Development of a Project Management Methodology for Supporting Mergers & Acquisitions (M&A)

FABIO SOTTILI CHAVES

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We learn wisdom from failure much more than from success. We often discover
what will do, by finding out what will not do; and probably he, who never
made a mistake, never made a discovery.

- Samuel Smiles
Abstract

Mergers and Acquisitions (M&A) are strategic tools at disposal of CEOs to accelerate growth and achieve objectives faster, as long as they are successfully implemented. In the last 100 years, plenty of examples both of successful and failed M&A attempts are available in the literature. Professionals in the area agree the best way to conduct M&A is through a project. Conducting a project requires a solid, purpose-build methodology to significantly increase the chances of success. Despite this fact, publicly available management methodologies for M&A projects are rare, as most methodologies are proprietary, thus owned by consulting firms and not openly available. This gap motivates the development of a project management methodology tailored to M&A undertakings. Such methodology is intended to serve both professionals already active in the area as well as beginners willing to get familiar with the fantastic realm of M&A.

This work proposes a methodology based on a framework which presents, in one single picture, all the knowledge areas involved in conducting an M&A project. Besides, the project is split in phases and stages set in a temporal dimension and obeying dependencies to set the sequence in which processes in each knowledge area are applied. Each knowledge area and phases are extensively explained along with real examples to facilitate learning. Phases and stages are also diligently covered.

The result is a simple, yet comprehensive methodology to support the undertaking of M&A projects. It is generic enough to be further developed and tailored to more specific needs. Notwithstanding, it is a great source of knowledge in the area for those interested in having a high-level overview of what M&A are about.

The major implication of this work is delivering a publicly available Project Management methodology tailored for M&A undertakings, serving as a comprehensive overview of what Mergers and Acquisitions are, best practices in the field and how such an undertaking can be successfully carried out.

**Keywords:** Mergers & Acquisitions (M&A), Project Management, Marketing, Finance, Project Management Office (PMO), Corporate Strategy
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Stockholm, June 2012
Table of Contents

Abstract ................................................................................................................................. i 
Acknowledgements ............................................................................................................ ii 
Table of Contents ............................................................................................................... iii 
List of Figures ..................................................................................................................... vii 
List of Tables ....................................................................................................................... ix 
List of Acronyms ................................................................................................................ x 
1. Introduction .................................................................................................................... 1 
   1.1. Motivation .................................................................................................................. 2 
   1.2. Problem Statement .................................................................................................. 2 
   1.3 Objectives and Research Contribution .................................................................. 3 
   1.4 Unique Contribution ............................................................................................... 3 
   1.5 Scope and Limitations .............................................................................................. 3 
   1.6 Report Outline ......................................................................................................... 4 
2. Research Background .................................................................................................... 5 
   2.1. Mergers & Acquisitions (M&A) .......................................................................... 5 
      2.1.1. The Definition of M&A .................................................................................... 5 
      2.1.2. Types of M&A ............................................................................................... 12 
      2.1.3. Corporate Governance and M&A ................................................................. 14 
         2.1.3.1. Definition of Corporate Governance ........................................................ 14 
         2.1.3.2. Corporate Governance Structure ............................................................. 14 
         2.1.3.3. The Link between Corporate Governance and M&A ............................ 17 
      2.1.4. Executing Due-Diligence ............................................................................... 18 
      2.1.4.1. Private vs. Public Companies Valuation .................................................... 19 
      2.1.4.2. Discounted Cash Flow (DCF) Valuation Method ....................................... 21 
         2.1.4.2.1. Determining the WACC ...................................................................... 22 
         2.1.4.2.2. Calculating the Free Cash Flow (FCF) .................................................... 23 
         2.1.4.2.3. Calculate the Terminal Value ............................................................... 24 
         2.1.4.2.4. Calculate the Enterprise Value ............................................................. 24
2.1.4.3. Ratio-Based Valuation ................................................................. 25
2.1.4.4. Valuation Based on Comparable Transactions Analysis ................. 27
2.1.5. Reasons for Resorting to M&A ...................................................... 28
2.1.6. Why M&A Very Often Fail to Fulfill Expectations ............................ 32
2.1.7. M&A Waves and What They Can Teach Us .................................... 33
2.2. Portfolio, Program and Project Management ......................................... 34
2.2.1. Framework vs. Methodology ....................................................... 35
2.2.2. The Definition of Project ............................................................. 36
2.2.3. Project, Program and Portfolio Management ..................................... 37
2.2.4. Project Management Office (PMO) .............................................. 41
2.2.3.1. PMO Models ............................................................................. 43
2.2.3.2. Line-Of-Business PMO ............................................................... 47
2.2.3.3. Enterprise PMO ......................................................................... 48
2.2.3.4. PMO Automation and Tooling .................................................... 50
2.2.3.5. Project Management Maturity Model (PM3) ................................. 53
2.2.4. Project Lifecycle and Organization ................................................ 55
2.2.5. Stakeholders ................................................................................. 56
2.2.6. Organizational Influences on Project Management ............................ 57
2.2.6.1. Organizational Culture and Style ............................................... 57
2.2.6.2. Organizational Structure ............................................................ 58
2.2.6.3. Organizational Process Assets ................................................... 60
2.2.6.4. Enterprise Environmental Factors ............................................. 60
3. Research Methodology .......................................................................... 61
3.1 Sources of Information ......................................................................... 61
3.2 Research Methods ................................................................................ 61
3.3 The Research methods adopted in this work ...................................... 64
4.1. The Case of “A Limited” ................................................................. 65
4.1.1. Defining “A”’s Corporate Governance Structure ............................... 65
4.1.2. Defining A’s Mission, Vision and Values ....................................... 66
4.1.3. Defining A’s Strategic Framework ............................................... 67
4.1.4. Implementing the Strategy through the Acquisition of “B” Ltd .................................... 71

5. Project Management Methodology Enabling Successful M&A ........................................ 73

5.1. Defining the Structure of M&A Projects ........................................................................ 73

5.2. Portfolio, Program, Project, Phases: Which to Use? ....................................................... 75

5.3. The Role of PMO in M&A Projects .............................................................................. 76

5.4. The Proposed M&A Project Management Framework .................................................. 76

5.5. Core Functions (Basic Diligence) .................................................................................... 79

5.5.1. Scope Management ..................................................................................................... 79

5.5.2. Time Management ..................................................................................................... 80

5.5.3. Cost Management ...................................................................................................... 80

5.5.4. Quality Management .................................................................................................. 81

5.5.5. Legal Aspect Management ......................................................................................... 81

5.5.5.1. European Union (EU) Legal Framework for M&A .................................................. 82

5.5.5.2. The Canadian Legal Framework for M&A ............................................................ 82

5.5.5.3. The Brazilian Legal Framework for M&A ............................................................ 83

5.5.6. Financing Management ............................................................................................... 84

5.5.7. Valuation Management ............................................................................................... 85

5.6. Support Functions (Strategic Diligence) ......................................................................... 87

5.6.1. Human Resources Management .................................................................................. 88

5.6.2. Communication Management .................................................................................... 88

5.6.3. Risk Management ...................................................................................................... 89

5.6.4. Procurement Management .......................................................................................... 92

5.6.5. Marketing Management .............................................................................................. 93

5.6.6. Budgeting Management ............................................................................................... 95

5.6.6.1. Company’s Financial Leverage vs. Management’s Ambitions ............................... 95

5.6.7. M&A Tactics Management ......................................................................................... 96

5.6.7.1. Attack Tactics .......................................................................................................... 96

5.6.7.2. Defense Tactics ....................................................................................................... 97

5.7. Integration and Coordination Functions ......................................................................... 100

5.7.1. Project Charter Definition .......................................................................................... 100

5.7.2. Stakeholders Management ......................................................................................... 102
5.7.3. Integrated Change Management .......................................................... 103
5.7.4. Issues Management ............................................................................ 104
5.7.5. Dependencies Management ............................................................... 104
5.8. The M&A Project Phases ......................................................................... 104
  5.8.1 Project Phase 1: Project Planning & Definition ..................................... 106
  5.8.2 Project Phase 2: Search & Screen Target Companies .......................... 106
  5.8.3 Project Phase 3: Go-No-Go Assessment & CoC ................................. 107
    5.8.3.1. Approaching the target company ................................................. 108
    5.8.3.2. Negotiation .................................................................................. 109
    5.8.3.3. Change of Control (CoC) .............................................................. 110
  5.8.4 Project Phase 4: Integration Works ...................................................... 112
    5.8.4.1. Integration Planning ..................................................................... 115
    5.8.4.1. Integration Execution ................................................................. 115
      5.8.4.1.1. IT Integration ......................................................................... 116
      5.8.4.1.2. R&D Integration ................................................................. 116
      5.8.4.1.3. Purchasing Integration .......................................................... 117
      5.8.4.1.4. Manufacturing (Operations) Integration ............................... 117
      5.8.4.1.5. Inbound and Outbound Logistics Integration ....................... 117
      5.8.4.1.6. HR Integration ..................................................................... 118
      5.8.4.1.7. Marketing & Sales Integration .............................................. 118
    5.8.4.2. Building a New Company Culture .............................................. 119
6. Results and Discussion .................................................................................. 120
  6.1. Limitations ............................................................................................. 121
7. Conclusions ................................................................................................. 123
  7.1 Recommendations for Future Research .................................................. 124
References ....................................................................................................... 125
Appendix A: Strategy Setting Toolkit ............................................................... 132
Appendix B: Contacting the Author ............................................................... 137
List of Figures

Figure 2–1: Relationships between narrow and broad meaning M&A. Adapted from Nakamura (2005) ................................................................. 5
Figure 2–2: Relative risk level (mainly risk of failure) among the many business strategies ...... 12
Figure 2–3: Value chain representation .................................................. 14
Figure 2–4: Example of Corporate Governance Structure .......................... 15
Figure 2–5: How synergy translates into increased company value (McKinsey et al., 2000) .... 20
Figure 2–6: Product-market diversification (DePamphilis, 2011: 6) ......................... 30
Figure 2–7: Project Management Framework. Adapted from (Madras, 2008: 24) ............... 37
Figure 2–8: The triple constraint (Madras, 2008: 21) ..................................... 38
Figure 2–9: Example of a Portfolio .................................................................. 41
Figure 2–10: How (Kerzner, 2001: 100) suggests the relationship between PMO and PM-CoE ........................................................................... 46
Figure 2–11: The competence continuum range in Project Management ...................... 46
Figure 2–12: Enterprise PMO, adapted from (Caruso, 2010) ................................. 50
Figure 2–13: Example of an EPM solution, adapted from (Perry, 2009: 172) ................. 52
Figure 2–14: Project Management Maturity progression, adapted from (Kerzner, 2001: 42) ... 54
Figure 2–15: Project lifecycle periods and respective costs and labour efforts (Project Management Institute, 2008) ................................................................. 55
Figure 2–16: Sequential phases in a project ..................................................... 56
Figure 2–17: Overlapping project phases .......................................................... 56
Figure 2–18: The various stakeholders in a project ............................................. 57
Figure 2–19: Dimensions of organizational culture (Robbins, 2006) ......................... 58
Figure 2–20: Product-based and geographically-based functional structures (Ritson, 2011: 11) . 59
Figure 2–21: Example of strong matrix structure (Ritson, 2011: 13) ......................... 59
Figure 2–22: Example of projectized structure (Project Management Institute, 2008: 31) ....... 59
Figure 3–1: Deduction, induction and abduction approaches ............................... 62
Figure 3–2: The research onion, adapted from (Saunders, Lewis and Thornhill, 2009: 108) .... 63
Figure 3–3: The research methodology chosen by the author for this work .................... 64
Figure 4–1: “A”’s Corporate Governance Structure ........................................... 66
Figure 4–2: The Company Strategic Framework, adapted from (Kaplan and Norton, 2004: 33). 68
Figure 4–3: The Strategy Map for 2012-2014 at “A Limited” ......................................................... 69
Figure 4–4: Balanced Scorecard and Action Plan for “A Limited” ............................................. 71
Figure 5–1: Six stages segmented in the nine main activities ................................................. 74
Figure 5–2: Temporal representation of the 6 stages and their implementation through 4 projects phases ........................................................................................................................................ 75
Figure 5–3: The M&A Project Management Framework .............................................................. 77
Figure 5–4: CRIM Framework. Adapted from (McGrath, 2011: 88) ........................................ 90
Figure 5–5: Brand Relationship Spectrum architecture with examples. Adapted from (Acker and Joachimsthaler, 2000) ....................................................................................... 93
Figure 5–6: Before and after supply and distribution networks re-engineering ....................... 118
List of Tables

Table 2-1: Valuation methods (Frykman and Tolleryd, 2010: 27) .............................................................. 21
Table 2-2: Relative Enterprise Multiples, adapted from (Frykman and Tolleryd, 2010: 46-71) .. 26
Table 2-3: Fundamental Enterprise Multiples Calculation, adapted from (Frykman and Tolleryd, 2010: 46-71) ................................................................. 26
Table 2-4: Most used relative equity multiples ......................................................................................... 27
Table 2-5: Most common fundamental equity multiples ............................................................................. 27
Table 2-6: The game of P/E (Weston and Weaver, 2004: 89) ................................................................. 32
Table 2-7: Effects on acquirer and target companies (Weston and Weaver, 2004: 90) ........... 32
Table 2-8: Project management processes listed per process groups and knowledge areas, adapted from (Project Management Institute, 2008: 43) ...................................................................... 39
Table 2-9: Comparison of key aspects in projects, programs and portfolios. Adapted from (Project Management Institute, 2008: 9) .......................................................... 44
Table 2-10: Differences between PMO and PM-CoE from (Kerzner, 2001: 100) ....................... 45
Table 2-11: Differences in the naming assigned to each maturity level as per Dr. Kerzner and SEI ......................................................................................................................... 54
Table 5-1: Process groups and knowledge areas in the new M&A framework ............................. 79
Table 5-2: The different ways of financing an M&A transaction ......................................................... 84
Table 5-3: The impact of marketing in branding – before and after M&A (joint-venture, merger and acquisition in this order) ................................................................. 94
Table 5-4: The tripe-constraint consideration for each project phase. Adapted from (McGrath, 2011: 110) ............................................................................................................. 105
List of Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>B2B</td>
<td>Business to Business</td>
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<tr>
<td>B2C</td>
<td>Business to Customers</td>
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<td>BPM</td>
<td>Business Process Management</td>
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<td>BU</td>
<td>Business Unit</td>
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<td>CAGR</td>
<td>Compounded Annual Growth Rate</td>
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<td>CAPEX</td>
<td>Capital Expenditures</td>
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<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>Chief Financial Officer</td>
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<td>CFR</td>
<td>Code of Federal Regulations</td>
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<td>CFROI</td>
<td>Cash Flow Return on Investment</td>
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<td>CIO</td>
<td>Chief Information Officer</td>
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<td>CoC</td>
<td>Change of Control</td>
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<td>COGS</td>
<td>Cost of Goods Sold</td>
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<td>Consumer Packaged Goods</td>
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<td>Chief Technology Officer</td>
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<td>DCF</td>
<td>Discounted Cash Flow</td>
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<td>DDM</td>
<td>Dividend Discount Model</td>
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<tr>
<td>EBIT</td>
<td>Earnings Before Interest Taxes</td>
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<td>EBITDA</td>
<td>Earnings Before Interests, Taxes, Depreciation and Amortization</td>
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<tr>
<td>EDI</td>
<td>Electronic Data Interchange</td>
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<tr>
<td>eHACCP</td>
<td>Electronic Hazard Analysis and Critical Control Points</td>
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<td>EPM</td>
<td>Enterprise Project Management</td>
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<td>Enterprise Resource Planning</td>
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<td>EVA</td>
<td>Economic Value Added</td>
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<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<td>FDA</td>
<td>Food and Drugs Administration</td>
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<tr>
<td>FTC</td>
<td>Federal Trade Commission</td>
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<td>GAAP</td>
<td>General Accepted Accounting Practices</td>
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<td>Good Automated Manufacturing Practices</td>
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<td>HMI</td>
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<td>Human Resource Management</td>
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<tr>
<td>IMIM</td>
<td>International Masters in Industrial Management</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>KPI</td>
<td>Key Performance Indicators</td>
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<td>LIMS</td>
<td>Laboratory Information Management System</td>
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<td>M&amp;A</td>
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<td>MOM</td>
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<tr>
<td>MV</td>
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<td>Original Equipment Manufacturer</td>
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<td>Procter &amp; Gamble</td>
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<td>Price to Earnings Ratio</td>
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<td>P/E</td>
<td>Price-Earnings Ratio</td>
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<td>PEG</td>
<td>Price to Earnings to Growth Rate Ratio</td>
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<td>PIMS</td>
<td>Product Information Management System</td>
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<td>PMBOK</td>
<td>Project Management Body of Knowledge</td>
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<td>PM-CoE</td>
<td>Project Management Centre of Excellence</td>
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<td>Acronym</td>
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<tr>
<td>PMI</td>
<td>Project Management Institute</td>
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<td>PMIS</td>
<td>Project Management Information System</td>
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<tr>
<td>PMO</td>
<td>Project Management Office</td>
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<td>PMP</td>
<td>Project Management Professional</td>
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<td>PO</td>
<td>Purchase Order</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>ROA</td>
<td>Return on Assets</td>
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<td>Return on Investment</td>
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<tr>
<td>ROIC</td>
<td>Return on Invested Capital</td>
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<tr>
<td>S.M.A.R.T.</td>
<td>Specific, Measurable, Achievable, Results oriented, Time-bound</td>
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<tr>
<td>SaaS</td>
<td>Software as a Service</td>
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<td>Supply Chain Management</td>
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<tr>
<td>SG&amp;A</td>
<td>Selling, General &amp; Administrative Expenses</td>
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<tr>
<td>SOW</td>
<td>Statement of Work</td>
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<tr>
<td>TCO</td>
<td>Total Cost of Ownership</td>
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<td>US</td>
<td>United States</td>
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<td>VP</td>
<td>Vice-President</td>
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<td>WACC</td>
<td>Weighted Average Cost of Capital</td>
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1. Introduction

