

# Effectively Optimizing Costs in Mergers and Acquisitions

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As organizations are merged or acquired, the costs that arise during the integration of merged or acquired entities can quickly accrue and degrade deal value. Executive leaders must optimize costs throughout the phases of a deal to ensure that M&A transactions achieve their goals.

## Overview

### Key Findings

- All deal types pose challenges for the various business functions, depending on the underlying synergy objectives, the extent of business process and platform transformation required, the necessary data and asset transfers, and the workforce changes involved.
- Transaction teams often underestimate the amount of time and effort required to achieve cost savings from a merger and acquisition (M&A).
- Of all deal phases, the integration of the entities represents the greatest opportunity for cost optimization — and presents the greatest likelihood of excess spend and delays.
- Organizations that critically assess their acquisitions and undertake cost-saving-focused actions and divestments during M&A transactions outperform those that do not.
- Organizations are more likely to achieve M&A goals when they effectively plan and manage their transactions, engage the appropriate external support, and execute with a managed time frame.

### Recommendations

Executive leaders seeking to maximize cost optimization efforts during an M&A transaction:

- Identify the most efficient and effective integration approach by utilizing the strategy phase and due diligence activities to critically review target company assets and resources.
- Plan for inevitable integration issues and difficulties, such as change resistance, by comprehensively planning for integration and incorporating contingencies into estimates.

- Develop specific cost optimization goals for the transaction by identifying specific actions for all functional elements of enterprisewide budgets.
- Improve the chances of integration success by identifying the most beneficial areas for the use of external M&A consulting support. The consulting support could include staff augmentation, access to methodologies and industry experience, knowledge transfer, and independent assessments of integration opportunities and risks.

## Analysis

### Prioritize Cost Optimization Throughout M&A

As organizations seek to grow through acquisition, they will accumulate an increasingly diverse or duplicate set of capabilities and systems, whose integration costs can quickly become suboptimal without attention to rationalization. Careful investigation of a transaction and planning for the integration are essential so that the full benefits can be achieved. The failure to rationalize and optimize costs and eliminate redundant systems, technology and processes — both before and during integration — will degrade the value of the transaction.

M&A transactions are typically highly disruptive events for all organizations. As such, the entire transaction must be planned and executed carefully. Failure to do this — especially during the integration stage — can lead to delays and the accrual of costs that can quickly spiral.

Leaders must focus on cost optimization in all stages of a deal, from target identification through due diligence (DD) to integration and operations. Doing so will give organizations a better chance of moderating M&A-related costs and delays.

While the drivers of activity can vary, many M&A transactions are major enterprise transformations aimed at generating significantly greater business value through a combination of complementary business assets. As corporate deal teams evaluate acquisition targets, some leaders are not always involved, although their functional area expertise is crucial for assessing the risks and opportunities of a deal.

Acquiring leaders should work with their transaction teams and functional leaders from both organizations to:

- Leverage the economic benefits from the M&A transaction.
- Prioritize cost optimization early and consistently throughout the entire M&A process to ensure that benefits are realized.
- Plan carefully for the entire transaction, including the integration or transition of the acquired entity.

Efficient business operations, workforce management, effective communications and strategic alignment must be maintained in every stage of the transaction. Of all transaction phases, integration raises the most challenges and the most costs — regardless of the purpose of the deal.

The absence of consistent information about current operating costs or financial transparency is a significant obstacle to effective cost optimization following a merger or acquisition. Data inconsistency can exist within one company, but is a certainty when two different entities come together. Multiple and disparate systems and charts of accounts make it difficult to identify and track the potential savings from a merger.

