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SPECIAL REPORT

M&A as an Exit Strategy: The Executive Leadership Dimensions

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Twenty years ago, an initial public offering (IPO) was considered the gold standard for success in the start-up and business community. The IPO was a liquidity event that held a certain cachet and garnered the respect of senior business leaders across industry lines. However, with the dot-com bubble and subsequent crash in 2000, the resulting Sarbanes-Oxley Act of 2002, and the financial crisis in 2008, the regulatory environment for public companies became more stringent than ever before, forcing many organizations to devote more time and money to complying with new regulatory demands. As a result, some organizations began to second guess the ultimate goal of going public.[1] Still wary of the risks associated with an IPO—increased public scrutiny, regulations, and the costs related to SEC compliance—many of today's entrepreneurs are building their companies with multiple end-game strategies in mind, including merging with or getting acquired by another organization.

[1] Barrett, Amy, "Is the IPO Party Over?" Inc.com, September 2012, http://www.inc.com/amy-barrett/is-the-ipo-party-over.html?cid=readmore.

A number of non-financial factors have also contributed to the rise of M&A activity among small, medium and large companies that might have considered going public years ago, the first of which being the mentality of today's innovators. In past years, entrepreneurs were more focused on developing and flipping products. Today, the Gen Y leaders are interested in building careers around their interests and passions, while still maintaining creative control over their products and services. An IPO elicits more pressure and emphasizes the importance of short term gains over long-term goals, thus hampering founders' entrepreneurial spirit and freedom to pivot, modify, delay, and perfect products as necessary without pushback and opinions from key stakeholders.[2] By coordinating a friendly merger or acquisition with a larger organization, the business can operate as a wholly owned independent subsidiary with the added resources of a major company. Angling for an acquisition or merger is a more attractive option for many companies looking to maintain creative control while generating capital to expand its business model and service offering.

A second consideration that has caused many organizations to seek a merger or acquisition as an end goal is that an IPO often changes employee motivation. When senior managers are focused on the numbers and maintaining or raising stock prices, employee morale can swing from one end to the other on a daily or weekly basis and the business can suffer as a result. If a company underwent a merger or acquisition and continued to operate as an independent organization, employees would have more freedom to focus on their products and customer satisfaction instead of getting bogged down by financial statements and shareholder expectations.[3]

Thirdly, some IPOs have fallen short of the level of profitability anticipated by the company's senior leaders and analysts. Many struggle with low returns and have to manage regulatory costs that burn big holes in the company's checkbook. Organizations that are acquired by larger corporations get to take advantage of their economies of scope to speed production and get their products to the market in a shorter timeframe, and absorb hefty regulatory costs that would have otherwise fallen squarely on their shoulders.[4]

Although IPO activity is still very much alive and well in today's market, many companies—from established brands to start-up businesses—are choosing to pursue acquisition strategies. Mergers and acquisitions provide even the most well-known, successful organizations the opportunity to combine resources, talent, and product offerings to grow the business to new heights. Some recent deals to highlight this trend include Facebook's acquisition of WhatsApp, a mobile messaging application, for $16B in February 2014—the company will continue to run as an independent brand under the Facebook umbrella; Priceline's $2.6B acquisition of OpenTable, an online restaurant reservation application, in which technology and marketing expenses for both companies will decrease as a result and OpenTable's management team will continue to run the business as an independent brand; Zimmer Holdings' acquisition of Biomet, both musculoskeletal medical supply companies, for $13.35B, thus combining two world-class management teams and giving both companies more resources to weather the medical device tax; Texas-based Kainos Capital, LLC's recent acquisition of Slim-Fast, a weight-management food and beverage company, from Unilever N.V., which will "give Slim-Fast the resources and entrepreneurial focus that will drive the brand to new heights," according to Andrew Rosen, Managing Partner of Kainos Capital; Anheuser-Busch's acquisition of Long Island-based craft brewery, Blue Point Brewing Company, which will continue to operate under it's Blue Point brand and leverage Anheuser-Busch to expand its operational capacity.[5,6,7,8,9]

As M&A gains traction as a preferred outcome for some businesses, the topic of human capital should color all strategic conversations relating to potential buy-outs. How entities manage the convergence of two established teams, each with its own set of policies and procedures, corporate culture, and performance metrics, will ultimately shape the profitability and success of the merger or acquisition.

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How to Structure and Assess Talent in the Midst of M&A Activity

M&A FROM THE ACQUIRING COMPANY'S PERSPECTIVE

There are a number factors that drive acquiring organizations to pursue an M&A strategy, including gaining pure market share in a core business area or tangential market, establishing or increasing their geographical footprint and capabilities, and eliminating a competitor operating in the same business area. Despite the many dimensions that impact acquisition strategies, organizations are generally open to acquisition when they see the value in a specific product or service and believe that it will positively affect their go-forward global growth strategy.

