Corporate Directors Share Their Insights on M&A Success

Fostering robust dialogue and asking tough questions are amongst the leading practices corporate directors interviewed for this article perform to ensure M&A success.

By Jackie Bassett and Jay R. Taylor,
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Many companies with balance sheets flush with cash are now seeking to accelerate corporate growth through mergers and acquisitions (M&A). Today's environment is creating tremendous opportunity for corporate directors who are responsible for creating long-term, sustainable growth and shareholder value—to optimize the value of an M&A.

Peer exchange, particularly at the corporate director level, is one of the most effective and highly valued methods of learning what works best and delivers the most value. But, which directors are leading the change in how boards engage in the M&A process? More important, which directors are getting great results from their innovative methodologies? Would these successful directors be willing to share their leading practices with their board peers?

To answer these questions, we held one-on-one interviews with some of the most seasoned corporate directors in the United States. Each director actively serves on a board committee in organizations ranging from multi-billion dollar to mid-tier companies in industries including health care, energy, consumer products and technology. The combined M&A experience of these corporate directors represents hundreds of highly complex acquisitions and a total market value of more than US $6.8 billion. According to the directors interviewed, engaging boards in robust dialogue and asking tough questions are amongst the leading practices needed to be on the road toward M&A success.

Foster Robust Dialogue

John E. Lawler, who has been a corporate director for more than a decade and currently serves on the board of two public companies, NCI (NASDAQ) and L1 Identity Solutions (NYSE), as well as two private organizations, stresses that each board member remembers the primary and fundamental goal of a public-sector director: the creation of long-term, sustainable shareholder value.

Lawler also sees great value in the diversity of skill sets and experiences that each board member brings and believes that this diversity should be leveraged to lessen group think and create more provocative discussions. Furthermore, Lawler believes that directors appreciate in-depth discussions and differing viewpoints.

> *"The ability to have a spirited and robust dialogue at those board meetings should be considered a strength, one that is especially valuable in developing M&A strategies and guiding the entire process to successful integration. Board members need to have in-depth discussions about the impact of an M&A on shareholder value based on a perpetual model of the company being a going concern."*
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> John. E. Lawler, board director
> NCI, Inc., L1 Identity Solutions, Inc

Dr. Richard Sherman, a cardiologist who serves on the board of ICU Medical Inc. also shared his insights on the importance of having robust dialogue with the full board during an M&A.

To have vibrancy, the entire board should be made aware of a potential acquisition early in the process and have regular interaction with management throughout the negotiations. This approach will allow board members time to reflect on some of the more critical questions relative to each event.

> *"It's very important to ensure we have a mix of board members with various areas of technical expertise. We believe 'board vibrancy' in making key decisions about M&A is good for shareholders."*
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> Dr. Richard Sherman, Cardiologist
> board director, ICU Medical, Inc

Ask Tough Questions

Having robust dialogue is the foundation for asking the right — oftentimes tough — questions. According to Ernest Godshalk, board of director at GT Solar, Verigy and Hittite Microwave Corp., M&A success lies in the questions the board asks. In particular, Godshalk shared three cases where the board needs to be fairly assertive in asking tough questions:

1. Management appears too eager to get the deal done.
2. Management is reluctant to participate in a merger or acquisition.
3. The deal is too good to be true.

In situations where management appears too eager to close a deal, board members should ask managers to examine the situation carefully. “What’s the rush?” is often a good question to get the dialogue started. However, if management appears too reluctant to act on an opportunity, the board could ask management to identify the reasons for their hesitation. For instance, board members could ask, “Is the company being too risk averse, and if so, why?”

> “*What will we gain from this deal? And, what do we stand to lose? are key questions that can help management identify hidden risks or obstacles in achieving the deal’s success*.”
>
> Ernest Godshalk, board director
> GT Solar, Verigy and Hittite Microwave Corp

Finally, if the deal is too good to be true, Godshalk advises that board members ask management to identify the merger’s or the acquisition’s true strategic value.

