

Ensure M&A Success by Avoiding Common Pitfalls

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Mergers, acquisitions and divestitures are important levers for enterprise transformation. Executive leaders must understand the most common traps and risks involved, and adopt potential countermeasures to better navigate the challenges ahead.

Overview

Key Findings

- Mergers and acquisitions (M&As) are important strategic levers for significant enterprise transformation; yet, many transactions are fraught with peril.
- There are five groups of common pitfalls covering the different phases of every transaction.
- Typical pitfalls may stem from misjudged opportunities, unclear deal drivers, misconceived benefits, outright execution flaws and excessive power politics.

Recommendations

To increase the likelihood of merger and acquisition transaction success, executive leaders should:

- Prepare for the most common pitfalls by assessing the likelihood of their occurrence.
- Identify their potential effect on the organization by evaluating the business impact of each pitfall.
- Mitigate the impact of the pitfalls by identifying the potential countermeasures that can be adopted.

Analysis

M&A transactions are long-standing, important strategic vehicles for significant enterprise transformation. Yet, many deals are fraught with peril. M&A-related pitfalls can stem from many sources – from incorrect assumptions or an incomplete understanding of the underlying drivers of a transaction, to misconceived benefits or outright failures in the preparation or execution of a deal. As many of the pitfalls apply across the business functions, all executive leaders will play a role in achieving successful M&A outcomes.

Five Groups of Common Pitfalls

We discuss five groups of common pitfalls, covering different phases of an M&A transaction, to help executive leaders identify potential countermeasures and inform their teams about the most important challenges that lie ahead (see Figure 1).

Figure 1: Five Groups of Common M&A Transactional Pitfalls

Five Groups of Common M&A Transactional Pitfalls



The What	Misjudged Opportunities
The Why	Overambitious, Unclear, or Undeclared Drivers
The Where	Misconceived Benefits
The How	Execution Flaws
The Who	Power Politics

Source: Gartner

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1. Misjudged Opportunities (The "What")

Acquisitions require a significant amount of management time and company resources. Successful acquirers, therefore, must demonstrate strategic and financial discipline for all M&A transactions — allowing them to strategize, execute and integrate from a position of strength.

Pitfalls: If a target company's performance is significantly better than the acquirer's, then the deal may be an attempt to address problems within the acquirer's business. This is likely to be unsuccessful. Equally unsuccessful are mergers between two ailing companies hoping to solve their problems by joining forces. All transactions involve and necessitate a degree of cultural change, and without successful execution such deals often have limited success.

Another common mistake made by acquirers evaluating targets in the same industry is to not challenge assumptions about synergies, growth prospects and competitive realities of a known market with the same scrutiny as they would for an adjacent or unknown market. Such a blind spot often limits the acquirer's ability to identify looming problems in its own ecosystem that have led a divesting company or the target firm to opt for a business sale.

Impact: Focusing on the wrong type of acquisition targets and evaluating known markets superficially can exacerbate M&A transaction risks and set a deal up for failure.

Action: During the M&A strategy phase, acquiring executive leaders must ensure that they identify, target and then, ultimately, transact on the appropriate targets for the acquirer's situation and deal

strategy.

2. Overambitious, Unclear or Even Undeclared Deal Drivers (The “Why”)

Often, the declared strategic drivers for an acquisition or divestiture are a long list of strategic and financial objectives. Strategically, these can include exploiting new markets, expanding sales channels and/or unleashing the disruptive potential of product ideas. Financially, these drivers often include capitalizing on strong financial market valuation and investing capital with the expectation of growing long-term shareholder value. Realistically, though, companies are able to achieve only a few major goals in any given transaction.

Pitfalls: At times, an enterprise’s decision to pursue an acquisition can be the result of the company feeling under attack — for example, by the public announcement of a major rival executing an important deal. Increasing shareholder or market pressure to respond swiftly can make it more likely that an organization will get drawn into a competitive acquisition frenzy and lose sight of the fundamental value-generating drivers that must be the basis of any deal.

Some companies have acquired competitors to avoid or end patent violation lawsuits, or to remove potentially disruptive ideas or new products from the market before they erode revenue or market share of the company’s own products. Others have specifically targeted a competitor’s intellectual property or R&D pipeline for acquisition.

At times, acquirers have found it easier to justify a reduction of excess capacity in existing facilities or resources after the purchase of a smaller, competing firm operating in the same market. Likewise, some divestitures have been motivated by facilitating the process of liquidation of a range of underperforming assets and folding them into a stand-alone, separate entity. For other firms, the catalyzing effect of an acquisition has been regarded as an essential lever for launching a major business transformation program to dramatically improve continued, weak, stand-alone performance.