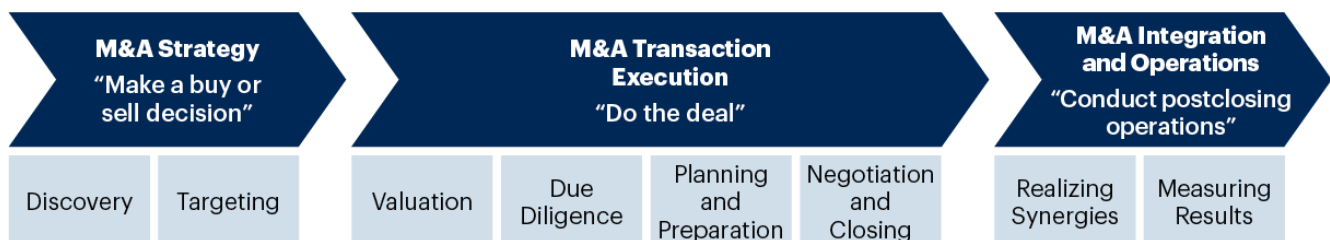
To facilitate the integration of finances across the acquired company and acquiring company, executive leaders should track M&A-related costs through a dedicated cost center structure. This structure can facilitate the combination of child cost centers, while maintaining integrity across the two company ledgers until they are consolidated into a single ledger.

## Three Phases of the M&A Process

The M&A transaction process consists of several phases and stages. Across each of the stages, executive leaders should evaluate the deal drivers and assess the need and opportunity for cost optimization. There are three overarching phases and eight stages in every transaction (see Figure 1).

**Figure 1: The Three Phases of the M&A Process**

### The Three Phases of the M&A Process



Source: Gartner  
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The likely success of the transaction depends on executive leaders' early involvement in the M&A Strategy and M&A Transaction Execution phases — such as Targeting, Valuation and DD. As part of this early involvement:

- The most suitable integration strategy can be identified.
- Appropriate integration plans are prepared.
- Realistic timelines are established.
- Potential integration risks are identified and mitigated.

- Cost optimization opportunities and the timing of their realization are identified.

Beyond this, executive leaders can ensure that the necessary resources for the success of the transaction are identified and allocated to the initiative.

Integration is somewhat like a home renovation project. The most exact planning, budgeting and scheduling will often fail to anticipate every delay and expense, or every piece of faulty plumbing hidden in the walls. Thus, leaders should work with the transaction team to develop a risk or contingency budget for unexpected issues.

As an organization begins to consider candidates for merger or acquisition, several questions can help executive leaders understand where the deal can reveal areas for potential efficiency — for example:

- Is the DD process identifying problematic areas?
- Can integration be realistically completed in the desired time frame?
- Is the use of external advisors — typically one of the biggest M&A expenses — appropriately defined and scrutinized?

## Type of M&A Affects Time Frames for Synergies

Acquisitions can be broadly divided among the following categories:

- Financial acquisitions that focus on exploiting the financial value or earnings of a target company.
- Strategic acquisitions that are aimed at accelerating revenue growth, profitability or market penetration of the acquirer by leveraging the target company's assets or capabilities.
- Opportunistic acquisitions that are aimed at exploiting an economic, market or financial opportunity.

The critical path and time frames of transactions need to be carefully considered. Factors that influence the time frame include the scope, complexity and regulatory requirements of an acquisition, and the chosen integration approach. The total time frame for DD and integration planning (up to the legal close) can range from three to six months. From deal completion, the initial and main integration phases can take from nine to 24 months, while the benefits realization phase often spans multiple years.

Strategic acquisition transactions involve either the full absorption of the target company into the acquiring enterprise or a best-of-breed-style integration to unlock the anticipated synergies, which take the form of revenue enhancements and cost savings.

Such synergies, however, tend to be time-sensitive. The longer the acquirer waits, the more difficult optimization is to capture. This is because it is difficult for any enterprise to stay focused on a complex project for more than 18 months, and as time goes by, change is usually met with increasing resistance.

Most synergies are, therefore, captured during the first year after an acquisition.

The first three to four months after a deal closes are particularly important in this respect, because in relevant organizations, they influence the much-expected first-quarter financial results of the new enterprise.