There are several obvious business considerations that must take place before an acquisition can occur. In addition to the dimensions discussed above and the financial viability and long-term potential of both the acquiring company and the entity it plans to purchase, there are also numerous aspects relating to human capital that need to be evaluated.

THE IMPORTANCE OF TALENT ASSESSMENT

Evaluate Cultural Fit

The success of a merger or acquisition often depends on the level of cultural fit between the two organizations. Understanding the similarities and differences between corporate cultures, management styles, and communication protocols will give key decision makers insight on whether the two established cultures can coexist and move forward through the merger or acquisition process. The leadership teams at both companies need to define the components of the post-merger culture in order to identify the people who will fit most appropriately into the new business structure.

Assess Talent Gaps

The leadership teams should also pinpoint the functional areas that are crucial to the combined success of the organizations and assess the talent gaps in both companies to recognize where the talent pipeline is weakest and strongest across all functions and business units. By doing so, the restructuring team can see which executives are best suited to lead their respective functions moving forward, which departments need to be further augmented, which areas could be consolidated or streamlined, and which combination of leaders would give rise to the most effective teams.

Identify High Potential Future Leaders

How an organization decides to structure the combination of two entities during a merger or acquisition—either keeping the acquired company as a stand-alone business or completely integrating and merging it into the core business—will greatly impact the management and leadership strategy. To help with this decision, companies should take time to assess and distinguish who the critical people are in both organizations—not only at the senior level, but two or three levels down—and recognize that they will lose great people if they don't take the time to understand where the talent lies or if they fail to provide a gateway for those key players to move forward after the acquisition. Too often during human capital assessments, evaluators only focus on the qualifications of senior leaders; in reality, it is equally if not more important to identify high potentials and individual contributors that are crucial to the company's success. It falls on the CEO and integration team's shoulders to communicate their intentions to these key individuals to ensure the company doesn't lose out on their top talent.

Comprehensive assessments also allow the decision-makers to see who thrives in the new environment and who gets bogged down in the many moving parts of integration. The team responsible for the merger or acquisition must assure individuals with the clarity of vision, who keep the train running on time and, more importantly, are crucial to the growth strategy, that the organization is committed to them.

The assessment team will likely find overlap in team members' responsibilities throughout the evaluation process. On one hand, the comparison exercise might make the choice between two individuals for one role fairly easy to decide. On the other, there will be many professionals who bring certain competencies in product development, product marketing, finance, IT, operations, manufacturing, R&D, supply chain, etc. who are essential to the continued success and innovation of the combined entity. Recognizing the people on both sides who are crucial to the organization will paint a clearer picture of who should remain after the integration is complete. The ability to identify where the high potential and key leaders sit in the organization, define their roles moving forward, and communicate to those people how and why they are needed in the company will be an essential factor in a successfully integrating two teams.

DECISION-MAKING PROTOCOLS

I believe that the CEO of the integrated company should ultimately own the decision around how to structure the team moving forward. However, in many of the best well run organizations, the Chief Human Resources Officer (CHRO) plays an integral role in assessing, structuring, and integrating all executives that will come together in the new business. The CHRO will work with the CEO—and more broadly, an integration team—to decide how to assign responsibility for key roles and which individuals are essential to the go-forward strategy of the organization.

Key board members should also play a role in assessing the leadership teams throughout the acquisition process. I suggest that the CEO choose one to three board members who have the professional background to assess individuals who will be slated into important roles. For example, the chair of the audit committee should be involved in evaluating the CFOs at both the acquired and acquiring company to comment on who would be the most appropriate person to lead the combined organization. Companies often assume that the acquiring company's CFO should remain in the position, but the best CEOs in industry today recognize that the talent coming in from the other organization may be in a better position to lead under the new circumstances. Leveraging the chair of the audit committee to help assess CFO candidates is just one example of how board members can contribute to determining overall responsibilities.

Third Party Support

Mergers and acquisitions are very complex initiatives that require an extraordinary amount of assessment and due diligence by the leadership team. In many cases, third party support may be necessary in order to independently assess the talent in each company with an unbiased perspective and alleviate the pressure on the CEO and integration team responsible for making cuts or evaluating tenured employees.

In certain cases, the integration team may find that there are executives who are indispensable to the organization who will serve in key leadership roles, but lack a certain competency around integration. For those leaders who are slated into post-merger senior positions, but don't have much experience with building a team of people from two different organizations with unique corporate cultures, management styles, and technical competence, I strongly recommend that they partner up with third-party coaches and mentors who can help them define the requirements of the roles reporting to them, as well as assess individuals to see who would be most effective in those reworked positions. People often assume that everyone knows what to do in the face of a merger or acquisition, but the reality is that very few people have managed integrations exceptionally well, and having people around who can coach and be a sounding board to key leaders would be a valuable tool for those business executives moving forward.

