<u>When Your Deal Closes</u>

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"***Now the real work begins***." These five words come out of the mouths of CEOs, CFOs and private equity principals in the minutes after a deal closes more often than any others. While the investment bankers and M&A lawyers may feel somewhat belittled by these words, for those of us who have spent significant time on both sides of the fence it is clear that the success or failure of the vast majority of transactions is contingent on how well the acquirer implements its business plan.

This is the first in a series of posts that will set forth the primary ingredients necessary for an acquirer to successfully execute on its business plan after closing a deal. This piece focuses on the importance of the acquirer's messaging to the target employees.

Words matter. Every word of every communication from an acquirer is scrutinized, analyzed and interpreted by every target employee. Specific phrases are committed to memory and recited at the dinner table. An acquirer must remember this.

"Integration" or "Transition"

Successful execution of a business plan requires putting businesses together. This is integration; not transition. The words are not synonyms; they are not interchangeable. The Merriam-Webster Dictionary defines "transition" as a passage from one state to another and as a movement or evolution from one form or stage to another. It is the end of something. By contrast, "integration" is defined as incorporation as equals into a society or an organization of individuals or different groups. Integration builds something new and is permanent. Transition is temporal.

Even if in reality, an acquirer is absorbing the target and most of the target's systems and processes will be phased out, a communication plan that is rooted in integration rather than transition greatly increases the likelihood of successful implementation of the business plan.

Some may scoff that this is a distinction without a difference; others may not care one iota about the emotional feelings of the target employees. After all, the attitude of many acquirers is "I paid for this business; I can do whatever I want with it." This approach is short sighted and not only leads to delays in implementation of business plans but also to the loss of value creation opportunities. Beyond definitions and employee emotions there are practical, economic reasons why the theme of integration should be communicated, not transition.

Let's start with the fact that the "I paid for it attitude" is not accurate when it comes to the vast majority of the target employees who continue with the combined organization. The employees who the buyer really paid to acquire the business, i.e. the ones who held equity, received substantial transaction bonuses or had severance packages are for the most part the ones who leave shortly after the deal closes. With respect to the few target executives who remain with the combined business, whether for a few months or on a permanent basis, the use of the integration nomenclature is beneficial.

It is likely that these executives developed many of the target's systems and processes and even more likely that they believe that their existence contributed to the success of the company. When an acquirer communicates a theme of integration and considers maintaining some of the target's systems in the combined organization it helps foster a sense of value and self-worth in these executives who may otherwise have seen their authority diminished. Under these circumstances the target leaders are more likely to be enthusiastic about the new owner and the prospects for success of the combined enterprise. A positive attitude from these legacy executives is important for two reasons. First, an acquirer must typically rely heavily on the remaining target executives to oversee many of the integration activities. Second, an acquirer needs these leaders to encourage their employees to embrace the new corporate culture as opposed to being resentful of it, particularly if the acquirer was a competitor. An acquirer who pursues a monolithic transition program that discontinues all of the target's systems and processes does so at its own peril.

With respect to the employees further down in the organization the emphasis on integration rather than transition is even more important. This stratum of employees is the fulcrum where the degree of success or failure of timely implementation of the business plan will be most significantly influenced. These are the people who actually take the actions that are required to integrate the businesses. Whether these employees are expected to continue on in the organization or are expected to be terminated, in both instances a buyer needs them as enthusiastic as possible and firing on all cylinders.

Further, for target employees, the use of the word transition implies that every capability of the acquirer is superior to the corresponding capability of the target. This dismissive approach leads to lost opportunities for the acquirer to improve on its own systems and processes. An important part of creating value in connection with an acquisition is to look for what may be better practices in the target in certain areas. Target employees should be encouraged to think creatively about additional ways to improve the efficiency of the combined operations. Stampeding forward with pure transition efforts rather than seeking to integrate what may be certain outstanding processes from the target is a lost opportunity. Additionally, as noted above, this attitude may significantly affect the morale of the target employees who have pride in their processes and feel that they have contributed to the decision by their acquirer to acquire them.

Finally, all business plans have a timeline for eliminating costs. Focus and speed of execution are essential. Target employees who are part of the team working to eliminate these costs, but who are uncertain about their future, who hear and see the word "transition" every day will constantly be reminded that it is likely that their employment has an expiration date. These employees will be incentivized to work slowly rather than quickly. When delay inevitably occurs, the business plan targets will be missed. They will not only be missed due to the delay in obtaining the specific costs savings expected from integration of certain services, but also due to the higher payroll costs resulting from the sluggish work pace. In contrast, employees who hear the word integration, particularly those who believe they may have the opportunity to continue with the combined businesses, will view their work as ongoing and creative rather than leading to an inevitable conclusion. These employees are most likely to demonstrate urgency and help businesses to exceed expectations with respect to completing integration projects.

Communicating the theme of integration is a vital component of successful M&A execution. Done properly it can help capture the hearts and minds of the target employees and it is essential for a business plan to not only succeed, but succeed on schedule.