Public-sector and not-for-profit-sector mergers often present some unique challenges when compared with private-sector ones. These are related to greater scrutiny exercised over the deal by government authorities or citizens, a general lack of clarity about integration success and connected metrics, and poorer agility in addressing required workforce changes.

No two transactions are identical, and the type of transaction, the sector and the specific objectives will largely drive the activity. It is critical that the executive leader suite is involved early in the transaction to ensure that enterprise outcomes are successful.

## M&A Integration Approaches Also Affect Time Frames

M&As can take three different integration approaches:

- **Stand-alone** — This leaves the acquired company's products, processes and platforms largely as they are. This approach is common in a financial acquisition or when the acquired company is composed of businesses that are very different from those of the acquirer.
- **Absorption** — This brings the entire acquired enterprise onto the acquirer's business processes and platforms. This is a frequent choice for competitive acquisitions or when the acquirer is significantly larger or has more mature processes and technology than the target.
- **Best-of-breed** — This adopts components of both the acquired company's and the acquiring company's processes and platforms in the combined business. This approach is often adopted when both entities have mature processes and technologies and similar business operations. It's also used in situations where specific business needs exist for one or both organizations. The best-of-breed approach has typically the longest integration cycle due to the complexity and time frame required for identifying and implementing the new operating model for the merged entity.

## Cost Optimization by M&A Phase

### M&A Strategy

It is rare for all executive leaders to have a large involvement in this phase. However, it can be extremely beneficial to have the individual leaders investigate, for example, the maturity or

innovative value of an acquisition candidate, and help the business identify potential synergies and suitable integration approaches.

Executive leaders should ensure that their teams are well-prepared for a potential deal. This requires identifying the appropriate internal resources — or securing external expertise — to explore and assess others’ products, processes, technology, resources and assets. As M&A is typically not a core competency of most enterprise functions, organizations generally use external expertise directly or as backfill in this stage.

M&A Transaction Execution

Due Diligence

Other than M&A integration and operations, DD is the most time-consuming and complex stage of a transaction. During this stage, executive leaders and their representatives will drive their functional area component of the overall DD process. Typically, using DD checklists, playbooks and specialist advice, executive leaders will take a comprehensive approach in this stage. This will include identifying the target’s current business environment across all of the functional areas as shown in Table 1.

Table 1: Organizational Functional Scope		
Sales	Supply Chain	HR
Marketing	IT	Legal
Customer Service	Finance	Real Estate