In the globalized economic climate we currently live in, shareholders and investors alike normally expect more than the single-digit growth achieved through organic means. Chief Executive Officers (CEOs) need to be creative in attracting investments to finance growth in such competitive market landscape. The sharp reduction in the product lifecycles requires intense investments in Research and Development (R&D), state-of-the-art production facilities, suppliers who are actually partners, and nimble distribution channels to deliver innovative and customer-delighting products as fast and cheap as possible. The capital markets, the main source of funds, require quick turnaround through high return on invested capital (ROIC) to provide you the funds you need. One alternative to break this cycle is through Mergers and Acquisitions (M&A).

There are few activities in the world of business that can match MA& in terms of opportunity to transform, potential for reward and risk of failure (McGrath, 2011: 3). Given the magnitude of many M&A deals, they have the power to either put the CEO on a pedestal or put him out of his/her job.

To some extent, a merger can be roughly compared to an ordinary marriage\(^1\). The phase leading to the proposed engagement or merger is filled with uncertainties and excitement – both are getting to know each other and assessing whether they can build a future together – congruency of long-term goals and mutual expectations, i.e. whether there is a fit. Then the pre-marriage (pre-merger) phase comes bringing all the many tasks leading to the official marriage (merger). Consummating the act by signing papers is the easy and quick part. The challenge comes after the ceremony, when both need to behave as one entity, working out the differences to, integrated, work towards common goals. As many factors could not be foreseen before the marriage or merger, such post-integration discrepancies turn up, often making the union to fail. Such failure can be in form of a demerger or bankruptcy. All the aforementioned phases require motivated, well-versed and disciplined people following a well-structured approach to pull the entire “deal” diligently together. Chances are you agree with the fact that both marriage and merger processes are unique\(^2\), time-bounded, phase-driven, which involve human resources and require different capacities (or knowledge areas). Then, as a consequence both processes can be considered a project.

Considering a merger or acquisition as a project, the likelihood of success can be significantly increased by using a proper project management methodology and skills. Merger and Acquisitions can range from small deals, such as integrating two local supermarkets, to multi-billion dollar global mergers, involving companies in different continents, different currencies, complex and sometimes contradictory legal frameworks, opposing management styles and company cultures.

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\(^1\) Consider a marriage in the western world. The comparison is for illustrative purpose only!

\(^2\) Changing one or both the groom and the bride will inevitably change the institution (the marriage). The same applies to the merger of two companies.
Mergers and Acquisitions are no novelty. As it will be seen, the first appearance of such activities is dated back to late 1800s and early 1900s in the United States (DePamphilis, 2011). However, globalization incurred a major shift in the M&A paradigm: transactions went from local to global. The impact of such change cannot be underestimated. Transactions increased in total value, magnitude and complexity, so did the possible rewards and the risks of failure and losses. Reducing such risks by diligently managing the M&A projects by applying a good methodology increases the likelihood of success and returns.

1.1. Motivation

My personal and professional ambitions with this work are:

- Use the multi-disciplinary knowledge acquired in the International Masters in Industrial Management (IMIM) and my previous work experience in different countries and companies to add new perspectives to the current state-of-the-art knowledge in the area of mergers and acquisitions;
- Complement my professional knowledge and skills portfolio by exploring the fascinating world of M&A;
- Propose a Project Management Methodology to help others having a better understanding of what M&A entails and support advancing the current body of knowledge in this field.

M&A projects are very interesting whilst challenging endeavours, as no cookie-cutter approach fits all projects but it offers the unique opportunity to exercise nearly all knowledge areas one could enumerate in the corporate world. This is the main driver that led me to focus on this topic.

I would be immensely satisfied if my work is of use to anyone, either as a source of knowledge or applied in real M&A projects.

1.2. Problem Statement

As it will be visible along this work, conducting mergers or acquisitions requires a mix of skills, experience, science and art. It requires managerial and soft-skills to deal with both the transaction as a pile of paperwork as well as dealing with people, culture and the “emotions” involved in laying off employees with long-tenure. It requires experience to manage time, negotiate the best deal and make quick decisions under pressure. It is a science as it involves Finance and other Engineering knowledge areas. It is art as defining a new corporate culture means dealing with people, behaviours and many other “soft” intangible areas.

Such complexity can justify the absence of publicly available and comprehensive methodologies for M&A projects. Investment banks and consulting firms specialized on M&A transactions claim to have their own proprietary methodology in conducting such deals; however access to such material is precluded. A significant portion of such
methodologies may be on the head of their most experienced consultants, who have mastered the skills and knowledge required to pull together what is needed in such projects. There are some books available in the market providing a framework of some sort, mostly based on the professional experience of those involved in real M&A projects. Despite their best efforts, the contents are sometimes too complex to those without the required background, or important pieces of information are withheld for many reasons.

1.3 Objectives and Research Contribution

Considering the above, the main objectives for this work are:

- Propose a publicly-available Framework to support the planning, execution and delivery of mergers and acquisitions projects;
- Provide readers not familiar with the topic of mergers and acquisitions with an easy-to-read and understand source of information, promoting appreciation to this exciting topic;
- Give the author the opportunity to contribute to the current body of knowledge and his own understanding of the topic, which is of his professional interest.

In light of the above, the research contribution is:

Develop a Project Management Methodology to support the undertaking of mergers and acquisitions projects

1.4 Unique Contribution

As previously stated, the lack of a complete, publicly available, easy-to-read and understand whilst applicable project management methodology on mergers and acquisitions is a unique source of information to anyone interested in the topic, either for learning purposes or application in real M&A projects.

1.5 Scope and Limitations

As it will be discussed, M&A project approaches tend to differ depending on the industry or sector in consideration. This work will attempt to create a methodology generic enough to be applicable as-is or easily adapted to M&A projects in most industries. M&A in the banking sector is one example of a case in which a specially designed methodology is needed given the much higher regulatory pressure compared with other industries (McGrath, 2011). Special cases such as the latter are out of scope of this work. As an attempt to create awareness about the drivers behind M&A activities and to make the methodology more tangible and understandable, the example of two fictitious companies, “A” and “B”, active in the Food & Beverage industry will be introduced. Considering the complexity and the highly regionalized nature of legal aspects involved in M&A transactions, they will be only superficially dealt with in this work. The geographical areas
under consideration are Latin America (Brazil), North America (US and Canada) and Western Continental Europe.

Despite the fact this work intends to develop a methodology, the development of templates, flowcharts and other guiding documents is outside of scope, as such additional material significantly increases the need to narrow down the industry served and extending the require time to beyond the time frame of a Master Thesis.

1.6 Report Outline

The report is structured in the following way:

- **Chapter 2**: Literature review, exploring the topic mergers and acquisitions (M&A) in section 2.1 and Project Management in section 2.2. It provides the required basic background to understand the contribution of this work as well as to critically analyse the existing body of knowledge in both knowledge areas.
- **Chapter 3**: A short case study is presented as a prelude to the contribution of this work.
- **Chapter 4**: The chosen research methodology for this research is presented.
- **Chapter 5**: The proposed Project Management Methodology for M&A transactions is developed.
- **Chapter 6**: Overall results are presented and limitations exposed.
- **Chapter 7**: Conclusions are drawn and directions for future research are pointed out.
2. Research Background

This chapter will be devoted to present a holistic view about the two main knowledge areas needed to support this work: mergers and acquisitions (M&A) and Project Management. Section 2.1 introduces the reader to the conceptual background of M&A, while section 2.2 covers the area of Project, Program and Portfolio Management.

2.1. Mergers & Acquisitions (M&A)

Mergers and Acquisitions (M&A) is an area which has been given increased interest in the last decade. The total number of M&A transactions reached its peak in 2007, only to see a steep drop during the financial crisis in 2008-2009 due to generalized lack of liquidity in the capital markets. Companies resort more and more to mergers and acquisitions as a quick way to innovate, add products to its portfolio, conquer market share and grow to sizes which may prevent it from being taken over. With products having ever shorter lifecycles and complexity in developing new exciting products increasing sharply, some companies are complementing in-house R&D activities with acquisitions as a way to shorten the time-to-market for new products and services.

2.1.1. The Definition of M&A

It is quite prudent at this point to clearly define what the term “mergers & acquisitions” imply. In the literature the term M&A is treated at different levels of granularity. Picot (2002) presents M&A in the broad sense as including: the purchase and sale of undertakings; the concentration between undertakings; alliances, cooperations and joint ventures; formation of companies; corporate successions/ensuring the independence of businesses; management buy-in and buy-out; going public or IPO; change of legal form; and restructuring. Nakamura (2005) claims the use of M&A in the broad sense leads to confusion and misunderstandings. Therefore, the author defends that a narrow sense for M&A should be used instead (presented in Figure 2–1).

![Figure 2-1: Relationships between narrow and broad meaning M&A. Adapted from Nakamura (2005)](image-url)
The approach taken in this work will also follow the narrow sense of M&A to avoid confusion and increase focus on the subject matter. Mergers can be defined as:

“Two or more companies joining together. The new entity can be at holding level or at company level.” (European Central Bank, 2000)

Acquisitions are defined as:

“A company buying shares in another company to achieve a managerial influence. An acquisition may be of a minority or of a majority of the shares in the acquired company.” (European Central Bank, 2000)

The definitions above are quite generic and can be complemented (and made more specific) with help of Figure 2–1. A merger can normally be of 2 main types:

- **Absorption merger**: a company (called the receiving company) merges with another one (the merging company), in which the receiving company keeps its corporate identity while the merging company ceases to exist as an entity. Normally the receiving company is either bigger in size or has higher brand equity in the market than the merging company.

- **Combination merger**: the merging companies cease to exist forming a new receiving company. Normally mergers of this type take place when the merging companies are of equal size/value or have equal brand equity in the market. The new company can have a new name which resembles the merging company’s names or it can have an unrelated name. A combination merger is also called consolidation merger. A recent example is the combination of British Airways and Plc Iberia Lineas Aereas de España SA, from which the International Consolidated Airlines Group SA was formed. However, what is named a combination merger sometimes is not a real “merger” even if the receiving company’s name hints to that. A famous counterexample is DaimlerChrysler, a “merger of equals” between the German automaker Daimler Benz GmbH and the American carmaker Chrysler Group LLC announced in May 1998. In reality, Daimler Benz acquired Chrysler4 (Finkelstein, 2002: 6).

**Acquisitions**, on the other hand, intend to impose more or less control on the acquired firm, but keeping it at an arm’s length. Acquisitions occurs when a company takes a controlling ownership interest in another firm, a legal subsidiary of another firm, or selected assets (e.g. manufacturing facilities) of another firm (DePamphilis, 2011: 15).

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3 A merger of equals applies whenever the merger participants are comparable in size, competitive position, profitability and market capitalization, and so it is unclear whether one party is ceding control to another and which party is providing the greatest synergy (DePamphilis, 2011: 14)

4 In autumn 2000, DaimlerChrysler CEO Jürgen Schrempp let it be known to the world – via the German financial daily Handelsblatt - that he had always intended Chrysler Group to be a mere subsidiary of DaimlerChrysler. "The Merger of Equals statement was necessary in order to earn the support of Chrysler's workers and the American public, but it was never reality". This statement was relayed to the English-speaking world by the Financial Times the day after the original news broke in Germany.
Acquisitions can range from pure investment purposes and little control exerted on the acquired firm to hostile takeovers done by corporate raiders, whose intentions are to break the company apart, sell its parts to pay off junk bonds to finance new hostile raids (Colliins, 2001: 23). Acquisitions can be subdivided in four types:

- **Assets purchase and business transfers:** Sometimes acquiring a target company which has a strong foothold in a market not served by the acquiring company is a quick way to get into the market immediately. A good example is the acquisition of Yoki, a Brazilian company, by the North-American General Mills in February 2012 (Vaz, 2012). After a fire destroyed General Mills’ pasta factory in Brazil, the group sold the remaining business back to their previous owners, leaving the Brazilian market. In order to take advantage of the explosive growth of the recent Brazilian food sector, General Mills re-entered the market through Yoki’s acquisition. Given the high barriers of entry imposed by the Brazilian Government, the opportunity cost of starting a new business is much higher than acquiring an established brand with immediate access to market. Similarly, companies may resort to acquisitions to expand its production capacity or refurbish an existing production plant, when a company with similar assets costs less than replacing all assets with new ones (Tobin’s Q ratio\(^5\)). Companies can also purchase (or sell) Intellectual Properties and patents. Kodak started selling about 1,100 of its patents (about 10% of its portfolio of patents) in late 2011 to try to dodge an imminent bankruptcy (Bloomberg Business Week, 2011).

- **Stock acquisition:** Many companies discover untapped potentials in other entities, leading them to invest in such stars through stock acquisition. Such acquirers decide how much stock to buy depending on the level of control they seek in the acquired company. Full ownership means the acquirer will hold the acquired company as a wholly-owned subsidiary, in which the management team is normally replaced partially or entirely by managers from the parent company. The decision to replace the current management team will depend on how aligned the current business strategies and management performance of the acquired company are in relation to the parent company’s expectations. When the ownership is partial (majority or minority). The acquirer tends to provide strategic management support and expertise to the acquired company’s management team when they see a potential for improvement and the current management is deemed competent. Wise CEOs recognize when merging companies incur too much risk of failure due to cultural or business grounds. When the company EMC, a storage hardware vendor, purchased VMWare, a software-based server virtualization business, in December 2003, it saw a great business potential and portfolio complementarity between both companies. However, given the different business models of both companies, EMC decided to run VMWare as a separate company. The original EMC’s business model continued to perform well, but allowed

\(^5\) Tobin’s Q is a ratio between the market value of the company assets in the capital markets and the replacement costs of such assets.
it to grow at exceptional rates\(^6\) due to the VMWare’s disruptive business model\(^7\) (Christensen et al., 2011: 54-55). It is worth mentioning that stock acquisitions can be considered friendly or hostile (called hostile takeover). It will be explained in more details in a later section.