Impact: Failure to clearly identify and communicate the primary rationale — the *why* for a targeted M&A deal — will lead to poorly or incorrectly defined postdeal business transformation objectives, which can seriously compromise benefits realization.

Action: During the M&A strategy definition, it is critical that the “why” you are buying is clear to all involved. Without a clear understanding of the reason you are transacting, you should not even start the process. Executing a transaction without clarity over why you’re doing it will only lead to problems in execution and likely failure in integration and operations.

3. Misconceived Benefits (The “Where”)

Flawed synergy estimates and incomplete assessments of enterprise transformation costs can put an entire M&A deal at risk.

Pitfalls: Financial markets are readily persuaded by the cost-saving opportunities of a transaction, because these are usually easier to quantify and reap than synergies for revenue growth. As a

consequence, acquirers may be led to set overly aggressive cost-saving goals that could damage, rather than streamline, the new business.

Just as bad as excessive cost-saving estimates are growth synergies that are highly improbable. Quantifying realistic, organic revenue momentum following an acquisition is difficult and requires a scrupulous and conservative modeling approach. Common “dis-synergies” or risks following a transaction, such as the potential loss of customers or disruptions in the ability to execute, are often completely overlooked during deal evaluations.

In many divestitures, former parent companies experience higher-than-expected operating costs in the remaining business after the transaction because of broken internal synergies with the separated unit. Such “stranded costs” have often not been accounted for correctly during deal evaluation and can, therefore, gradually erode the expected financial returns.

In a competitive bidding situation, enterprises often pay too much for a target firm. The acquirer then becomes an unfortunate winner, because the synergy potential of the transaction does not justify the price paid, eliminating the chances for value generation, regardless of how well the deal may be executed.

Just as “deal fever” (that is, the pressure to close a transaction after a long-running bidding war) may compromise the value of an acquisition, so can “deal obstruction” in the case of divestitures. Operational managers are frequently reluctant to propose the divestiture of a nonstrategic or underperforming asset in their portfolios, because this might lead to a loss of power or perhaps be seen as an admission of failure on their part. However, concealing asset underperformance until a loss-making fire sale becomes inevitable compromises the chances for a successful divestiture and destroys significant shareholder value.

Impact: Incorrectly estimated benefits and costs or rushed deal making can weaken the financial prospects of an M&A transaction substantially — sometimes to the point where even the most diligent execution can no longer reap the expected value.

Possible actions: Executive leaders should support their fellow leaders and business development/strategy teams in identifying realistic business synergies, and in assessing comprehensive enterprise transformation costs and risks during the evaluation phase of potential deals. The realization of benefits in an M&A transaction is a journey. Often, this will require acquirers to operate with “two of it” for a period of time. Reactive cost-cutting actions are rarely strategic or beneficial in the mid- to long term and must be considered with the overall strategy in mind.

4. Execution Flaws (The “How”)

Four key execution flaws are common in underperforming transactions.

Incomplete Due Diligence

Many companies focus primarily on the financial, legal and tax aspects of a targeted acquisition and dedicate less time to a thorough review of the cultural, operational or commercial foundations of the business to be acquired.

Pitfalls: Big companies acquiring much smaller firms, for example, often overlook a target's less mature or only partially documented business processes and IT platforms. In doing so, they underestimate the impact of eventually poorer-quality master data for customers, products, employees and other business assets.

In a so-called "hostile takeover," the acquirer will have limited access to information about the target company's financial situation, business operations and organizational structure prior to the legal close of the deal. Often, this significantly increases planning risks and uncertainties for postdeal acquisition integration.

Impact: Incomplete due diligence can lead to major M&A execution risks, such as substantial cost and time overruns for business integration and missed synergy targets.

Action: All executive leaders should ensure that they are involved in due diligence to identify and address potential integration risks early. Further, they should also assemble a team of experienced problem solvers to mitigate any unforeseen issues as they occur. For each area of diligence (i.e., finance, HR, IT, tax, commercial, legal), teams should prepare reports that indicate the quantitative and qualitative risks that must be (1) mitigated prior to closing, (2) factored into the purchase price and definitive agreements or (3) incorporated into postclosing integration actions.

Lack of Transformation Governance

Strong transformation governance is essential to resolve the many known and unknown challenges of any sizable M&A deal.

Pitfalls: It is common for postdeal integration planning to commence after the final signature (close) of the deal. This leaves very little time for developing and defining a structured integration approach between the merging entities and for establishing an adequately skilled and empowered integration program office. Weak integration governance is also the main cause for recurring resource and priority conflicts among reproposed, predeal business initiatives and the postdeal enterprise integration program.

In many divestitures, senior managers are prone to adopt an "out-of sight, out-of-mind" mentality with respect to the business being divested. Their reluctance to provide support and resources to the critical disentanglement process is motivated by the need to focus on consolidating the retained entity. This, however, gives rise to often costly and drawn-out transition services between the former parent company and the divested business or its acquirer.