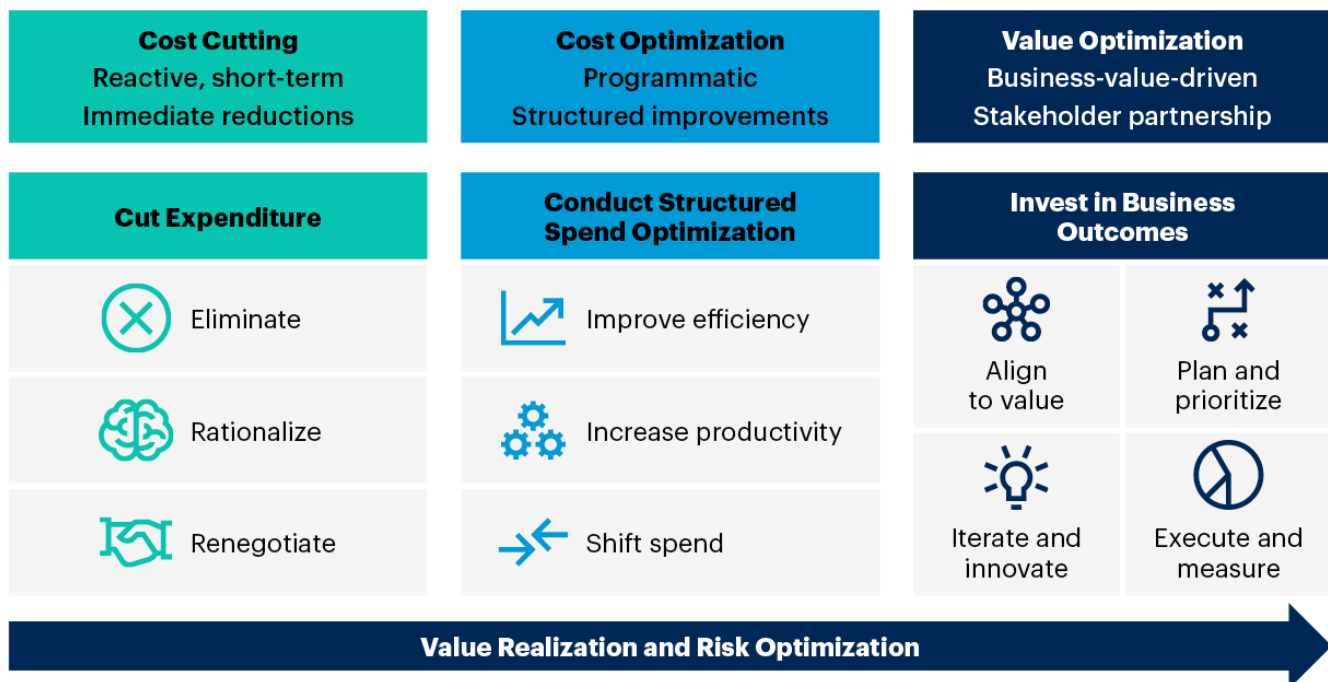
Source: Gartner

Here, the M&A team will assess and evaluate how to eventually match the target entity’s components with the acquirer’s existing processes, applications and platforms. This may also unearth better processes or products at the target that would be beneficial to the acquiring organization.

During DD, the M&A team should also develop estimates of one-time integration costs, and of a postdeal operating budget for the new combined entity. To this end, executive leaders can use an evaluation process like the methodology in “[Strategic Executives Manage Cost Across the Enterprise](#)” in concert with maintaining integrity of the two companies’ ledgers, as discussed above (see Figure 2).

Figure 2: Cost Management Approaches

### Cost Management Approaches



Source: Gartner  
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Furthermore, executive leaders should identify major integration risks and potential mitigation measures. Executive leaders must also assess whether transition services — from the acquired entity or its service providers — need to be established:

- If an absorption-style integration is to occur, DD will focus mostly on the changes to be made to the acquirer’s systems and processes to support the target company’s operation.
- For a stand-alone integration, DD focuses on the quality and integrity of the target company’s platforms.
- If a best-of-breed integration approach is chosen, a strong, structured dialogue between the functional counterparts will enable them to reach mutual agreement on which systems and processes are best-suited for each business function or purpose.

### Planning and Preparation



This is a critical step in planning for a successful outcome. As a result of the selected integration approach, executive leaders must identify and put on a timeline all activities necessary for integrating the acquired business's resources (for example, IT applications, physical assets, personnel and business processes). In many cases, preintegration activities take place, but most start in earnest from Day 1, the legal close of the deal.

During the DD phase, several cost optimization opportunities will have been identified. It is now that executive leaders should revisit those and evaluate all required initiatives in an objective manner. Using [“Prioritize Your Cost Optimization Initiatives Using Gartner’s Decision Framework,”](#) acquiring executive leaders can now identify which opportunities to simplify, standardize or centralize during the integration planning phase (see also [“Tool: Decision Framework to Prioritize Cost Optimization Initiatives”](#)).

## **M&A Integration and Operations**

### **Realizing Synergies**

The acquiring executive leaders should work closely with the CFO and the finance department to track all preintegration costs as a comparison to postintegration costs. This allows for tangible evidence of how the functions in the organization have managed the integration budget and succeeded in folding two separate organizations into one.