- **Management Buy-in and Buy-out:** these two types of acquisitions are normally a “going-private” transaction, where a company goes from being publicly traded to private hands. In the management buy-out, the current managers of the company decide to leverage funds to take the company private (DePamphilis, 2011: 206). Normally funds come from venture capitalists and small groups of wealthy investors (hedge and pension funds for example). In the management buy-in, management of another company decides to purchase the company in the same way, so they can destitute the current management team as they assume they can do a better job than the current team. So, the only difference is that in the management buy-out the management team already works for the company and may decide to buy it out to avoid losing their jobs.

- **Takeover:** A takeover can be a friendly or a hostile one and normally aims at purchasing 100% of shares or at least a majority. A friendly takeover is normally welcomed by the target company’s management team, who tries to persuade its shareholders to accept the deal. The acquirer normally pays a purchase or control premium. The premium corresponds to the price paid for the controlling interest, the savings through synergies of both companies and any overpayment\(^8\) (DePamphilis, 2011: 16). In a friendly takeover, the acquirer submits a tender offer to the target company’s management. If the target company did not solicit the tender and it is not seeking any buyer, it constitutes a hostile tender offer. As the premiums for a friendly takeover are normally much lower than in a hostile one, companies sometimes try a friendly takeover first. If the target company rejects it, than the bidder tends to circumvent management and place a bid to buy as much shares as possible from the open market and current shareholders to gain control and dismiss the management team rejecting the takeover, constituting a hostile takeover. As it will be discussed, the target company’s management team has a number of defenses against such tactics.

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\(^6\) From 2004 to 2010, EMC had a 44-fold increase on the initial investment in VMWare.

\(^7\) Disruptive business models focus on creating, refining, reengineering or optimizing a product, service, technology, industry or market (Myatt, 2009). Disruptive companies are those initial products are simpler and more affordable than the established players’ offerings (Christensen et al., 2011: 54). In VMWare’s case, it introduced a disruptive technology which replaced the expensive and inflexible vendor’s hardware solutions with lower-cost, more flexible software solutions.

\(^8\) Overpayment is the amount paid in excess of the current market value of the target company. The market value is the present value of expected future cashflows discounted at a given discount rate, which reflects the minimum rate of return expected by investors and lenders based on the level of risk faced by the business.
**Cross-ownership** can be used to achieve two main objectives: to demonstrate trust and long-term commitment to a working relationship\(^9\) between two companies (A and B), by owning each other’s shares. The second variant is to hedge losses in a merger, when A’s largest shareholders own a significant portion of A’s and also B’s shares before voting in favour of a merger. According to (Matvos and Ostrovsky, 2008), many studies show that average returns to acquiring-firm shareholders are negative, or at best, slightly positive, while average returns to target-firm shareholders are very positive, assuming both companies are publicly traded. So, why would the largest shareholders in A agree to a merger if they would lose significant amounts of their stake in A? It seems intriguing, but the reality is that they make up for the losses and even make profit with B shares. So, the shareholders with cross-ownership in A and B are sheltered from losses in A’s market value, while those without cross ownership stand to lose, especially when they don’t have enough voting rights to block the merger\(^10\).

A **holding company** works as an umbrella, under which one or more companies are owned fully or partially with controlling rights by the holding company. Each company is managed separately from the holding company without merging with the latter. Holding companies can be big conglomerates, such as General Electric, as well as small companies and they exist as a way to isolate liabilities incurred by one company from affecting another, and to diversify investments (portfolio theory).

A **strategic business alliance** is some form of contractual relationship designed to secure a national or international (global) venture without involving a shareholding (Lynch, 2009). It generally falls short of creating a separate legal entity and the agreement can be formal (legally binding) or informal (DePamphilis, 2011: 19). Equity business alliance occurs when both partners have 50% stake in the alliance. The attractiveness and relative simplicity of business alliances can be significant to justify its implementation. Many companies can join efforts to develop a unique product through combining each other’s distinct R&D capabilities and so improve their competitive advantage. Companies willing to sell their products in a region or country they are not currently present can incur prohibitive marketing and sales expenses for building production facilities and setting up distribution and sales channels. In such cases companies peer up to leverage their strengths to share existing footprint in a given market and avoid imports taxes. MillerCoors brews

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\(^9\) Each company owns a small share of each other, not enough to give controlling rights. As soon as A or B own controlling rights in each other, it constitutes what was discussed in stock acquisition for the sake of owning controlling rights and eventually acquire or merge with the company.

\(^10\) On October 27, 2003, Bank of America (BAC) announced plans to acquire FleetBoston Financial (FBF). In the week following the announcement, BAC’s market capitalization decreased by $9 billion, from $122 billion to $113 billion, while the FBF’s market capitalization increased by approximately the same amount, from $33.5 billion to $42.5 billion. The 10 largest shareholders of BAC owned 24% of the company and so lost more than $2 billion dollars on their BAC holdings. The merger was subsequently approved by the BAC shareholders. 8 out of the 10 largest shareholders of BAC were also big shareholders in FBF, so that combined they lost more than $2 billion, whilst gaining over $2.3 billion from B’s shares ownership (Matvos and Ostrovsky, 2008: 391-392).
Foster’s beer in its breweries in US and use its sales channels to commercialize the product under license from Australian Foster’s Brewing International. This way, Foster’s has access to the US and Canadian markets, avoiding costly transportation costs overseas and import taxes. US and European pharmaceutical companies share distribution channels to sell drugs in both continents avoiding huge expenditures with the creation of marketing channels. Airline companies operate certain common destinations under code share agreements to increase airplane saturation and save costs, such as fuel and maintenance (Lynch, 2009: 720). Franchising is a form of license agreement that grants the franchisee the right to use the technology, business model and to sell the products under the franchiser authorization. The franchisee may get support from the franchiser in form of consulting and financing in exchange for a portion of the revenue. Notorious examples are McDonald’s, 7-Eleven and Pizza Hut.

A joint-venture involves two or more companies creating a legally independent company to share some of the parent company’s resources and expertise with the purpose of developing competitive advantage and achieve common strategic goals (Lynch, 2009: 719). To better illustrate the benefits a joint-venture can bring about, let’s briefly discuss the MillerCoors case as described in (Sottili Chaves, 2011) and (Sealover, 2009). The US beer market is considered mature and of low growth (1-3% annum) and it has been surpassed by the Chinese in volume, but it is still the single most profitable market worldwide. In 2007, Anheuser-Busch detained around 50% of the market share in US operating 12 breweries across the country. While SABMiller owned 6 breweries and 18.4% market share, MolsonCoors owned 2 breweries and 11.1% market share. With the announcement that InBev was bidding to acquire Anheuser-Busch in 2006, SABMiller and MolsonCoors decided to join forces against the giant. The joint-venture creating MillerCoors was announced in 2007 and officialised in June 2008, just a month before the creation of Anheuser-Busch InBev. The synergies achieved were outstanding:

- Reduction in transportation costs
  - Less half-full trucks: trucks carry products of both brands;
  - Less emissions: elimination of 75 million tons of CO₂ by driving 45 million miles less as beer is brewed closer to the point of consumption;
  - Less fuel, less trucks, less maintenance costs.
- Stronger bargaining power with suppliers, economies of scale in procurements;
- Savings by leveraging each other’s competencies;
- Savings in IT systems and elimination of redundancies;
- Savings were forecasted in US$400 million for the 3 years following agreement, but it achieved US$500 million in 2,5 years.

There are plenty of other examples. CAMI was a joint venture between General Motors and Suzuki (Japanese car maker). A joint assembly plant was built in Ingersoll, Canada in 1992 with the purpose of allowing Suzuki to expand in the American market and GM of learning Japanese manufacturing methods (technology transfer). The joint venture was dissolved in 2009, with GM buying Suzuki’s stake. Sony-Ericsson joint-venture was created to leverage on Ericsson’s technological strength in phone hardware and Sony’s
strength in software and cameras. Sony dissolved the venture in 2011 buying out Ericsson’s stake.

Sometimes M&A are said to be change agents, leading to corporate restructuring, which can be operational or financial in nature (DePamphilis, 2011: 2). Operational restructuring involves any of the operations within the M&A broad approach and actions such as workforce reduction/relocation, flotation\(^\text{11}\), divestures (sale) of part of business or product lines, spinoffs and downsizing/closure of money-losing portions of the business. Financial restructuring are actions taken by the company to alter its capital structure\(^\text{12}\), for example, by stock buyback program, dividend payout, to reduce borrowing costs (cost of capital), reduce taxes due by higher leverage or exhaust borrowing capacity to make a takeover less attractive.

Some companies sell off some parts of the business to leverage funds to purchase another business which has better strategic alignment or show better future prospects. For example, Siemens AG sold its Siemens VDO division (car electronic parts maker) to Continental AG (tyres maker) in 2007 to leverage cash to purchase Unigraphics (UGS) to expand its portfolio of industrial software for enabling the digital factory proposition. Other divestitures are forced on merging companies as pre-conditions to be met by anti-trust authorities. In mid-2009 the meat and poultry processing & packaging company Perdigão (already called then Brasil Foods) signed a merger with its biggest competitor, Sadia, in Brazil. In reality Perdigão acquired Sadia, which was in a difficult financial situation after losing significant amounts in the derivative markets. However CADE, the Federal Government Agency responsible for approving such transactions, imposed conditions to approve the deal, among others to sell 30% of its productive capacity to the national market and suspend sales of some brands and products for up to five years (Rodrigues, 2011).

After providing an overview of the main types of transactions or ventures under the M&A umbrella, understanding the relative risk profile of each one is of importance. The simplest dimension to analyse qualitatively is the relative risk level. It is commonplace to think that “the higher the risk, the higher the prospect gains”, however, considering the complexities involved in each type of venture, the aforementioned “rule” cannot be taken for granted, especially without considering other dimensions. For example, a hostile takeover (by a corporate raider) can have a great return in the short term to the acquirer when the raided company is broken in pieces and sold off. However, this predatory transaction may not add anything to the acquirer in the long-run. Besides, the acquired company and the community have only to lose, due to higher unemployment and fewer taxes collected from a well-managed business.

Due to time limitations, this work will focus on the narrow sense of M&A only.

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\(^{11}\) Flotation is the listing of a company's shares on the stock market through an initial public offering (IPO) (Financial Times, n.d.). It is known as “going public”.

\(^{12}\) Capital structure is the relative proportion of equity and debt held by a company.
2.1.2. Types of M&A

Understanding the types of M&A is important in many ways. For example, in determining whether a transaction infringes the anti-trust regulations, or to speculate the type of strategy is being used by a competitor. A few typologies were developed to classify M&As. In 1980, the Federal Trade Commission (FTC) in the US developed a classification system still in wide use today (Krugg, 2009: 74):

- **Horizontal**: a company acquires or merges with another one selling the same products (same industry) in the same geographical area. This is mainly used to increase the market share (access the other company’s customers), consolidate value chain activities, increase bargaining power with suppliers, reduce capacity by eliminating redundant or inefficient assets whilst increasing saturation of existing productive assets. Besides, the ratio fixed costs to combined revenues falls. Still mills are a good example. Fixed costs are a big portion of the overall costs in steel production. A small dip in demand (as in 2008-2009 crises) is enough to cause losses. In such cases, as a way to survive, big steel mills purchase smaller ones, sometimes only to access the customer base. Production is consolidated in the most efficient mills and the least efficient assets are sold.

- **Market Extension**: Companies producing the same product in different geographical area or markets. A company mergers or acquires another to have access to another market to sell its products. It is especially useful when entry barriers are high and competitors are well-established and have cost advantages. Besides, production in locus avoids import taxes. A brewery can acquire another in a distant country, producing its beer according to its recipe locally, avoiding import taxes and long distance transportation. Consolidation of value chain activities and other synergies may not be possible, as the companies operate in different geographical areas. This is especially true for perishable products. Transporting fresh milk from one region to another is expensive and may compromise quality, both from the supplier of raw milk and the finished product point of view.

- **Product Extension**: Companies producing complementary products without competing with each other. When Procter & Gamble (P&G) acquired Gillette, one of the intentions (besides growth and market share) was to complement P&G’s Personal
Care product portfolio with Gillette’s highly profitable line of razors for both men and women. Another good example is a strategy called “financial supermarket”. Many banks trying to diversify their product portfolios to have as much market share as possible to distribute the high fix costs among different business units. All units use the same ERP and other financial systems and brokers can also represent multiple products, increasing capacity utilization and lowering the ratio fix costs to total revenue.

- **Vertical**: Merger or acquisitions of companies in the same value chain, with a supplier (backward integration), or a customer or distributor (forward integration). Vertical integration can be worth exploring in a few situations:
  - When a company invested in developing a technology, production technique or trade secret, it should remain within the company to generate competitive advantage. Initially novelty production processes and techniques require expertise and “baby-sitting” to guarantee acceptable quality and yields. When such production steps are outsourced, it may cost less but it can seriously jeopardize the product quality and the company’s reputation. Therefore well-managed companies keep critical production steps under their roof and outsource the commoditized parts or components. Intel still keeps its state-of-the-art production processes in-house. Its 32-nm silicon production method is unique and a key competitive advantage to retaining its prestige in the customer’s mind in terms of performance and quality. Apple seems to be going towards the verticalization route after the acquisition of P.A. Sami in early 2008, Intrinsity in 2010 and Anobit in 2012. The first two acquisitions are in the chip design area, giving Apple an edge by providing in-house capability to design ever more powerful processors for its smartphones and tablet computers and get ahead of its competitors, mainly Samsung. Anobit was a strategic acquisition, as Anobit is a flash memory designer (Solid State Memory), a crucial piece of hardware which is slowly replacing hard-drives, in an attempt to increase power autonomy and make thinner and lighter devices (Schonfeld, 2012). Besides, with its 95 patents, Apple would prevent its competitors from having access to such crucial competitive advantages in the hot smartphones market.
  - Acquiring a distributor or retailer to force selling its own branded products and not the competitor’s. Apple sells its products in boutiques (Apple Store) to increase its status as a product for the elite.

- **Conglomerate**: A business acquires other companies in an unrelated sectors or industries. A notorious example is General Electric, which operates in several sectors: Industrial Solutions, Health Care, Financial, Entertainment, Energy, Real Estate, Transportation and others. The holding strategy is used to make revenues more stable overtime, as negatively correlated businesses in the same portfolio can ease off variations in earnings due to seasonality or business cycle effects. For example, the Industrial Solutions Business Unit may suffer with a downturn, but this is compensated by Business Units dealing with big infra-structure projects issued by governments, such as Energy and Transportation.
2.1.3. Corporate Governance and M&A

Understanding what M&A transactions are is as important as knowing who decide on pursuing such transactions, their level of authority and possible motivations (personal and professional).

Chapter 3 is devoted to show an instance of how Corporate Governance relates in practice to mergers and acquisitions. As such link is normally not explored in the literature, the reader may benefit from understanding such connection. First, Corporate Governance will be defined, its structure described and the link between Corporate Governance and M&A established.