Blythe J. McGarvie, board director for Viacom Inc., Accenture and Wawa, recommends that board members ask clarifying questions, particularly from sales and marketing managers, to ensure directors understand the true value that will be derived from the deal. McGarvie is CEO of Leadership for International Finance and has participated in numerous acquisitions while serving as Chief Administrative Officer for the Pacific Rim at Sara Lee.

> *“The best way to understand the value of a potential acquisition is to spend time with top management both formally and informally. You can learn about people, concerns and customs by asking questions and listening when an answer is halting or not quite as thorough as you would expect. I find that going to dinner with the CEO and having one-on-one time to discuss his concerns often yields answers and insights that would be difficult to ascertain in a larger more formal setting.”*
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> -Blythe McGarvie, board director
> Viacom Inc., Accenture, Wawa

Her questions help to clarify not only the current value of an acquisition or merger, but identify whether management has a focus on future growth. For example, “What are we doing to grow profitably?” “Is the goal to expand geographically or to expand our product offerings?” “Is our goal to enhance customer focus?”

Here is a list of key questions compiled from our interviews that board members can ask to initiate robust dialogue sessions with their corporate director peers pertaining to their organization's planned M&A activities:

Aligning With Corporate Strategy

- How does the M&A fit within the organization's corporate strategy?
- What is the organization really trying to accomplish, and can we?
- What is the organization buying (e.g., product offerings, clients, presence in a new location)? Will the purchase provide complementary or competing products and services?
- Will the deal provide specific enhancements in technology, processes, or patents, or does it expand the sales force?
- What is the true strategic value of the merger or acquisition?
- What are the synergies? Are these synergies measurable?
- Is the deal driven by "ego" or the desire to fill a strategic need?
- Is this really a good deal?
- What's the rush with this acquisition?

Measuring Deal Substance

- Does the organization need any technical expertise to assist on this deal?
- What are the specific benchmarks and timelines expected as a result of this M&A?
- When does the acquisition become organic?
- What risks has management identified, and what can be done to manage them?
- What are the opportunities?
- Has management looked at the mergers or acquisition's fit from a cultural standpoint?
- What makes management sure the terms are right?
- Is management focused on profitable growth, for example:
  - Focusing on what existing customers need?
  - Innovating the product line and entering an emerging market?
  - Expanding the business geographically?

Integration as Part of Strategy

- What is the integration plan, and how is the speed of the integration assured?
- Who are the key management executives responsible for the integration?
- Do the right rewards and penalties exist for integration success?
- Is there an opportunity early on to do a "test fit" (post-integration operations simulation) of the acquired company?
- How does management plan to integrate the sales force?

Create Process Innovations

In addition to fostering robust dialogues between the board and management and asking tough questions, these board directors shared some of the process innovations they use to enable M&A success. They reported that each of these process innovations was created specifically for situations where directors' demanding schedules conflict with the detailed level of preparation that is required in today's increasingly complex M&A transactions.

Lawler explained that one successful process innovation he uses to facilitate an M&A strategy is to create a special board committee which includes one or two core directors. Additional corporate directors can be appointed to the special committee if a deal requires a particular skill set or knowledge in a specific business function. To avoid burnout, core membership can be rotated, thus helping to spread the work. However, all directors must continue to be fully informed of any planned M&A activity

Godshalk described one particular M&A transaction where he, as a corporate director along with the CEO of the acquiring company, took the time to meet directly with a director and the CEO of the company being acquired.

Paul Feldman, chairman of Midwest ISO and board director of Western Electricity Coordinating Council, creates M&A success by using a highly disciplined process innovation known as Stage Gate. Stage Gate is more commonly used in new product development yet has proven to be equally as effective in M&A transactions. He also suggests performing a "mini risk analysis" so that directors can identify challenges and opportunities, test assumptions and recommend activities that can be performed to manage risks.

