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Liability Insurance

Managing the Risks in Acquisitions and Mergers and Post Acquisition Integration

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In today's world of rapid change with pressure to stay ahead of the competition, many corporations are turning to acquisitions and mergers to fuel growth. Unfortunately, the complexity of doing deals and the effort required to capture the value that drove the deal is often underestimated.

Recent studies of merged or acquired companies show that only 50 per cent of companies realize the anticipated value that drives the deal and that it often takes years longer than initially envisioned to capture that value.

For this reason, directors should be actively involved in assessing the business strategy for any acquisition or merger and in helping to ensure that the deal analysis, business case and integration planning is thorough and complete. Since there is a high degree of inherent risk in acquisitions and mergers, deal specialists should be used to assist with the identification and mitigation of key risks, and in helping to validate the anticipated synergies in the deal.

While there are common risks and mitigation strategies in mergers and acquisitions, the characteristics and objectives of a deal are usually unique and, accordingly each deal should be carefully evaluated on its own specific merits.

Managing Risk in Mergers and Acquisitions

Target risk—A focused due diligence review should be conducted on the target-company, with careful assessment of the nature and operations of the target business, historical and projected financial performance, key assets and liabilities, the breadth and depth of the management team, the quality and timeliness of financial reporting, the effectiveness of the organisational structure, and the adequacy of information systems.

Industry/market risk—A thorough assessment should be conducted of the target industry and markets identifying key risks and opportunities. This is particularly critical when the acquisition is not directly related to the purchaser's market sector.

Deal-structuring risks and opportunities—Deal-structuring can add significant value to a contemplated transaction and often is the defining feature in a competitive bid. The inherent risk and the resulting scope of work may be significantly different if the transaction is consummated by an asset acquisition as opposed to a share purchase.

- The terms and conditions of the purchase and sale agreement should cover the key value drivers inherent in the business case. For example, if certain members of the management team are critical to the future success of the company, long-term management contracts for these individuals will likely be essential. Similarly, if earnings are unstable, consideration should be given to either an "earn-out" for a portion of the purchase price or alternatively a holdback until specified future performance milestones have been achieved.

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- Taxation planning is a key element of structuring transactions and in maximizing the return on the deal. Accordingly, the tax structure for the contemplated transaction often has a very significant impact on the valuation model. The acquirer should also consider the vendor's tax position. In many competitive bidding situations, the difference between winning or losing is often the identification of taxation strategies that benefit both the buyer and seller.
- The capital structure should be carefully considered to maximize returns and future flexibility.

Valuation risk—The acquirer should develop a detailed and supportable valuation model for the transaction which reflects a thorough assessment of synergistic and strategic factors as well as the key risk factors outlined above.

Process risk—There are a number of ways to manage risk and exposure during the acquisition process, through: letters of intent, exclusivity periods, break fees, conditional or unconditional offers. The formal agreement between the parties should be robust and address the respective parties' risks and concerns by, for example, representations and warranties and conditions precedent.

Managing Post Acquisition Integration Risk

Much of the current merger and acquisition activity appears to be driven by the assumption that post-deal synergies can be generated through a rapid and effective integration process thereby increasing shareholder value. However, studies show that fewer than 50 per cent of all deals create value that exceeds the cost of capital and less than 20 per cent deliver the value that was anticipated at the time the deal was announced.

Companies whose transactions significantly increase shareholder value identify and quantify synergies early in the deal process, continue to evaluate the synergies as the deal progresses and capture the value in the deal through an accelerated post-deal transition.

A rapid integration of the target-company by accelerating the post-deal transition is a proven strategy to capturing the synergies identified in the deal, minimizing culture clashes and reducing productivity downturns. The focus is on effective communication, building momentum towards targeted economic benefits and moving quickly to preserve key employee assets and capital assets.

Corporations and their directors face significant risks and opportunities in mergers, acquisitions and post-deal integration. A focused deal evaluation process led by experienced deal professionals will help to ensure that all relevant risks as well as value creating opportunities are identified and effectively managed.

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