2.1.3.1. Definition of Corporate Governance

In publicly traded companies, given the number of owners may vary from a few dozens to millions spread worldwide, it is virtually impossible for the real owners to lead the company they own. To solve this problem, managers are hired to lead the company in lieu of the owners (shareholders). Managers are expected to conduct business and make decisions on the shareholder’s behalf in a way that it is aligned with the shareholders’ best interests, i.e. to maximize the company value. However, managers are humans and they may have personal and professional interests which conflicts with those of the shareholders. In such cases, a system composed of many instruments, such as code of ethics, code of conduct and accounting standards are devised to make sure conflicts of interest are detected and removed. This system is called Corporate Governance.

The implementation and maintenance of such system is very onerous to the company. Nevertheless, the benefits of a good governance system exceed its costs. Investors are willing to pay a premium for good corporate governance and reliable financial information, varying from 11% in Canada, 14% in US and 20% in Japan (Jamal and Jansen, 2006). The reason may be traced back to scandals such as Enron and WorldCom, which poor corporate governance allowed their management to hide the truth from investors, leading to huge losses.

2.1.3.2. Corporate Governance Structure

The Corporate Governance structure of a publicly traded company varies depending on many factors, such as the requirements set out by the Government in the country where the
company was incorporated, its size, business line, regulations of the sector it operates in, etc. An example can be seen in Figure 2–4.

The Board of Directors has 3 main overarching duties: define the company’s strategy, governance and oversight (Phillips and Levitin, 2010: 2). The Board of Directors sets and approves the corporate strategy and delegates its execution to the Management Board (CEO/President), which is responsible for the company’s day-to-day affairs. The Board of Directors oversees the strategy execution and intervenes if required, providing counselling to the Management Board, monitoring the management’s performance, overseeing Risk Management, among others (Phillips and Levitin, 2010: 2).

The Chairman of the Board (or Executive Director) is also elected by the Board of Directors. Vice-presidents, who will head the business units and subsidiaries, are elected by the Management Board with the Board of Directors’ blessing.

Within the Board of Directors there is an Audit Committee, responsible for managing and supervising the external auditors and the work of the Audit Function. The Nomination Committee handles the election, replacement and general “management” of the Board of Director’s members as well as its compensation scheme. Both the Audit and the Nomination Committee are governed by a respective Committee Charter, which is a document setting forth the expected committee members’ qualifications, purpose, roles and responsibilities.

The Internal Auditors are responsible to supervise the Management Board’s and its Support Unit’s conduct, accounting principles used to calculate and disclose financial figures and investments. The internal Auditors are also called the “Internal Audit Function” and report to the Board of Directors.

External Auditors are companies chosen by the shareholders to supervise the Board of Director’s work and to ensure they are acting in the shareholder’s best interest (or are obliging to their fiduciary duty towards the shareholders).

When a company is incorporated, the Corporation Bylaws and the Articles of Incorporation or Corporate Charter are filed as part of the Corporate Governance System.
The Corporation Bylaws sets forth provisions related to: number of directors, their tenure and minimum qualifications; Time and place and governance for meetings of directors, officers and shareholders; The corporation’s fiscal year; Steps to be taken in situations of conflict of interest, removal and resignation of Board Members, litigations; Set rules for approval of stocks, contracts, loans and others (The Pennsylvania State University, 2006), (All Business, n.d.).

The Articles of Incorporation or Corporate Charter sets forth what the main purpose of the company is; what it intends to do or produce; what assets it is allowed to own, build, sell and negotiate, either tangible, intangible or financial assets; the types of stocks and their characteristics and more.

The Support Unit may house executive level members that provide tactical and operational support to the CEO, such as:

- **Chief Financial Officer (CFO):** responsible for the financial policy and planning. Large corporations normally have the Treasurer and the Controller supporting the CFO. The Treasurer is responsible for raising cash for the company’s projects, operations and investments, and holding relationships with banks and debt holders. The Controller prepares the financial statement, internal firm’s accounting and tax obligations. Sometimes the CFO is the Treasure and the Controller in a small/medium company (Brealey and Meyers, 2003: 6-7);
- **Chief Operating Officer (COO):** responsible for the operations in a company, found especially in manufacturing-based companies;
- **Chief Technology Officer (CTO):** normally seen in high-technology companies, responsible for guiding the selection of technologies to be used in its production facilities and products;
- **Chief Information Officer (CIO):** responsible for IT infrastructure, especially of IT-sector companies;
- **Chief Investment Officer:** responsible for the investment decisions in the company;

It is worth remembering that most of the members of the Board of Directors are normally part-time and are not employees of the company, it means they are independent and hopefully free of conflicts of interest. They act as advisors and provide constructive criticism to the Executive. In some companies the CEO is also part of the board, therefore taking part in the Strategic Plan setting.

The Corporate Governance Structure mentioned previously is valid to small, medium and large corporations. However, in smaller companies, some of the functions are covered by one person, such as the CFO being the Treasurer and Controller at the same time.

13 There are many other C-level executives depending on the company’s size, industry and country.
2.1.3.3. The Link between Corporate Governance and M&A

Shareholders hold the Board of Directors as their main proxy, who is there to defend the shareholder’s best interest. The Board of Directors provides the vision and set goals to be achieved, so that the company has a direction to go. An overarching Corporate Strategy is set as a main guidance, however it is the Management Board’s task to break it down into more concrete actions through a business plan, which can be refined further to define the specific actions for each business unit, in each country. The combined achievement of results of each business unit, in each country should be enough to reach the goals set by the Board of Directors. As such goals are set for the long term (3 to 5 years horizon), the Management Board will define yearly business plans and the results each year, when extrapolated, should yield the results expected by the Board of Directors.

In chapter 3, this link is cleared, when the CEO devises the strategy for achieving the overall corporate strategy and goals set by the Board of Directors. The decision to acquire or merge with another business comes from the Management Board and may be supported or rejected by the Board of Directors. According to (Phillips and Levitin, 2010), the role of the Board varies with the significance of the transaction. Directors should be highly involved in major, strategic acquisitions or sales of important assets or the entire company. The level of involvement and diligence of the Board should increase in the same direction as shown in Figure 2–2.

Regarding mergers and acquisitions, the Board of Directors have different roles and responsibilities depending whether the company is on the buy-side or on the sell-side (Phillips and Levitin, 2010).

It is very common that members of the Board have been through mergers and acquisitions before in their tenure in other companies playing different roles. Therefore, the Board has experience in the matter and understands whether a merger or acquisition adds value to a company. The Directors have a unique vantage point in the company: they set the Corporate Strategy based on shareholders’ expectations, taking into account the market situation, and selecting/influencing the choice of Officers and Top-Management in the Business Units. Therefore, Directors are in the best position to know whether the company has to resort to a merger/acquisition to grow and if the current financial and managerial resources are sufficient to succeed in it. They also have enough experience to “feel” whether the CEO is pushing for an acquisition for his own profit. In case the Board of Directors do not want to recognize this fact, shareholders have an important weapon against such behaviours: the Corporate Governance System. A well-set system have enough power and provisions to avoid exploitation of company resources which does not aim a maximizing its value.

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14 Corporate Strategy can be defined in simple terms as the “direction an organization takes with the objective of achieving business success in the long term” (Venture Line, n.d.).
While on the buy-side the Board is more on the advisory side, away from the pressure of the deal, on the sell-side the Board is legally bound\textsuperscript{15} to the outcome of the deal. On the buy-side, the CEO is putting his reputation on the line when he/she decides to move forward with the transaction, with the possibility to be forced to step out if it does not meet shareholder’s expectations. On the sell-side, the CEO does not play an active role. The Board is the one who has to decide whether to sell, and the value of the transaction. With the support of advisors and based on the Directors’ own past experiences, the Board should assess whether that is the right time in the business cycle\textsuperscript{16} to sell, or whether the shareholders would benefit selling it later or remain independent. This decision should be based on what is known as the \textit{business judgement rule}, which is acting on an informed base and in good faith. Acting on an informed base includes the right of getting a \textit{fairness opinion} from financial and other advisors (whose compensation is not only linked to proceedings of the deal). Good faith means the absence of conflict of interest and self-dealing (Phillips and Levitin, 2010: 2). The Directors, bearing a solid fairness opinion along with their own judgement based on their knowledge of the company, the industry and its prospect, can be well-prepared to prevent litigations through allegations of lack of due care.

\subsection*{2.1.3. Executing Due-Diligence}

Due-diligence is defined as” A detailed check of the financial and operational status of an acquisition target, supplier, or other potential business partner before a deal is finalised” (Financial Times Lexicon, n.d.). As it will be explained in more details in chapter 5, the due-diligence is a crucial step in determining the true value of a company, beyond the market value of its assets and liabilities. The premium the acquirer can pay for the target will be linked to the synergies the acquirer can take advantage of, and it is intimately linked to the particularities of the acquirer. Only through access to the financial records, facilities and business as a whole the synergies can be adequately estimated. As at this point the acquirer is still accessing the viability of the deal, the target would only grant access to its records and facilities by signing a \textit{Letter of Intent (LOI)} and a \textit{Confidentiality Agreement}.

\textsuperscript{15} Even in countries with similar Legal Frameworks, such as US and Canada, based on the Common-Law System, the exact terms of what duties the Directors are ought to fulfill vary.

\textsuperscript{16} Business cycle is the fluctuation in the output of industrial activity or consumption compared to the trend levels (Miles and Scott, 2011: 367). Selling a company belonging to a sector which is experiencing recession may cause bids values to be lower than expected compared to when they thriving during an expansion.
2.1.4. Principles of Corporate Valuation

Contrary to what many may think, what matters in the valuation of a company is the future financial performance. So, to “predict” the future the valuator needs to consider the factors which affect the company’s performance, such as intellectual capital, patents and management’s calibre. Past data is history, which can only help evaluating how the company has been doing, without guaranteeing how it will perform in the future.

There are 3 important principles to take into consideration when valuing a business [adapted from (Frykman and Tolleryd, 2010: 5)]:

- **Valuations are subjective**: They depend on the inputs, considerations and assumptions, which varies with the experience level of the valuator;
- **Different parties have different motivations**: The target’s advisor may try to overvalue the company, because this makes his customer happier and maximize the commission the advisor will collect from the transaction;
- **The arguments and assumptions used in the valuation are critical**: inputs can be manipulated to yield a desired result. So, be prepared to justify and properly document the choices made in valuing the company.

If the company is private, there are no requirements for the owners to publish financial data. Besides, as shares are not publicly traded, market value cannot be calculated based on the number and price of outstanding shares. Having access to internal books is the only safe way to come up with a reasonable valuation. For public companies, annual reports and filings with the security commissions are normally a good starting point for a preliminary valuation.

An important aspect of valuation is related to the type of buyer. There are mainly 2 types, the financial and the strategic buyer (PrivCo, n.d.). The **financial buyers** - commercial banks, investment banks, hedge funds, venture capitalists, leverage buy-in – either value the company based on the probable proceeds from a liquidation of fixed assets (building, machinery, inventories) or based on the future cash flow they think the company has the potential for when managed with their guidance. The former is a common approach by commercial banks and the latter for venture capitalists and leverage buy-in. A **strategic buyer** – a company in the same industry, value chain or a conglomerate – can achieve economies of scale and scope, justifying paying a premium based on possible synergies. The fact that the target’s business has brand equity in the market means nothing to a commercial bank, as they can’t sell it for cash or use it in any way that generates cash. On the other hand, “A” can easily generate value out of its intangible assets, such as brand equity, expertise in healthy snacks manufacturing and out of its fixed assets as well. Therefore “A” can pay more for “B” than the bank, as it can generate more returns on “B”’s existing assets than the bank would.

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17 This section is not an exhaustive guide to corporate valuation in any shape or form. It is intended to present the very basic concepts to educate the readers.
During the company valuation process, quantifying the synergies from the strategic buyer’s point of view is required to determine the premium the buyer can offer to beat a financial buyer in a bid war. Figure 2–5 shows the synergistic factors to be taken into account in the valuation. The perceived market value may differ from a fair value, which can only be determined after a due-diligence in the company internal records. As the strategic buyer is active in the same industry, operational inefficiencies in the target’s current operations can be detected, improvements suggested and valued. Redundant Assets or of no use to the business can be sold, generating proceeds. New uses to tangible and intangible assets can unlock value unexploited so far. The company capital structure can be restructured to change the equity/debt ratio, lowering the cost of capital or unused tax breaks can shield profits in the buyer’s company. All of these synergies determine the premium over the market value. Of course, the buyer has to discount the risk (contingency) of realizing such assumed synergies as some may be difficult to achieve.

Another important concept is the difference between market (or equity) value and enterprise value (Frykman and Tolleryd, 2010: 25). **Market or equity value** is the market capitalization, what belongs to the shareholders.

$$\text{Company Market Value} = \# \text{ of outstanding shares } \times \text{ price per share}$$

**Enterprise value** reflects the full value of the company and any claim against it minus any cash or liquid securities (consider as if you pocket the company’s cash).

$$\text{Enterprise Value} = \text{Company Market Value} + \text{Market Value of Debt} + \text{Pension Provisions} + \text{Other Claims} – \text{Cash (Equivalents)}$$

Figure 2–5: How synergy translates into increased company value (McKinsey et al., 2000)
There are several valuation methods which are widely used by professionals, classified in two groups (Frykman and Tolleryd, 2010: 18-19):

- **Fundamental Valuation**: based on the economic figures as stated in the financial statements (balance sheet, income and cash flow statements) which are of relevance to the company and its future. Examples of financial figures are EBITDA and free cash flows.

- **Ratio-based valuation**: the company valuation is done by using ratios of key figures from similar companies in the same industry. For example a multiple of sales or earnings.

The valuation basis sets out the financial figure used in the valuation method. For the cash flow based methods, the free cash flow (net income to equity and debt holders) are used. The earnings-based methods are based on the difference between the return on the invested capital (ROIC) and the company cost of capital (WACC). In the assets-based valuation models, the assets value as stated in the balance sheet are used.

<table>
<thead>
<tr>
<th>Valuation Approach</th>
<th>Valuation Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fundamental</td>
<td>Cash Flow, Earnings, Assets</td>
</tr>
<tr>
<td>DCF, CFROI, Real Options, DDM</td>
<td>EVA, Residual Income, NAV</td>
</tr>
<tr>
<td>Ratio-based</td>
<td>EV/EBITDA, EV/EBIT, EV/FCF, P/E, PEG, P/B</td>
</tr>
</tbody>
</table>

*Table 2-1: Valuation methods (Frykman and Tolleryd, 2010: 27)*

### 2.1.4.1. Private vs. Public Companies Valuation

Any of the above methods can be used with both private and public companies valuations. However, the choice for a method over another should consider the availability and reliability of the financial information needed as inputs for the method.

Public companies have their financial statements officially audited, documented and overseen by the government authorities (PrivCo., n.d.). Such companies are obliged to follow well-defined accounting principle as stated by FASB. Therefore, a fundamental valuation method such as Discounted Cash Flow (DCF) can be used to value a public company. However, the DCF is not recommended for start-up and high growth companies as they normally have negative cash-flows.

Private companies are not obliged to prepare and publish financial reports, having no government oversight, except in highly regulated sectors. When such reports are prepared, they often do not follow FASB standards and earnings are manipulated to minimize taxable income, which is the opposite done in a public company (to increase shares value). It is common to see owner’s personal expenses claimed from the company earnings and other “special” accounting treatments not accepted in a public company. In such cases, using a fundamental method such as DCF may require extensive research and time-consuming adjustments, besides being only possible if access to its financial records is granted. Thus, **Ratio-Based** and **Comparable Transaction Analysis** are mainly used to estimate the company value. The three aforementioned methods will be discussed
separately in the following sections. Nevertheless, the most advisable approach to value private and public companies is to use a combination of at least any two methods to allow for cross-checking results, as each method carries its own strengths and weaknesses.