COMPONENTS OF A SUCCESSFUL INTEGRATION

Independent Decision-Making

In my experience, the biggest struggle a CEO will face as he or she structures the team of individuals who will remain after the merger or acquisition is taking an independent position during the assessment process. Crucial to the success of a merger or acquisition is creating a team of people who truly have a grasp on what the next two or three, even five to seven years will look like in their specific market. It's not enough to have great leaders who have worked at the company for many years and helped grow the organization to $1B, $2B to $5B or more. CEOs have to question whether the person they are evaluating, despite historical success and longstanding relationships, is truly the best person to take the combined business to a higher level. It's not easy letting go of individuals who have played key roles in getting the organization to where it is, but the best CEOs in the world understand that at times, it's like a relay race where you have to hand the baton to the next generation of leaders who have the vision, energy, intellectual horsepower and potential to grow to the next level of corporate ethos. It can be difficult to look past performance and understand the necessary attributes and skill sets required for a person to thrive in a position moving forward. It's really incumbent on the CEO's part to have a world-class CHRO who can carry the burden in many ways around the different aspects of assessing the skills of those individuals coming in so that they can make the best business decision for the organization.

Swift Course of Action

It is also important to establish an appropriate timeline for the integration. If the merger moves too quickly, crucial action items will get lost in the shuffle and there will be less time for management to thoroughly conduct talent assessments. Alternatively, if the timeline stretches over too long of a period, people, initiatives and deliverables get bogged down by the bureaucracy, history and legacy of each organization, resulting in increased tension and less willingness to compromise on the changes needed for a seamless transition. There needs to be a detailed plan and strategy of integration across the entire business with clear goal dates and time markers.

Clear Communication

Oftentimes, there is not enough communication taking place within the organization when an acquisition takes place. The best thing that the CEO can do is to make sure the lines of communication are open and that everyone in both organizations knows exactly where things stand—that is, when the CEO and leadership teams can divulge that information. There is certainly a quiet period and timeframe where it might appear as though the CEO or leadership team is withholding information about the merger or acquisition, but employees need to recognize that there is a window of time where the leadership teams cannot communicate confidential matters to the rest of the organization. However, when the team makes a decision and publicly announces the merger or acquisition, it is really critical that there is an internal communication mechanism in place to keep people in both organizations up to date on the moving parts as openly and directly as possible. There will be significant changes in people and responsibilities and a certain level of anxiety around the integration, but at a lot of different levels, much of this can be waylaid with great communication and thoughtfully constructed integration strategies that allow both sides to understand the next steps in the process.

CLOSING STATEMENT

M&A continues to grow as a viable end-game strategy for businesses across most industries because many business owners and entrepreneurs feel that they will have more freedom, less pressure, and greater control of the organizations they built than if they were to file for an IPO. While the financial burdens of filing for an IPO may also encourage business leaders to look to M&A opportunities, a new cost dimension arises when considering M&A as an end game strategy; namely, the time and capital required to thoroughly assess the talent landscape in both entities. Having a clear picture of who the key leaders are, where they will fit into the combined organization, and how their management styles will work with other team members is necessary for a successful, streamlined integration. Before engaging in M&A activity, companies must first be prepared to commit time and resources to the talent assessment process. As we all know, people are the most important spice in any recipe for business success.

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ABOUT NGS GLOBAL

With offices across the Americas, Europe and Asia, NGS Global provides the extensive resources of major global executive search firms along with high-touch service, accelerated completion cycles and superior candidate access made possible by a mid-sized platform without external shareholders. Through our commitment to industry expertise, cultural knowledge and partner-led search execution, we deliver exceptional value to our clients.

ABOUT DAVID NOSAL

David Nosal is Managing Partner at NGS Global and is a member of the firm's Global Operating Committee. He founded NGS Global's predecessor firm in the Americas, Nosal Partners, in 2005.

Mr. Nosal has conducted numerous executive search assignments across multiple industries throughout North and South America, Europe, and Asia on behalf of FORTUNE 1000 companies, as well as small- to mid-sized organizations. The majority of Mr. Nosal's executive search assignments over the past 25 years have focused on recruiting CEOs/Presidents, board members and other C-level executives into a wide range of global companies - from early-stage private to multi-billion-dollar public firms. His problem-solving approach and commitment to quality and service are recognized assets in the industry, as evidenced by his substantial repeat business.

Mr. Nosal was formerly with Korn/Ferry International, where he was Head of the firm's CEO Practice. He also led Korn/Ferry's West Coast Board Practice. In addition, Mr. Nosal was Managing Director for Korn/Ferry's Central and Northwest Regions, overseeing the firm's San Francisco, Silicon Valley, Seattle, Denver, Chicago, and Minneapolis offices. Prior to joining Korn/Ferry in 1996, Mr. Nosal was with another international executive search firm as a senior partner. He was previously a consultant with a senior-level executive search firm in Minneapolis. Mr. Nosal's career also includes tenure as a consultant with the American Consulting Association in Chicago, as well as at Abbott Laboratories in its Chicago corporate office.

Mr. Nosal graduated with a BS degree from the University of Wisconsin Whitewater.

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