measure the potential synergy before you start the deal, you have a greater likelihood of accelerating value creation once the integration begins and, more important, a much greater likelihood of sustaining that value. So many deals aim low because they are trying to account for the "unexpected" and then fall off because it is harder to make course corrections once the deal is well underway.

You mention motivations. Do you see common motivations occurring?

Motivations can be proactive or reactive. For example, proactive motivations are led by the desire to increase market share as well as access new regions and new capabilities. This may include a desire to offer whole-product solutions. Reactive motivations right now are fueled by Covid-19, and they include lowering operating costs or even survival. In a less pandemic-driven market, we often see eliminating a competitor and improving customer service and quality as reactive motivations. These motivations inform the questions we ask during a readiness assessment, and we help organizations keep these in mind during the entire lifecycle of the deal.

Does your work typically end with the readiness assessment?

By no means. We are regularly asked to be in an advisory role throughout the integration, and, many times, we set up the project management office and help to run that. A mistake that happens too often is that people in the organizations who already have full-time jobs are tasked with due diligence, developing the integration plan and, then, managing its execution. They may have never faced these roles before and may not have the experience necessary. Nor do they have the time if their current responsibilities are not reassigned.

We bring a "design thinking" approach and use workforce analytics to drive workforce planning and forecasting. We also examine culture and quickly surface the differences that can be issues and integration impediments. Last, we work with leaders to develop change management and communications strategy and plans that emphasize five keys: clear, concise, contextual, relevant and often. Keeping the people informed helps to allay fears and build confidence in the organization and the plan.

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