2.1.4.2. Discounted Cash Flow (DCF) Valuation Method

DCF is the most used fundamental valuation method by professionals across many industries. There are different types of DCF models in the literature, and the one presented here is the McKinsey version, published in 1990 by the same consulting company. Some of the advantages of DCF method are:

- It has been widely used across many industries over the years, from small high-growth to mature multinationals;
- It reflects the way the financial markets value companies in reality;
- DCF is less sensitive to accounting manipulations, as it deals with cash flows;
- Its proper use requires a professional with knowledge in the industry sector the company is in.

The McKinsey DCF method calculates the value of a company today as all future free cash flows (FCF) discounted to the present at a rate which reflects the risk of each free cash flow. The DCF itself can be compared to an enhanced version of the net present value (NPV) calculation.

There are four main steps required to use the method:

I. Determine the weighted average cost of capital (WACC) for the firm
II. Estimate the free cash flows
III. Compute the terminal value
IV. Discount the cash flows to the present to obtain the enterprise value.

Each of the four steps above will be discussed briefly. For more detailed information on the McKinsey DCF method please refer to (McKinsey et al., 2000) and (Frykman and Tolleryd, 2010).

2.1.4.2.1. Determining the WACC

Any business is subject to risk of failure in conducting its operations, and as a consequence having not enough cash inflow to pay its investors and lenders while keeping liquidity for day-to-day operations (working capital). In a projectized company, the risk of projects failure is a good proxy for the company risk. This perceived level of risk reflects the cost of borrowing funds in the market. The cost to the company is the return demanded by the capital market to provide funds to it. And the cost also reflects the debt level to be serviced by the company. The higher the debt level, the higher the risk of default, therefore the higher the return requested by the market for new debts.

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18 Section based on (Frykman and Tolleryd, 2010: 74-99)
Capital usually comes from 3 different sources: retained earnings, shareholders and lenders. Lenders and preferred stock holders normally demand lower returns than common shareholders as the formers have priority in being paid in case the company is liquidated. Companies also enjoy tax-brakes based on the interests paid to lenders. Therefore, there is the need to find a weighted average cost of capital to the firm considering the cost of equity ($C_E$), the cost of debt ($C_D$), equity ($E$), Debt ($D$) and the tax rate ($T$).

$$WACC = \frac{E}{D+E}C_E + \frac{D}{D+E}C_D(1-T)$$

The WACC should be determined for the current and future years, requiring the following:

- Finding the current capital structure in market values: $E$ and $D$ values in market values, not book values;
- Finding the capital structure of similar companies: compare with the current company and if large differences are seen, investigate why. It might be due to the corporate strategy (increase leverage to grow by acquisitions);
- Determining the likely future capital structure based on the financial policies and corporate strategy: the future WACC estimation will depend heavily on the policies and strategies set by management;
- Determining the capital structure that minimizes the WACC for enough interest coverage and a good balance between financial and operating risks.

The cost of equity ($C_E$) can be estimated with the Capital Asset Pricing Model (CAPM):

$$C_E = R_f + (R_m - R_f)\beta$$

Where $C_E$ is the cost of equity; $R_f$ is the risk-free rate of securities (Government Bonds); $R_m$ is the market risk for the industry sector the company operates in; and $\beta$ is a measure of the company-specific risk. If $\beta$ is bigger than one, it means the company is riskier than its peers.

The cost of debt ($C_D$) is the return demanded by lenders, which is the risk-free rate of return and a risk premium.

### 2.1.4.2.2. Calculating the Free Cash Flow (FCF)

The free cash flow needs to be calculated for each year in the explicit period. The explicit period is while the company is growing and still didn’t reach a steady state. Ideally the financial statements for each explicit year should be prepared for provide the figures to calculate the free cash flow.

$$FCF = EBIT - Tax + DA - CAPEX - \Delta WC$$

Where $FCF$ is the free cash flow; the $EBIT$ stands for Earnings Before Interest and Taxes; $Tax$ are the taxes (to be discussed soon); $DA$ is the depreciation and amortization; $CAPEX$ stands for the capital expenditures; and $\Delta WC$ is the change in working capital.

The term $Tax$ in the formula above is made of:
\[ Tax = EBIT (1 - T_R) - T_D + T_I \]

\( Tax \) represents all tax-related cash flows: \( T_R \) is the corporate tax rate; \( T_D \) is the tax deduction on the interest paid on debt (interest on debt times the corporate tax); \( T_I \) is the tax on any non-operations related cash flow (interest from investments, capital gains, divestitures, etc.).

Change in working capital (\( \Delta WC \)) affects cash flow and should therefore be calculated. By definition working capital is the difference between current assets and liabilities.

\[ \Delta WC = \Delta \text{cash} + \Delta AR + \Delta I - \Delta AP - \Delta O \]

Change in working capital is the change from one year to another in the balance sheet of cash, accounts receivable (AR), inventories (I), accounts payable (AP) and other non-interests bearing operations related debts.

2.1.4.2.3. Calculate the Terminal Value

Another important step is estimating the length of the explicit period in years. The terminal value is calculated starting at the year the company is assumed to enter into a steady-state operation, when the free cash-flow is assumed to grow at a constant rate \( g \). In the steady-state, the rate \( g \) should be less than the GDP growth in the country the valuation is for and in nominal terms, i.e. non-inflation adjusted. For example, if the country is expected to have a stable real GDP growth of 2% and inflation between 1.5% and 3%, then \( g \) should be between 3.5% and 5%. The terminal value can only be calculated if WACC is bigger than \( g \).

\[ TV = \frac{FCF_{t+1}}{WACC - g} \]

\( t \) is the year in which the explicit period ends, which is highly dependent on macroeconomic conditions (inflation, amount of capital stock, access to financing, intellectual capital and others) and on the industry sector and its future development.

2.1.4.2.4. Calculate the Enterprise Value

The enterprise value can be calculated by discounting the free cash-flows in the explicit period and the terminal value to the present.

\[ EV = \frac{FCF_1}{1 + WACC} + \frac{FCF_2}{(1 + WACC)^2} + \cdots + \frac{FCF_t}{(1 + WACC)^t} + \frac{TV}{(1 + WACC)^t} \]
2.1.4.3. Ratio-Based Valuation\textsuperscript{19}

Ratio or multiple-based valuation is widely used by professionals, especially when performing acid-tests to find out undervalued assets/companies and when not enough information is available to conduct a more thorough calculation such as DCF. Public companies are obliged to publish key financial information and therefore there is plenty of data to run fundamental ratios or DCF. Private companies normally pose a challenge as very few data is available, and the best one can do is comparing to data of similar companies, i.e. using relative multiples. Even having access to the internal records would require extensive data normalization and adjustments due to the use of different accounting rules, non-recurring revenue streams and extraordinary expenses. It is important to note that valuation based on multiples normally disregard the possible synergies and control premium, as well as value drivers and destroyers in the valuation (PrivCo., n.d.).

There are 2 main types of multiples: enterprise and equity. **Enterprise multiples** use company data relevant to all claimants (shareholders and lenders) to calculate the enterprise value (EV), e.g. revenue and EBITDA. **Equity multiples** are based on data relevant only to shareholders to calculate the company market value (MV), e.g. net income and book value.

It is very important not to mix enterprise and equity multiples as they yield incorrect results. Ratios such as market value per sales are technically incorrect, as market value reflects the valuation of the shareholder’s claims and sales belong to both shareholders and lenders.

There are three crucial steps to be taken when applying the multiple-based valuation (Frykman and Tolleryd, 2010: 51-52):

- **Understand well the business**: It is the most basic step in any valuation is to understand the business activities of the company to be valued, such as its operations, products sold or services rendered, markets served, market share, brand strength, revenue and its growth, gross margins, capital expenditures, operational and financial risk, and its capital structure.

- **Compares apples to apples**: good multiples come from similar companies in all aspects as previously mentioned. If no comparable companies are available, then a portfolio of companies can be picked and average multiples can be used.

- **Private vs. public companies**: if the company to be valued is private and the multiples are from public companies, the valuation should be applied a “liquidity discount”\textsuperscript{20} of 20% to 30% (PrivCo., n.d.).

\textsuperscript{19} This section is based on (Frykman and Tolleryd, 2010: 46-71)

\textsuperscript{20} Liquidity discount is a term used to describe the value loss a private company has compared to an identical public firm, as the former do not have access to the capital market to request funds, what makes the private company less liquid than a comparable public company.
I. Enterprise Multiples Valuation

Valuation based on enterprise ratios tend to be more comparable among companies in the same industry. Data such as sales is almost unaffected by the accounting rules, such as depreciation and amortization, expenses recognition and the financial structure. Sales figures can only be affected by how revenues are recognized and deferred. EBITDA is the most cash-flow like figure, being therefore widely used. As revenue, EBITDA is also very insensitive to differences in accounting rules among companies, except on how expenses are recognized and it can hide how efficient the company is in using the proceeds from sales (SG&A costs, salaries, non-operational investments). If a true cash flow is needed, then operational free cash flow (OpFCF) can be used. As a cash flow figure, it is completely insensitive to accounting principles and very similar to DCF. Nevertheless its calculation is complex, demanding more data and it tends to fluctuate a lot from year to year, due to capital expenditures and extraordinary expenses.

<table>
<thead>
<tr>
<th>Most Used Relative Enterprise Multiples for Valuation</th>
</tr>
</thead>
</table>
| \[
\begin{align*}
EV &= \frac{EV \cdot Equity \ Value + maket \ Value \ of \ Net \ Debt + Provisions + Other \ Claims}{Sales} \\
EBITDA &= \frac{EV \cdot Equity \ Value + maket \ Value \ of \ Net \ Debt + Provisions + Other \ Claims}{Sales - COGS - OPEX - Restructuring & Assets Impairment} \\
OpFCF &= \frac{EV \cdot Equity \ Value + maket \ Value \ of \ Net \ Debt + Provisions + Other \ Claims}{EBITDA - CAPEX - Inflation on Working Capital}
\end{align*}
\] |
| \textit{COGS: Cost of Goods Sold (includes direct materials, components, direct labour)} |
| \textit{CAPEX: Capital Expenditures (replace, add new capital stock)} |
| \textit{OPEX: Operational Expenditures (SG&A, salaries, operational expenses, R&D)} |

Table 2-2: Relative Enterprise Multiples, adapted from (Frykman and Tolleryd, 2010: 46-71)

<table>
<thead>
<tr>
<th>Most Used Fundamental Enterprise Multiples for Valuation</th>
</tr>
</thead>
</table>
| \[
\begin{align*}
EV &= \frac{EV \cdot \frac{ROIC - g_s}{ROIC(WACC - g_s)}(1 - T)M}{Sales} \quad \text{where } M = EBITDA \ margin, \ g_s = Sales \ Growth \\
EBITDA &= \frac{EV \cdot \frac{ROIC - g_e}{ROIC(WACC - g_e)}(1 - T)(1 - D)}{ROIC(WACC - g_e)} \quad \text{where } D = Depreciation \ Rate, \ g_e = EBITDA \ Growth \\
OpFCF &= \frac{EV \cdot \frac{ROIC - g_o}{ROIC(WACC - g_o)}(1 - T)}{ROIC(WACC - g_o)} \quad \text{where } g_o = OpFCF \ growth
\end{align*}
\] |
| \textit{ROIC} = Return on Invested Capital; |
| \textit{WACC} = Weighted Average Cost of Capital |
| \textit{T} = Corporate Tax Rate |

Table 2-3: Fundamental Enterprise Multiples Calculation, adapted from (Frykman and Tolleryd, 2010: 46-71)
The enterprise ratios can be calculated using fundamental or relative figures as in Table 2-2 and Table 2-3.

**II. Equity Multiples Valuation**

Although equity-based valuation is widely used, its biggest weakness is the susceptibility to accounting principles and it reflects only the shareholder’s portion of the company. The major consequence is the need to make pro forma adjustments to the figures before multiples of similar companies can be used. Most common adjustments are:

- Depreciation and amortization rules used (e.g. accelerated, straight line);
- Investments (e.g. capital expenditures booked as expenses and vice versa);
- One-time expenses and investments should be excluded.

Ratios based on book value are easily calculated if access to the company books is provided. Nevertheless, book values are deceiving as assets values are stated in the book and not adjusted to inflation. Besides, technology based and consulting companies, which have the majority of their value based on intangible assets, would be greatly undervalued. In addition, the use of market value makes the earnings multiples more susceptible to fluctuations due to macroeconomic business cycles and market mood.

The main equity based ratios are shown in Table 2-4 and Table 2-5.

<table>
<thead>
<tr>
<th>Most Used Relative Equity Multiples for Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>( \frac{MV}{Net , Income} \times \frac{ Equity , Value}{Share , Price} )</td>
</tr>
<tr>
<td>( \frac{MV}{Book , Value} \times \frac{Equity , Value}{ Adjusted , Book , Value , of , Assets - adjusted , Book , Value , of , Liabilities} )</td>
</tr>
</tbody>
</table>

*Table 2-4: Most used relative equity multiples*

<table>
<thead>
<tr>
<th>Most Used Fundamental Equity Multiples for Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>( \frac{MV}{Net , Income} \times \frac{ROE - g}{ROE(C_E - g)} )</td>
</tr>
<tr>
<td>( \frac{MV}{Book , Value} \times \frac{ROE - g}{ROE(C_E - g)} )</td>
</tr>
</tbody>
</table>

*Table 2-5: Most common fundamental equity multiples*

**2.1.4.4. Valuation Based on Comparable Transactions Analysis**

Another approach suggested by (PrivCo., n.d.) is to use multiples and premium paid from actual closed acquisition deals instead of multiples based on trading values. The biggest challenge is finding truly comparable deals or making adjustments to rationalize the data.
to avoid arriving to wrong conclusions. Private companies are rarely directly comparable across relevant attributes such as:

- Industry sector
- Size: revenues, market share and geography
- Timing: transactions should have happened recently, not more than a few years especially in economies with high inflation
- Products and services offered

Care should be exercised when using this method alone to value private companies, as relevant attribute information are rarely available to be compared.

2.1.5. Reasons for Resorting to M&A

As discussed before, the CEO has many instruments to achieve the business plan(s), so that a merger or acquisition is just one more besides a joint venture, divestiture, purchase patents or organic growth. Those instruments can be seen as part of the portfolio of options or toolbox at the CEO’s disposal. The major challenge is choosing the one which would fulfill the needs with the lower overall costs and highest benefits. Before selecting which tool makes the most sense, the CEO has to do his/her due-diligence besides resorting to the board’s opinion and possibly those of business and management consultants/advisors. Sometimes, a single tool won’t suffice to fulfill the targets. For example, to avoid raising the WACC by increasing the leverage when making a big acquisition, divesting itself from a product line or subsidiary would help raising capital for the acquisition.

Unfortunately the choices a CEO may resort to are not only driven by objectivity as a result from due diligence, but also with personal reasons in mind, as discussed in (McGrath, 2011: 17-20):

- **Job security**: Due to its size, a company may too big to be taken over, securing the CEO’s job. Besides, a diversified company can maintain a steadier revenue flow, which in turn makes it more resilient to downturns, protecting management jobs.
- **Managerislim**: An increase in company size normally means bigger salaries and bonuses to CEOs and other managers as they take on more responsibility with the extended company. Also a merger or acquisition when completed normally yields big rewards to the CEO, monetary and in stock options. Another reason is the constant pressure to maintain or increase the growth rate of the company, what requires ever bigger acquisitions both because small acquisitions don’t cause enough impact and to compensate for the possible side-effects of previous acquisitions as it will be explained in the P/E magic.
- **Job enrichment**: the desire for self-fulfillment is almost universal. Managers may look at an acquisition as a way to increase their realm of influence within the company and so increasing their worth and skills which may be under-used;
• **Status**: The prestige factor is not to under-estimate. CEOs normally enjoy seen their names in the media, as it attracts attention and more job opportunities.