> "*Managers should hold a one-day offsite meeting to address M&A due diligence up front and run 'thought experiments' and 'what if' scenarios leveraging the diverse expertise of the full board.*"
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> Paul J. Feldman, Chairman of the Board Midwest ISO
> board director, Western Electricity Coordinating Council

Marshall N. Carter, Chairman of NYSE Group and Deputy Chairman of NYSE Euronext, described three considerations that often guided his decision-making about process innovations during the 13 M&As he directed while serving as chairman and CEO of State Street Bank and Trust Co.

First, the board should always be leery of cross-cultural issues where a target company is greater than one-third the size of the acquirer. Second, integration plans must be sensitive to the situation if the target company has invested a lot of sweat equity in a particular market, and it is wise to not disturb these operations for about 3 to 5 years. Third, Carter recommends boards stay true to their core businesses as he had at State Street.

"You must clearly understand what three areas comprise your company's core skills, and never do a deal just to do a deal."

Marshall N. Carter, Chairman of NYSE Group and Deputy Chairman of NYSE Euronext

Discuss Key Issues Early

Stephen Brown, CEO of PreCare Inc., has served as CEO and board member during the acquisition of multiple services-based companies. While working as CEO, Brown took the initiative to actively seek out the skills and wisdom existing within the board by laying out his strategy in one-on-one meetings during the planning stages of each acquisition. "How can you help me?" was a question Brown often asked board members during these one-on-one meetings.

These discussions, which also involved key directors from operations, helped Brown to assure that management was better prepared for the acquisition. In addition, Brown also advises that boards understand the existing level of "sales and marketing synergy" on both companies prior to each M&A, as most expectations are typically over-inflated in this area.

Doug Rainville, chief financial officer at Triangle Inc., has been involved in 10 M&A transactions representing a combined market value of more than $300 million. He cautions that, without a well-disciplined process of information sharing during the early stages of the M&A activity, transactions might be at risk of being "sold" to the board by a limited group, such as the CEO and one or two supporting board members.

The M&A process needs to be opened to the full board prior to the deal so that they can understand the justification for the acquisition and get the optimum level of board involvement. The Board also can hold management responsible for achieving the numbers they developed during the M&A process.

Final Thoughts

Corporate directors today have a tremendous opportunity, and even responsibility, to lead the change in how boards engage in the M&A process. An M&A is a call to action for corporate directors to initiate boardroom debates by asking tough questions until they obtain answers they can stand behind. Corporate directors should be open to process innovations that can provide the most value early in the M&A planning process.

When M&As become the strategy for accelerating corporate growth, change is the order of the day. But what will never change is that the number one fundamental goal of every corporate director is the creation of long-term, sustainable growth and shareholder value.

Jackie Bassett is CEO of BT Industrials Inc. a strategic growth management and technology advisory consultancy based in Boston. In 2000, she worked at Netscreen Security where she launched and grew the service provider market out of Washington, D.C. Netscreen carried out a successful IPO in 2001, then was acquired by Juniper Networks in 2004 for US $4 billion. Her background is in investment banking where she grew a portfolio of eurodollars to US $2.5 billion. She holds an MBA from Babson College and is the author of *Drawing On Brilliance*. Ms. Bassett may be contacted at jackieb@btind.com.

Jay R. Taylor, CIA, CISA, CFE, is general director of internal audit services at General Motors Co. in Detroit, Mich. He is responsible for assessing governance, risk management and compliance processes for global information technology, corporate treasury, financial services, and an SEC-registered investment advisory company managing US $100 billion in pension and other benefit assets. Taylor is a frequent speaker and writer on topics including risk management and internal auditing, and is currently serving a member of the Board of Governors for the Detroit Chapter of The Institute of Internal Auditors. Mr. Taylor may be contacted at jay.r.taylor@gm.com.