To best enable postclose business cost optimization, acquiring executive leaders should ensure that they participate actively in integration initiatives. This includes supporting any integration program office in establishing effective integration governance, and helping with delivering and tracking enterprisewide integration results.

Cost optimization needs to be an ongoing activity. So following integration, acquiring executive leaders should ensure that attention continues to be paid to the costs and that the costs are continually optimized. To ensure the economic success of the transaction, acquiring executive leaders must track the benefits and not allow costs to creep back into the business.

## **Specific M&A Challenges With a Cost Optimization Impact**

### **External Advisors and Consultants**

External advisors and consultants are typically used extensively in M&A transactions. Even for mature and frequent acquirers, external specialized resources are common. External resources are used across the entire deal life cycle, but the heaviest use, and therefore, the costliest, is in DD, integration planning and integration.

DD requires a variety of resources with wide-ranging skills, including lawyers, accountants, tax advisors, executive consultants, business process specialists, change managers and project managers. The use of these resources continues into integration planning and during the integration itself, where key external expertise is needed, either directly on the transaction or as functional backfill.

Significant potential benefits come from using external consultants during M&A-related transactions and integration work. Selecting among the different types of consultancies for different tasks and phases is critical for maximizing the returns. However, there are also potential risks to be avoided, including loss of leadership and control, weaker relationships with critical stakeholders, and significant onboarding efforts of external parties that must be executed in a short time frame.

Acquirers should identify the most beneficial areas for M&A external advisor or consulting support. These might include staff augmentation, access to methodologies and industry experience, knowledge transfer, and independent assessments of integration opportunities and risks. With all of these, the related costs should be carefully optimized. Executive leaders should ensure that their teams know what external resources are in place, what they are doing and for how long they will be available. All too often, one-off or interim roles and costs become ingrained for much longer periods of time than planned.

### **Third-Party Service Providers**

The transfer of contracts — including customers, services and assets from an acquired company to the acquirer — and the downsizing or outright early termination of contracts can often be challenging. Executive leaders should enlist the help of the acquired entity's vendor or contract managers to engage vendors or service providers of the acquired organization to avoid substantial contract penalties or adjustment fees postclosure. In many cases, it will be possible to divest of unwanted or excess capabilities, services or solutions from the acquired company or combined organization during integration.

### **Internal Stakeholders**

Uncertainty about future jobs and roles is often high for personnel in the acquired organization shortly before and after the announcement of a deal. This can lead to unexpected or unwanted staff attrition and, as a consequence, high costs and risks related to workforce and business operations. Acquiring executive leaders must, therefore, develop a clear communication plan that addresses the needs of all stakeholders affected by the deal — such as internal staff, external workforce, vendors and service providers, and other parties as applicable (see [“Cultural Integration During M&A”](#)).

Formal communication is usually not possible or is very restricted prior to the legal close of the deal. However, a detailed plan for Day 1 and beyond needs to be prepared, including key messages, timelines and the most suitable communication channels.

### **Executive Leaders Can Ensure Successful Integration**

All M&A transactions are complex. To mitigate the impacts to the business, executive leaders must ensure careful organizationwide planning and execution take place across all stages of the transaction cycle. Moreover, the whole executive leadership team must be involved early and

continuously across the transaction. Doing so will ensure that integration is effective; that costs, benefits and synergies are managed; and that the resultant business achieves its stated goals.

## Recommended by the Authors

[Navigating COVID-19 Impacts on M&A Buy or Sell Decisions](#)

[Strategic Executives Manage Costs Across the Enterprise](#)

[Acquisition \(M&A\) Integration Workbook](#)

[M&A Capabilities Assessment](#)

## Recommended For You

[Tool: M&A Synergy Valuation](#)

[M&A Pipeline Tool](#)

[Mastering Transition Services in Divestitures](#)

[Pivoting Your M&A Execution in a Pandemic](#)

[Tool: M&A Integration Workbook](#)

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