• **Agency problems**: Management is the agent for their principal (shareholders) and should look after the best interest of their principals, but it is not always so. It happens that management may be more concerned in job security and keeping their perks than efficiently managing the company. As the cost of such mismanagement is spread over thousands of shares, they may get away with it, as only a tiny impact is felt on the value of each share. Managers may also have access to privileged information which shareholders don’t, motivating them to leverage funds for a buy-out (DePamphilis, 2011: 10)

Other factors used to justify a merger or acquisition:

• **Operating synergy**: Also called the “2+2=5” effect is virtually always mentioned in an acquisition or merger pitch. *Economy of scale* allows idle capacity to be used and fixed costs to be spread over more units produced, increasing margins. This is specially valid in industries with high fixed costs, such as steel manufacturing, in which a merger would allow the less efficient mills to be decommissioned or sold and production in the more efficient mills increased by selling output to the customers of the steel company which was acquired. *Economy of scope* is also a great factor as support functions in the value chain of two companies can be centralized, with reduced staff number cutting costs in the head count.

• **Financial Synergy**: Big companies normally have bigger pockets and can withstand economic downturns better than smaller companies in the same sector. Merging with another company in a different sector or activity tends to reduce the average cost of capital, mostly due to diversification (portfolio theory), making it easier to find investors to fund new projects. Regarding down- and upstream the value chain, a bigger company has more bargaining power with suppliers and distributors/retailers and can also negotiate better payment terms, such as longer due dates and lower prices due to increased volume.

• **Product-Market Diversification**: With globalization, the opportunity to escape a saturated market for their existing products and sell in new markets became a reality. It is common practice for companies to acquire others which have products they don’t currently sell. For example, in 2004 Siemens acquired Bonus Energy in Brande, Denmark to enter in the wind power business. This is an example of a new product (wind power generators) in a current business area (energy generation) to be sold in known markets to Siemens. Developing solutions in the wind power niche internally would take years of R&D, causing the company to lose precious opportunities such as the feed-in programs and other subsidies to build wind parks, such as in Canada. Selling new products in markets which the company is unfamiliar with is a risky proposition, normally not very well received by shareholders. A well-known example of a conglomerate, i.e. a company doing unrelated diversification is General Electric. There is considerable evidence that investors do not benefit from unrelated diversification (DePamphilis, 2011: 6).
• **Tax avoidance or Deferral**: Believe or not, acquiring a company overseas can be a good way to save on taxes. This side-effect of M&A has not been cited in any of the books referenced in this work, but in the media. According to (Kirchgaessner, 2011) and (Bates, 2011), companies with operations abroad can take advantage of loopholes in the tax system in some countries such as US by avoiding paying taxes on profits make in other jurisdictions. In 2010 GE had US$14.1 billion in profits worldwide, from which US$5.1 billion in US. No tax was paid on the US$9 billion unless it is repatriated. US corporate tax rates are one of the highest in the world (35%), so that profits are parked in tax heavens such as Bermuda, Bahamas and Switzerland (where corporate tax rates can be as low as 15%). There has been allegations that US companies use dubious accounting practices to report, for example, heavy R&D investments in subsidiaries offshore and reporting losses in the US HQ, so no taxes are paid on the expatriated profits (Bar-On, 2011), (Stahl, 2011). Corporates as Cadbury and SABMiller transferred their HQ to Switzerland or Ireland for obvious reasons: lower tax rates. Taxes can also be deferred in two other ways: if the target company has accumulated losses, the acquirer can use that to reduce its taxable income. The assets of the acquired company when transferred to the books of the acquirer, they are revaluated to current market values to reflect the acquisition and so the acquirer can depreciate the assets also to reduce taxable income. In the case of intangible assets, such as patents, the goodwill can be depreciated at high rates and reduce taxable income.

• **Strategic realignment**: The rapid change in technologies, competition and global markets force companies to adjust their strategies by acquiring companies with promising patents and products which can complement an aging line of business. The example of Siemens entering the Wind Power business is an alignment to offset the lower sales of fossil fuel based power generation products, such as thermoelectric turbines. Smaller and more nimble niche players achieve rates of innovations which big bureaucratic companies cannot, being bought both to possess the new technologies and take such good companies out of the hands of the competitors.

• **Regulatory changes**: Deregulation tends to break down artificial barriers and stimulate competition. This was what happened in US in the late 90’s what triggered a wave of mergers and acquisitions in the financial sectors (DePamphilis, 2011: 8).

• **Hubris and the winner’s curse**: Managers may have more confidence in their own target’s valuation than the markets, overestimating the synergies with the merger or acquisition. This is driven by *hubris* (or excessive self-confidence), causing the company to pay more for the target than it is worth economically. Also the fear of
losing the company to other bidders and the pressure from the target’s Board can lead to pay a premium higher than required to win, causing the acquirer to regret the decision afterwards, known as the winner’s curse (DePamphilis, 2011: 9).

- **Tobin’s Q-Ratio (buying undervalued assets):** As explained before under acquisitions, the Tobin’s q-ratio is the ratio between the market value of a target company and the costs of the needed assets if purchased, for example to replace aging assets in the acquirer’s. If \( q > 1 \), it means it is cheaper to acquire the target and use their facilities than to purchase new assets. If a company needs a refinery, it won’t be ready in less then, let’s say two years. So, acquiring a company which has a refinery of the type needed and costing less than it would cost to build (considering lost opportunity for waiting two years to enter into operation etc.) would make sense. In environments with high inflation and interest rates, the market value of many companies may fall below their book value. Because the assets purchase costs are written in the books and are not allowed to be adjusted to inflation, in a high-inflationary country or with high import taxes it is sometimes cheaper to acquire a target company (DePamphilis, 2011: 10).

- **Price-Earnings Ratio (P/E) Magic:** Earnings (net income) per share is normally held as an important indicator of profitability of a company, even though net income is very susceptible to manipulations as it is an accounting measure\(^{21}\). For illustration purposes, the example taken from (Weston and Weaver, 2004) suits well. A company called “A” wants to acquire “B”, by paying 20% premium over its share price as an “appreciation” for having the control interest in the company and to account for synergies. In this way, “B”’s shares quoted at $50/share, went to $60/share ($50 + 20%). “A”’s management will issue 12 million new shares to take all “B”’s shares out of the hands of its shareholders (each “B”’s share is worth 60% of an “A”’s share, so 12 million “A”’s shares for 20 million “B”’s shares). The new “A” company has an increased EPS of $6.25 and share price of $125. “B”’s shareholders have shares now worth $75 (60% of $125), but suffered an EPS dilution to 3.75 ($75/20). But at the end, everyone became happy. As it can be seen Table 2-7, “A” got what it wanted (increase in EPS) and “B”’s shareholders got 50% increase in each share value they owned. However, this represents a risk to “A”’s shareholders as “B”’s low P/E ratio may reflect either low growth or high risk, which will affect either “A”’s future growth or increase its perceived risk, having effects in its cost of borrowing, for example. So, the P/E magic is a short term solution which may have adverse effects in the future. This kind of practice works only if new acquisitions are sufficient to offset the depressing influences of old acquisitions (Weston and Weaver, 2004: 90). Therefore, a snowball effect can be triggered with this practice, when, for example, CEOs need some positive numbers to be presented in the Annual Financial Report before the end of the fiscal year.

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\(^{21}\) Net income is defined as the total revenue of a company, taking out the cost of doing business (cost of goods sold, Selling, General & Administrative (SG&A) expenses), interest, depreciation, amortization and finally taxes. It is basically the profit of the company.
2.1.6. Why M&A Very Often Fail to Fulfill Expectations

Before continuing with the factors which contribute to a failed merger or acquisition, it is quite prudent to define *failure* in this context. It does happen that two sound companies with solid financial statements get together and years later they file for bankruptcy. One may blame a strong recession, but it could be that each company alone would have withstood the rainy days. *Failure* also means the inability to realize the anticipated synergies; the cost of capital didn’t fall as anticipated; the premium paid for the target could not be recouped and so on. Looking from this perspective, some sources state that between 50% and 80% of the M&A fail in some regard (McGrath, 2011: 3).

Some of the factors which contribute to a failed merger or acquisition are:

- **Overpayment**: Lack of proper due-diligence or inadequate calculation methods along with poor inputs can easily overestimate the value of the target, leading to overpayment and difficulties to recoup the invested capital;

- **Overestimating synergies**: some sources of synergies are easier to tap into than others. A risky source of synergy has lower value than one with high probability of generating returns to pay-off the premium paid by the acquirer for the target. Proper due-diligence and risk management can help avoid such pitfall;

- **Slow pace of integration**: The longer the integration takes place, the longer the gains due to synergies can be realized. The time-value of money only makes deferred synergies have lower value than estimated at the transaction;
- **Cultural clashes:** Differences in company and country culture, mentality and fear for their jobs can be a huge factor in failed integration or working towards common objectives;
- **Excessive leverage:** The more indebted a company is, the higher the upward pressure on the WACC, making borrowing money and paying off debt more expensive.

The aforementioned points will be extensively explored in chapter 5.

### 2.1.7. M&A Waves and What They Can Teach Us

Mergers and acquisitions are reactions triggered by changes in the environment where the companies operate guided by their strategies. In the same way citizens of a country adapt to difficult times during a recession by postponing purchases of big-ticket items and vacation trips, companies also have ways to adapt to economic downturns as well as taking advantage of expansion in the business cycles. Some authors, such as (DePamphilis, 2011), are the opinion that M&A are triggered when “shocks” in the economies and easy access to capital are present. Shocks can be defined are game-changing events, which present itself as opportunities or threats depending on a particular situation. Examples of shocks are:

- **Regulatory:** good example is the deregulation in the financial sector in the US in late 90’s, prior to which banks were not allowed to own or execute operations in the investment banking realm. During the deregulation of the energy sector, the results were the same: an M&A wave, looking for ways to get a share of the market and become “one-stop shop” houses to attract customers, cross-selling, etc.
- **Technological:** innovations such as the internet and hybrid vehicles are present golden opportunities for those companies which are able to adapt and take advantage of such technologies.
- **Economic:** Offer and demand of raw materials and commodities cause price variations which can cause companies to acquire strategic suppliers to guarantee better prices and availability than its competitors. High fuel prices and competition caused many airlines to merge in the attempt to code-share their common destinations and increase occupancy and reduce fuel consumption.

One factor with is an enabler to an M&A wave is “easy” access to capital. 2007 was the year with highest amount in terms of transactions and value in the history, in US and also globally. With the financial crisis and tightened credit availability, the value of M&A globally fell 25% just a year after and more in 2009. So, it is visible from the past that a shock alone is not enough to start an M&A wave, but abundant credit alone can trigger it (DePamphilis, 2011: 24). Therefore, credit availability is a critical factor in M&A waves.

As this work is being written (2012), the global economy is trying to get out of the biggest recession since the great depression in 1929. The availability of credit is not as tight as in 2008-2009 and there are “shocks” visible in the economy which could lead to another wave. For example,
• Fuel prices are slowly heading to pre-crisis levels;

• The advances in cloud computing has been fast and many big ERP players, such as SAP, have been active in adapting their business model to include selling ERP as SaaS. 80,000 jobs were created in US in 2010 due to this new technological wave and it will drive the economy in the next five years (Brenner, 2012).

• Electronic companies are realizing the Indium stocks are dwindling fast exactly when it is most needed as touchscreens are becoming the biggest selling point in many personal electronics. This may trigger electronic giants, such as Apple, to acquire hi-tech companies developing alternatives to Indium such as Graphene;

Therefore, in the author’s humble opinion, the ingredients for a new M&A wave are present for 2012-2014 start. Put your bets!

At least in the case of US, the merger waves share similarities and differences. Merger waves tended to occur in periods of sustained high rates of economic growth, low or declining interest rates and rising stock markets. However, their development tended to differ on the shock factor, such as technology, industry (rail, oil, financial) and regulatory changes, and the type of transactions, such as horizontal, vertical, conglomerate, strategic and financial (DePamphilis, 2011: 30-31).

2.2. Portfolio, Program and Project Management

This section intends to provide some background information on the second major subject which this work is based on: Project, Program and Portfolio Management. The development of the project management methodology for mergers & acquisitions will depart from an existing project management framework for the following reasons:

• No need to reinvent the wheel: there are a few well-known and proven project management frameworks available in the literature. Therefore, departing from an existing one saves time to focus on the objectives/contribution of this work;

• Reduce risks: Using an already proven framework as a base for further development limits the overall risk to those borne only by the framework extension;

• Reduced learning curve: Users already familiar with the base framework only need to concentrate their attention to its extension. Besides, by borrowing the same rules

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22 Indium is a rare-earth metal which has unique characteristics allowing the manufacturing of screens sensitive to touch, as it is transparent and conducts electricity. It is a “hit-hike metal” as it is not found as such in ore mines. It is mined together with Nickel, Zink and other metals in extremely politically unstable African countries and in China. Sources estimate that the Indium supply may be exhausted as early as 2017, it means, in 5 years from now (Vince, 2012).

23 Graphene is the subject of a 2010 Nobel-Prize about the applications of graphene. As lead and diamond , it is made of atoms of carbon, disposed in an atom-thick hexagonal net, which is basically transparent and can conduct electricity (Vince, 2012: 2).
and template to the extension saves significant time in the development and also in the learning effort from the reader’s perspective.

James Charvat in his book Project Management Methodologies (Charvat, 2003) defends that many issues can be avoided by using a proper project management methodology, such as costs overrun, scope creep, adherence to schedule and project management distress. Besides, there is no one-size-fits-all methodology, so that the project manager needs to identify the proper one based on the project type, size, complexity and specific situational parameters. Many experienced project managers have found that, in practice, they cannot use a methodology as it stands (Charvat, 2003: 4). There are mainly two types of project management methodologies (Charvat, 2003: 7):

- **Technological focus**: methodologies tailored towards the development of specific application or product. It focuses more on the technical than on the managerial aspect. Examples are the methodologies used to develop software, such as the “agile group” (SCRUM, Extreme Programming, Rapid Application Development), Waterfall, Reverse Engineering.

- **Project management approach focus**: More concerned on the way the project is conducted, resources allocated, management of schedule, scope and quality. Examples are the Rational Unified Process, PRINCE2 and the Project Management Institute (PMI) methodology.

In this work, given the fact that a merger or acquisition is more about delivering a solution than a technology or product, the latter approach is taken in selecting a methodology.

The PMI methodology will be used as a base for the project management framework, and the remaining elements on the methodology to be developed in this work (e.g. activities, phases) will include new approaches to elements suggested by authorities in the area of mergers and acquisitions.

The PMI is the de-facto standard in Project Management, recognized and respected worldwide. Those who work as Project, Program or Portfolio Managers can become officially certified as a Project Management Professional (PMP). A PMP-certified professional is expected to have extensive knowledge on PMI’s standards and framework, be already experienced in the Project Management field and be bound by Code of Ethics.

PMI developed a Project Management Framework, which is generic enough to serve as a base for developing a new framework by modifying or extending PMI’s to fulfill the needs of companies and professionals.

### 2.2.1. Framework vs. Methodology

Before using the terms framework and methodology extensively, it is wise to define what each term covers.

According to (Charvat, 2003: 3), a methodology is “a set of guidelines or principles that can be tailored and applied to a specific situation. In a project environment, these
Development of a Project Management Methodology for Supporting M&A

guidelines might be a list of things to do. A methodology could also be a specific approach, templates, forms or even checklists used over the project lifecycle.”

Still to the same author, a framework represents the segments of the project. The means to transition from one segment to another is provided by the methodology.

2.2.2. The Definition of Project

The term “project” is a very commonplace word. Sentences such as “I have a small project at home for today”, referring to mowing the lawn, or “I need to work on my personal-life project”, which may have several meanings, such as finding a bride, building a house, start going to the gym, and the list goes on. So, what type of project is it referred to in this document?