Impact: Poor transformation governance can distract valuable resources, delay integration or disentanglement efforts, and compromise the timely and cost-effective execution of any M&A transaction.

Action: Executive leaders should advocate and establish strong transformation governance, including specific teams for synergy realization, change management and performance management. They should also create cross-functional program management capabilities and establish effective escalation mechanisms to quickly address critical resource or priority conflicts during the execution of an M&A transaction. A structured and regular issue management and resolution cadence should be established for the integration phase, with at least weekly meetings in the first 100 days and extending to bimonthly or monthly after that.

Failure to Address Critical People Issues

People and cultural issues are those with the biggest influence on the success or failure of an M&A transaction. Without the commitment of the employees — often forced together into a new organization or separated from a familiar environment and thrown into an uncertain future — even the most carefully crafted deals will fail.

Pitfalls: Cultural clashes between the merging entities, loss of key talent and poor engagement of leaders in the divested business are only a few of the many people challenges that an M&A transaction needs to address.

Limited capacity for change is another important risk factor for major enterprise deals. Because acquisitions and divestitures demand a high amount of change from the affected employees within a relatively short time frame, staff resistance and the rate of execution failure are likely to increase as organizations are pushed beyond their limits. Every organization has a level of maturity related to change, and this level needs to be taken into account when planning and executing a transaction.

Impact: Failure to address critical people issues during an M&A transaction can jeopardize not only the transformational efforts of the enterprise, but also — and more importantly — the overall value generation of the transaction.

Action: All leaders should work closely with their HR peers to identify appropriate employee retention, motivation, professional development and cultural alignment measures, and adopt two-way staff communication and feedback mechanisms to prevent change capacity from being inadvertently exhausted.

Failure to Use External Advice and Expertise

M&A transactions are complex, specialized and, for most, infrequent activities. As a result, external specialized resources are typically required, but not all companies recognize this. Either as a result of cost pressures or mistaking ambition for ability, organizations enter into transactions with incomplete or inadequate external help.

Pitfalls: All phases of an M&A require specialized and highly valued expertise. This ranges from target identification, valuation, term sheets, sale contracts and transition services agreements to due diligence and then integration. There are professionals with wide-ranging skills, including

lawyers, accountants, tax advisors, IT consultants, business process specialists, change managers and project managers, who are required. The use of these resources continues into integration planning and also during the integration itself, where key external expertise is needed, either directly on the transaction or as functional backfill.

Impact: The absence of the appropriate professional skills at, and for, the required length of time can seriously inhibit the success of the transaction. Further, fundamental legal/regulatory, tax and accounting errors can be made that have implications far beyond timing, with potential financial and legal ramifications that can undermine the entire premise of a transaction.

Action: Executive leaders must ensure that external resources are used across the entire deal life cycle, but the heaviest use is in due diligence, integration planning and integration.

5. Power Politics (The “Who”)

All M&A transactions involve personal and power politics that have inevitable implications for all involved. There will be “winners” and “losers” across functions and at all levels in the organization.

Pitfalls: Depending on the nature and style of an M&A transaction, discussions for top management positions in the merged entity are often politically charged. Because these conversations are difficult and very personal, the M&A execution phase often does not lend itself to aligning on these decisions prior to a deal closing. Carrying this uncertainty into the integration phase can be a significant roadblock to working together as a team postclosing.

Just as contentious as power balance can be selecting the “best of breed” to lead the newly combined enterprise. Such selections must reflect the best people, processes and technologies to retain going forward. Because of the complexity of such a task and the multitude of interests at stake, managers often make only tactical decisions in this regard, as opposed to the more strategic and confrontational ones.

Impact: Excessive focus on power balance and structural heritage can paralyze a newly merged entity and compromise its ability to make quick, impartial decisions about future business strategies and required integration activities. Rapidly rising integration costs and time frames can soon place the entire deal and its anticipated benefits at risk.

Action: Executive leaders should support and demand swift, clear and strategically focused senior executive decisions on merger integration issues and raise awareness of the impact of relative delays or failures with all stakeholders concerned. Decisions over key roles and responsibilities need to be considered in light of potential impacts to the combined organization. Mitigation and contingency plans need to be developed and put in place for all leadership changes.

Recommended by the Authors

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

[Effectively Optimizing Costs in Mergers and Acquisitions](#)

M&A Survival Guide for the Acquired Executive

Mastering Cultural Integration During M&A

Recommended For You

M&A Pipeline Tool

Tool: M&A Synergy Valuation

Mastering Transition Services in Divestitures

Pivoting Your M&A Execution in a Pandemic

Tool: M&A Integration Workbook

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