The Project Management Institute (PMI) defines a project as “a temporary endeavour undertaken to create a unique product, service or result” (Project Management Institute, 2008: 5). It is a temporary endeavour because it must have a definite start and end. The start is triggered by a need, which can be countless and of different nature:

- **In a personal sphere**: need for a new house, a new car, a vacation trip, etc.
- **In the professional sphere**: pursue a master’s degree, earn a new certification, start one’s own business, etc.
- **In the business sphere**: achieve strategic objectives (launch a new product, increase market share, etc.)

The end is reached either when the objectives of the project were met or the project is terminated, as it can happen when the needs that originated the project no longer exist. The temporary nature of the project does not necessarily imply it is short in duration or that its outcomes are not long-lived. There are multi-year, multi-phased projects and those which are intended to build monuments which are to last several years or even centuries.

Quite often the word “Project” is misused when it is used in lieu of “process”. Some processes within a project can be repetitive in nature, but what distinguishes a project is the *uniqueness* of its outcome. Two construction projects can have the same phases and processes, but no building or bridge is exactly the same – changes in contractor, materials, and especially location make them unique.

A project may also involve a great deal of uncertainty as its outcome may be unknown for a long time. Risk is an integral part of any project and its risk profile may vary depending on its size, scope and duration. It can involve teams spread in different countries, working on different parts of the same project. Launching a satellite into space is a capital intensive, multi-year, multi-disciplinary venture involving cross-collaboration where each team develops a part of the satellite, propulsion, software, etc. The satellite can be perfect at the end, but if the launch fails, the project also fails as the outcome will not be fulfilled (the satellite in orbit and operational), even though some parts of it succeeded. The outcome of a project may be a required input for another project. Last, but not least, the
outcome of a project can be tangible (a product or part of thereof) or intangible (a service, a process, a business process, a methodology or knowledge from research activities).

Equally important is defining Program and Portfolio in the context of projects, as both words have different uses depending on the context they are applied to. As these terms will be explained thoroughly in the next section, it is enough for now to understand that:

- A Program is a group of related projects. A project may be part of a program or not, but a program will always contain projects.
- A portfolio may contain projects, programs or both concurrently, besides other types of work. All entities within a Portfolio are managed together to achieve strategic business objectives (Project Management Institute, 2008: 8).

### 2.2.3. Project, Program and Portfolio Management

Project Management is the application of knowledge, skills, tools, and techniques to project activities to meet project requirements (Project Management Institute, 2008: 6). The PMI prescribes a framework containing 42 processes in total. Each process belongs to one of the five process groups and one of the nine knowledge areas. Figure 2–7 depicts the PMI framework for Project Management with the nine knowledge areas. Each knowledge area is classified as Core, Support or Integration & Coordination depending on the role it plays in the project management:

- **Core Functions**: The most basic functions found in any project without which managing a project is not possible: Scope, Time, Cost and Quality Management.
- **Support Functions**: Functions needed to support a successful project management: Human Resource, Communications, Risk and Procurement Management.
- **Integration & Coordination Functions**: Required to integrate the capabilities and outcome of all functions and coordinate the achievement and delivery of the project objectives.

![Figure 2–7: Project Management Framework. Adapted from (Madras, 2008: 24)](image-url)
It is important to highlight that the Support Functions are as critical as the Core Functions in delivering a successful project and should therefore not be underestimated.

The five process groups are shown in the lower part of the framework in Figure 2–7: Initiating, Planning, Executing, Monitoring & Controlling and Closing. Table 2-8 shows all 42 processes classified according to the process group it is used and the knowledge area it belongs to.

As the requirements for each project differ, it is the task of the project manager to decide which processes to use in a specific project and to what extent. Thus, not all projects would require the use of all 42 processes. The project manager’s experience plays a key role in determining which processes are needed and when in the project management.

![Figure 2–8: The triple constraint (Madras, 2008: 21)](image)

As previously mentioned, every project will be created to address a unique need or problem to be solved. The expectations and requirements from the stakeholders will strongly influence the choice on which project constraint to focus on. As any type of resource is limited, there must be a compromise of some sort. Constraints such as time, cost, quality and scope are the most common. The Project Manager has to deploy the resources to execute the required processes in such a way as to put correct weights on each constraint. When developing a new drug or implantable medical device such as a pacemaker, quality is set above cost and time with fixed scope. When building low-income housing, cost is prioritized, as long as safety is not compromised.

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<thead>
<tr>
<th>Knowledge Areas</th>
<th>Project Management Process Groups</th>
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<tbody>
<tr>
<td></td>
<td>Initiating</td>
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<tr>
<td>Project Integration Management</td>
<td>Develop Project Charter</td>
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<tr>
<td>Scope Management</td>
<td>Collect requirements</td>
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<tr>
<td></td>
<td>Define WBS</td>
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</table>

24 Stakeholder is defined as anyone who may be influenced or affected by a project.
<table>
<thead>
<tr>
<th>Process Group</th>
<th>Knowledge Areas</th>
<th>Processes</th>
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<tbody>
<tr>
<td>Time Management</td>
<td>Define activities</td>
<td>Control schedule</td>
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<td></td>
<td>Sequence activities</td>
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<td></td>
<td>Estimate activity resources</td>
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<td></td>
<td>Estimate activities duration</td>
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<td></td>
<td>Develop schedule</td>
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<td>Cost Management</td>
<td>Estimate costs</td>
<td>Control costs</td>
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<td></td>
<td>Define budget</td>
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<td>Quality Management</td>
<td>Set quality plan</td>
<td>Perform quality assurance</td>
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<td></td>
<td></td>
<td>Perform quality control</td>
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<td>HR Management</td>
<td>Develop HR plan</td>
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<td></td>
<td>Acquire project team</td>
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<td></td>
<td>Develop project team</td>
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<td></td>
<td>Manage project team</td>
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<tr>
<td>Communications Management</td>
<td>Identify stakeholders</td>
<td>Plan communications</td>
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<td></td>
<td>Distribute information</td>
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<td></td>
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<td>Manage stakeholders expectations</td>
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<td></td>
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<td>Report performance</td>
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<td>Risk Management</td>
<td>Plan risk management</td>
<td>Monitor and control risks</td>
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<td>Identify risks</td>
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<td>Qualitative risk analysis</td>
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<td></td>
<td>Quantitative risk analysis</td>
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<td></td>
<td>Plan risk responses</td>
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<tr>
<td>Procurement Management</td>
<td>Plan procurement</td>
<td>Conduct procurement</td>
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<td>Administer procurements</td>
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<td></td>
<td></td>
<td>Close procurements</td>
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</tbody>
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Table 2-8: Project management processes listed per process groups and knowledge areas, adapted from (Project Management Institute, 2008: 43)

Therefore, projects are used as a means to execute parts of a strategic plan in response to (Project Management Institute, 2008: 10):

- **Market demands:** availability for healthier snacks and beverages;
- **Strategic opportunities/business needs:** build a new warehouse near a big customer to increase service level and reduce transportation costs;
- **Customer request:** a big retailer (e.g. Walmart) requests a special edition of a new snack to be sold exclusively by them;
- **Technological advance:** replacing an old production line with a more technologically advanced to reduce costs and increase production;
- **Legal requirements:** implement Hazard Analysis and Critical Control Points (HACCP) in the snacks production line to comply with FDA (Food and Drugs Administration) directives for food production.

A **Program** is a group of related projects and it will always contain projects whereas a project does not require a Program or Portfolio to exist. The projects are related when they can collectively deliver a product, service or result. The fact that some projects share similar technologies or customer is not enough to be assigned to a Program. For example, when launching a new product, the initiative will be run by a Program Manager to allow coordination among the projects required to successfully deliver the final product:

- **Marketing & Sales:** Investigate what customers want or are likely to accept through market research and analysis of competitors. Revenues are estimated to allow Management to decide to invest in the program or not.
- **Product Conception:** Product ideas are provided to R&D for developing the product itself with input from Marketing & Sales.
- **Operations:** Manufacturing, Packaging and Quality functions will develop ways to manufacture and package the product according to R&D’s specifications.
- **Supply Chain:** Sourcing & Purchasing will work with Inbound Logistics and Operations to make sure the required ingredients and materials are available for production. The Outbound Logistics will distribute the product to the distributors/retailers as per Marketing & Sales’ input.

Launching a new snack, for instance, is a multidisciplinary endeavour, putting demands on the entire corporate value chain, with several teams acting on separate fronts organized in projects and under a Program to collectively achieve a common goal. The program depends on the success of all projects to succeed. If a single project fails, the program fails and no snack is delivered to the customer. The need for a Program Manager to facilitate the orchestration and cooperation among all projects and teams is decisive to the success of the venture. Each Project Manager isolated would not have enough visibility to allow effective cooperation by sharing resources and resolving conflicts at the least cost, at the appropriate quality and on time. The Program Manager has the duty to align the projects to the Corporate Strategic and exploit synergies to fulfill the strategic plans.

**Portfolio Management** refers to the centralized management of one or more portfolios and/or projects, including identifying, prioritizing, authorizing, managing and controlling programs, projects and other activities under one direction to facilitate the achievement of strategic objectives and results (Project Management Institute, 2008: 9). Programs, projects and activities under one Portfolio are not necessarily related. To facilitate understanding, let’s draw a parallel to an investment portfolio. A well-educated investor would select financial assets (securities) from companies in different sectors in the economy and even in different markets (countries) to minimize the overall portfolio risk through diversification. As some sectors/companies will do well and other won’t in the same economy concurrently, the negative correlation among the securities should help achieving more stable returns overtime. Similarly, a Portfolio of Programs and Projects
would help Management achieving the corporate strategic objectives and financial results. The examples of initiatives to be put in the portfolio are countless:

- **Cut costs:** implement lean initiatives to reduce waste of all sort (productivity, material, in the supply chain), renegotiate with suppliers, change raw materials to less expensive ones, invest in new technologies, outsource production, etc.;
- **Increase revenue:** invest in marketing campaigns (distribute free samples, advertisements), sell in foreign markets, launch new products, etc.;
- **Stabilize revenue stream:** diversify operations (holdings in different markets)
- **Product leadership:** invest in R&D, acquire promising patents, products, companies…

So, each initiative (cut costs, increase revenue, etc.) is the objective of a portfolio. Cutting costs can have different fronts, each one can be a separate project, program or initiative as depicted in Figure 2–9. The combined results from the program “Lean Supply Chain”, the project “World Class OEE” and the “Early Retirement” initiative will determine the overall success of the portfolio. It may happen that the project “World Class OEE” does not yield the expected results, but the “Lean Supply Chain” program may be extremely successful, so that the strategic objectives pursued by implementing the portfolio can still be met. The components of the portfolio should be reassessed periodically to ensure congruency with the strategy the Portfolio is supposed to implement. Change in market conditions and customer demands may require shifting priorities and consequently resources among projects and programs to guarantee alignment with the Corporate Strategy.

### 2.2.4. Project Management Office (PMO)

There is no single best way to run a project. Companies need to develop or adapt their project management methodologies to reflect their business practices, nature of projects, lessons learned, maturity level and the areas within it which represent the biggest risks. In the pharmaceutical business, the level of documentation required by regulatory bodies
Development of a Project Management Methodology for Supporting M&A

(21CFR part 11\textsuperscript{25}, European Medicines Agency, etc.) in projects involving the development of drugs, medical devices and others are much more strict than for most ordinary projects. There is a clear advantage in standardizing and systematize the initiation, planning, execution, monitoring & controlling and closing of projects when projects of similar nature are often required, either for internal use or provided as a service. Reinventing the wheel for each project is time and resources consuming, increases the likelihood of errors which ultimately lead to project failures. Therefore, there is the need for a centralized entity which is in charge of defining standards, collecting and applying best-practices and lessons-learned, and support top management in making sure the projects are aligned to the company’s strategy. This entity is the Project Management Office (PMO).

The same way the culture and values of a company and management team influence the way the organization operates, the PMO as an entity is no exception. Therefore, it is critical to select the right PMO structure and function to make it effective and efficient. There is no “one size fits all” solution. Defining the structure means setting roles and responsibilities, reporting lines, governance model, resources and level of authority.

The PMO can assume any structure within a spectrum with goes from a decentralized entity to report on projects status only to a centralized structure which takes the lead on every aspect of the project management. Based on (Hauck, 2007), a few questions can be deployed to help defining the right PMO structure:

- What resources are you able to dedicate full or part time to the PMO?
- Do you currently follow a standard project management framework/methodology?
- How well do your business units or departments work together?
- How many projects does your organization usually complete in a year?
- What problems does your organization face when dealing with projects?
- What impacts such problems do cause to the organization?

It is very tempting to propose a PMO and start building it right away. (Mullaly, 2002) suggests that building a PMO should not be any different from carrying out a project: it

\textsuperscript{25} 21CFR part 11 stands for the Code of Federal Regulations File 21 part 11. It is a directive of the Food and Drug Administration (FDA) which defines the expectations in terms of electronic record keeping in an age in which companies are no longer saving crucial data from clinical trials and company’s internal processes execution on paper. As saving data electronically gives rise to a myriad of ethical, compliance, traceability and accountability issues, the 21CFR part 11 tries to set minimum requirements of the systems (ERP, MES) to be complied by regulated industries, such as pharmaceutical and medical devices users, on audit trails, electronic records and electronic signatures storage. In a few words, any data entry in a database has to be followed by at least date and approver (electronic signature). Changes after the fact are tracked to whom did it, when and why. More information on the regulation can be found at (US Food and Drug Administration, 2011).
requires a charter, planning, execution, monitoring and closing. Therefore, critical points to be addressed (also to answer the aforementioned questions) should include:

- Define the stakeholders and their expectations;
- Reasons for establishing a PMO;
- Key Performance Indicators to measure how well PMO is fulfilling its role.

(Mullaly, 2002) is the opinion that the PMO should walk on a fine line balancing between support and control. The balance should be stable to inspire confidence, but the truth is that the PMO is pulled to opposing directions by the different organization’s stakeholders. At one end are the senior managers with little understanding of project management and expecting the PMO to micro-manage projects to take accountability for every aspect of it. Thus, senior managers would have one point of contact to all projects, one to blame for not reaching goals, schedule and budgets whilst not getting involved with technicality they don’t understand. On the other end there are the project managers who wish to be left alone, use their creativity and freedom to manage projects the way they want. Project managers may think of PMO as a bureaucratic body which wastes their time by requesting them countless time-consuming status reports. So, the PMO must be clear about the challenges they face.

2.2.3.1. PMO Models

Different authors provide slightly different modes describing the types of PMO. (Reiling, 2009) provides a simple 3-type model for describing the different positions the PMO can stand in the continuum:

- **Supportive**: The PMO takes a passive but yet important role in providing solicited support to projects, by expertise, templates, best-practice, consulting. This model seems to work where project managers are empowered to run the projects and make decisions on their own. Therefore, control over projects is not deemed necessary or critical.

- **Controlling**: The PMO not only provide support passively, it also actively enforces the use of prescribed frameworks, methodologies, templates and processes. The PMO acts as a police, auditing the projects to ensure they are being run as per the rules. This “intrusive” behaviour can be detrimental to projects in terms of time and creating frictions with the project managers. For this structure to function, there must be a clear case that PMO will bring tangible improvements to the way projects are carried out, and strong endorsement from top management is required to support the PMO authority.

- **Directive**: The PMO literally “takes over” all projects by providing the project management experience and resources needed. The project managers will therefore be professional PMI members, ensuring the highest level of professionalism and consistency across the organization.
**Development of a Project Management Methodology for Supporting M&A**

<table>
<thead>
<tr>
<th>Scope</th>
<th>Project</th>
<th>Program</th>
<th>Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Well-defined, concrete and limited scope with set objectives. Scope granularity is increased as the project progresses.</td>
<td>Larger scope, set objectives. Potential to significant business benefits</td>
<td>Wider scope which changes with company’s strategic goals. Objectives are less tangible</td>
<td></td>
</tr>
</tbody>
</table>

| Change | Project managers expect changes as project progresses. Changes are managed and controlled with formal procedures. | Program manager must expect changes from inside and outside and be prepared to manage them | Portfolio managers continuously monitor the environment and make changes as required to fit strategy |

| Planning | The granularity level of planning increases as the project progresses. | Program managers develop the overall program plan and high-level plans to guide detailed plan at the components level | Portfolio managers develop the portfolio strategy and maintain required processes and communication with its component parts |

| Management | Project manager manages the project team to meet the project objectives | Program managers lead program staff and project managers, providing direction and leadership | Portfolio managers manage portfolio management staff |

| Success | Success is measured by product and project quality, timeliness, budget compliance, and degree of customer satisfaction | Depends on the fulfillment of the needs and benefits the program was created for | Depends on the aggregated performance of the portfolio towards the strategic objectives |

| Monitoring | The project manager monitors the project team’s outcome and its alignment with the expected results | Program managers check the progress of the program components against the goals, budget, schedule and benefits | Portfolio manager monitors the performance and value indicators against the targets for the portfolio |

Table 2-9: Comparison of key aspects in projects, programs and portfolios. Adapted from (Project Management Institute, 2008: 9)

In (Levatec, 2006: 67-76) the author named the “Supportive” model as “Consultative”, “Controlling” as “Blended” model and “Directive” as the “Strong” model, where the functions of each PMO model remained essentially the same as described above.

Additionally, (Hauck, 2007) specifies two extremes which the PMO should avoid to be at all costs:

- **Decentralized but yet highly controlling**: in a matrix organization in which individuals can be assigned to different projects, it is very difficult to keep track of the project in a detailed level. Therefore, this model is a recipe for failure.
- **Centralized with reporting function only**: it is hard to justify the overhead costs to keep a centralized PMO with dedicated resources for collecting information and report project status.

There is still what is called the **Project Management Centre of Excellence** (PM-CoE), which has a corporative role in advancing the organization’s project maturity and is seen as an internal consulting group. It may be seen as the body which has the best and brightest in the subject and are there to support the company to strive in continuous improvement and targets achievement (Karim, 2011). According to (Kerzner, 2001: 168), PM-CoE is a more informal committee whose members come from all functional units in the company, on a part-time or full-time basis, for 6 months to a year. As the members are regular employees and they don’t have the power and authority of a PMO, the line managers and employees tend to accept their recommendations more easily because they don’t feel threatened. Therefore, the PM-CoE can be adopted in lieu of PMO when the latter has low acceptance among employees and the need for a unit with strong project management related knowledge is needed. (Kerzner, 2001: 100) presents a good way to differentiate the roles of each entity, as shown in Table 2-10.

<table>
<thead>
<tr>
<th>Project Management Office</th>
<th>Project Management Centre of Excellence</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Project managers have line functions</td>
<td>• May be a formal or informal committee</td>
</tr>
<tr>
<td>• Focus on internal lessons learned</td>
<td>• Focus on external benchmarking</td>
</tr>
<tr>
<td>• Champion for the implementation of the methodology</td>
<td>• Champion for continuous improvement and benchmarking</td>
</tr>
<tr>
<td>• Expertise in the application of project management tools</td>
<td>• Expertise in the identification of project management tools</td>
</tr>
</tbody>
</table>

Table 2-10: Differences between PMO and PM-CoE from (Kerzner, 2001: 100)

Still according to (Kerzner, 2001: 100), the PM-CoE should stay under the PMO, as an arm of the latter supporting the PMO & PM-CoE combined mandates of:

- Governing, advancing, promoting and championing state-of-the-art Project Management practices within the organization;
- Being the reference point and go-to place for support in any matter concerning Project Management;
- Helping Human Resources in developing a Project Management career path and curriculum;
- Support Management in achieving the company’s strategic goals.
Professionals, such as (Karim, 2011), suggests the PM-CoE should be an independent unit within a large, complex organization which supports PMO and the Company’s Management in promoting research, innovation and leadership in the practice of Project Management, endorsing a consultancy role to provide impartial, conflict-of-interest free and expert advice and guidance.

Figure 2-10: How (Kerzner, 2001: 100) suggests the relationship between PMO and PM-CoE

Figure 2–11: The competence continuum range in Project Management

Na important point was raised by Mark Price Perry in his book “Business Driven PMO Setup”. It happens that the PMO is considered more of a burden to the organization than a strategic enabler of the company’s business objectives. The fact that the some see the PMO as “a cost-centre which does not directly generate revenues” (Perry, 2009: 385) can be traced back to a poor marketing and communications plan when the PMO was being implemented. In the same way, attributing the PMO’s role as “helping the organization at selling more or manufacture better” is not correct either. The PMO is there to help the company achieve its targets and business objectives and strategies. The Head of Sales is not expected to say that “our objective is to learn to sell more”. Their objective is to sell, meet the quotas and budgets. Learning to sell more is good, it is an appreciated and somewhat expected skill to perform better at work in the near future, however this is not their main role. The same way, the PMO is not there to simply “help the organization doing better at sales, delivering projects etc.” The PMO is there to help the organization...
achieve its objectives and then help them advance in the area (Perry, 2009: 384-385). So, the conclusion can be stated as: the fact that the PMO has no associated profit centre does not mean it does not pay for itself. A company without the PMO can still execute projects and deliver value, but with a PMO it can deliver more and better, and the associated extra revenues, less costs and more profitability more than pay for the costs associated with it.

2.2.3.2. Line-Of-Business PMO

As it was also mentioned, there is no “one size fits all” approach each. Each company requires a PMO tailored to their needs, geared towards the industry and the line of business the company is active in. According to (Perry, 2009: 385), it is common for well-managed companies to implement PMOs tailored to key business areas which are strategic for the company. PMOs can be found in departments such as Sales, HR, Marketing, Engineering & Operations, Supply Chain, Training, R&D, and, of course, in M&A units. The main takeaway is that PMOs are important in helping the organization achieving outstanding results in strategic, tactical, operational, both vertically and horizontally across the organization. Nevertheless, they need to be tailored to generate a positive net value between the gains in efficiency, effectiveness and success rate, and the losses due to extra paperwork and formalities.

A Marketing & Sales PMO would be headed by a Marketing & Sales VP to support achieving the sales objectives of the company. Such a PMO, differently from an IT PMO, normally has no technological or application development component (Perry, 2009: 387). Examples of marketing & sales projects could be:

- Sell a high-value complex solution to a strategic account with a total customer solution approach;
- Expand or open a new sales regions in new or existing markets;
- Analyse and benchmark competitors in different geographies, generating defensive and offensive measures to increase market shares;
- Develop tools and techniques to provide ROI and TCO figures to customers as part of the pre-sales services;
- Plan and execute conferences and roadshows;
- Generate compelling sales collaterals to support sales initiatives, such as success stories;
- Build a customer reference database with all sales and projects to apply data-mining techniques and extract important facts for sales campaigns.

Another important remark raised by Mark Price Perry is that for sales professionals to take advantage of the PMO there is no need to know all about the PMBOK or be a PMP. Those running marketing projects should not be labelled as professionals in project management, but professionals in Marketing. Marketing project managers should focus efforts in mastering the marketing processes and best practice in the industry, yet taking advantages of tools and processes in the PMO which can support them in their tasks. Instead of
devouring the PMBOK to become a PMP, the marketing project manager should become a Professional Certified Marketer (PCM) instead. Someone with formal knowledge and experience in project management AND marketing can help setup the Marketing & Sales PMO initially so the Marketing project managers don’t need to spend time and energy in the PMBOK learning what would not be required for their specific job.

A multinational and decentralized company, for example, would need a PMO/CoE at the headquarters level to support local decentralized line-of-business PMOs at the regional levels where the subsidiaries are. The standards for each regional PMO would be devised at the HQ level and implemented at the regional level, so significant investments at the HQ level would promote consistency across the company. So, the following PMOs are:

- **Marketing & Sales PMO**: With duties as exemplified previously;
- **Operations/Engineering PMO** to plan and build factories worldwide, develop technologies and proprietary production equipment for the factories. This approach would help leveraging internal knowledge, reduce number of different vendors and consequently spare parts, and savings in scale;
- **Supply Chain PMO** to support projects related to sourcing, purchasing, inbound and outbound logistics, relations to suppliers, retailers, distributors, distribution network architecture and operation, etc.;
- **IT PMO** would work with all other PMOs to deploy the IT systems for production (Manufacturing Operations Management), business (Enterprise Resource Planning and Customer Relationship Management) and Supply Chain Management systems;
- **Strategic PMO** at the executive level to support Corporate in implementing portfolios and provide high-level guidance to the other PMOs.
- **M&A PMO** would be responsible to establish their own framework/methodology to conduct mergers and acquisitions for the company, as well as have project managers and other experts in the area to cover all requirements and activities to conduct M&A from start to end.

The key resources and competences would reside in the HQ and “lent” to the regions when needed. This model helps creating critical mass of knowledge and expertise in one location (HQ), standardization across the company, aligning the systems and technologies, facilitating cooperation and knowledge sharing among all regions and HQ and other numerous benefits.

2.2.3.3. **Enterprise PMO**

In large, multinational corporations active in projects worldwide in different sectors may require an extra layer of coordination on the enterprise level to allow for excellence in cross-sector project initiatives. For illustrational purposes, let’s consider as an example a
company such as Siemens\(^\text{26}\). Currently Siemens operates in 3 main sectors: Energy, Industry and Health Care. Each sector has its own Project and Program Management Offices to carry out projects in the \textit{operational} level. Each sector has a Portfolio Management Office to manage all the initiatives required to achieve its individual targets. So, the Portfolio Management Office operates in the \textit{tactical} level from the enterprise perspective. Therefore, besides the strategic elements being missing from the CEO/CIO point of view, there is the need of an extra organizational unit to provide standardization for the cross-sector PMOs to provide the corporate level with the type of information they need to make decisions. This is the role of the \textbf{Enterprise PMO or EPMO}, as per (Rathore, 2010) and (Caruso, 2010).

There are many advantages in implementing an EPMO, among them:

- Strategic alignment of each sector with corporate: although each sector can make decisions independently on how to carry out business, projects of strategic size and significance to the whole group should be followed by an above unit which would report directly to the C-level management and get their buy-in (or out).

- Allow the execution of cross-sector projects: a mediator above the sector level should exist to coordinate efforts in large cross-sector projects. Problems which normally arise in such situations are poor communication, ineffective use of resources and dispute of profits and losses. So, in such cases, an authority such as the EPMO would act as a mediator and facilitator. Besides, more importantly is making sure the PMOs in each sector follow some standard policies and templates to facilitate cooperation before it is needed. So, an EPMO is decisive in such efforts.

- In cross-sector projects, the EPMO would compile information from each PMO involved and deliver the information that matters to and in the format expected by the C-level management. The EPMO sees the \textit{big picture} often missed by lower-level PMOs.

- The EPMO can drive transformational capabilities which affect the entire enterprise.

- Lower level PMOs can do the things right in the operational and tactical levels, while the EPMO can take it a step further by doing the right things to align all strategically with the enterprise’s goals and targets.

- In mergers & acquisitions, especially when the target company has to be integrated, there is the need to align with an existing PMO due to different processes and policies which may stand in the way to consummating a full integration of both companies.

\(^{26}\) It does not mean this is the way it works in the specific case of Siemens. This is just exemplifying the way it could be in the author’s opinion.
2.2.3.4. PMO Automation and Tooling

The number of software-based Project Management tools in the market has proliferated over time. Software vendors noticed the existence of this niche and its potential. Traditionally projects were carried out documenting everything on paper. However, this trend has given place to electronic documents (e-documents). The advantages of this new approach are many:

- **Globalization**: Complex projects are executed in hard to reach locations, such as mining, and exchanging of information between the in-locus project manager and his superiors can only be done electronically and at near-zero costs and delay in relaying important information about the project, all thanks to the internet;

- **Up-to-date information accessible and in the right format**: Different audiences expect the information that matters most presented in different formats. Top managers only have time and focus to look at key performance indicators presented in charts such as in an executive summary, whereas project management team members require data and information with more details. The web-based dashboards for configuring the data and information presentation layer, and the document repository for secure access across the board are very desirable features in current systems.

- **Collaboration**: Projects are getting bigger, complex and so involving many teams with specialized knowledge and skills. Besides being separated by thousands of kilometres and in different time zones, there are other factors which may affect productivity and success rates. Teams in different countries are more comfortable with their own language, with their own way of working. In such cases, the system can help decouple the work of the different teams, whilst keeping them connected and sharing information on a timely basis in different languages and formats.

- **Integration with Business Systems**: More and more business processes are being automated with the use of Enterprise Resource Planning (ERP), Supply Chain Management (SCM), Customer Relationship Management (CRM) and others. There are many advantages in such integration, besides reducing administrative efforts and overhead. ERP and SCM have many modules and functionalities that add value to
Human Resource Management (HRM) module keeps track of all resources within the organization, including skills and training records, which can be used by project managers to select suitable resources to projects. Financial and Controlling modules help allocating labour, materials and procured services costs incurred in the project directly to the appropriate costs centres, providing up-to-date figures to manage budget and billing/invoicing.

- **Facilitate audits and data archival:** Project paperwork is sometimes archived for years to comply with regulations and company internal policies. In a company which business relies heavily on projects, the amount of paper and consequently room to keep all the paperwork can be immense. Therefore, electronic document repository presents itself as a great alternative to keep records for as long as needed and taking no more space than a few cubic centimetres in the computers room. Audits are much faster and thorough when done over archives in electronic format.

- **Falling Total Cost of Ownership:** With the advent of Software as a Service (SaaS) and cloud computing (and storage), having such systems became very affordable even to small companies. Small companies can have facilities that were only available to corporations for a small monthly fee.

Companies may have some difficulty finding the correct tool for their needs. It is highly advisable to either hire external consultancy or have in-house IT and Project Management savvy people to build a matrix with the criteria which are most relevant to the organization, attributing weights to each criteria and look through the options in the market. The short-listed ones can be called for a demonstration with the key decision makers or the implementation of a pilot system. Again, the complete selection process is a project on its own and careful planning and discipline also applies here. Access to expert reports on the current state-of-the-art and evaluation of systems in the market are of great help. One example is a report Gartner releases each year on Project and Portfolio Management Applications, which link is found in (Stang, 2011).

Two important factors which may be overlooked are the organizational maturity level and the learning curve of the new system. The maturity level may play a key role in the proper selection of the system to be adopted. Companies with established business processes and procedures to carry out projects would help weeding out the systems which would either not support implementing the same processes and procedures electronically or be too expensive to do so. For example, the use of a workflow definition tool to set the approval process for each type of process. A high level of organizational maturity gives the vendors a harder time convincing the buyers if the product can’t do what they want. The learning curve touches upon the overall costs in terms of training time and effort to properly start benefiting from the tool as well as the lost productivity or output while learning the tool.
Two examples of software products commonly used in the market are the Microsoft Project Server System and SAP Project System (PS) module27. The standalone Microsoft Project software is well known and in use by many project managers around the world. Microsoft extended the tool to the enterprise scope by adding features and facilities that addresses the needs from project managers up to portfolio managers in the senior management level. The integration of Microsoft Project with other tools, such as Microsoft SharePoint for document repository, Microsoft Office to manage the different file formats, and Microsoft Dynamics ERP integration, makes it an interesting off-the-shelf product. Figure 2–13 illustrates a sample of a complete Corporate EPM solution based on Microsoft Tools and Technologies28. SAP PS, on the other hand, is a module integrated within SAP ERP system which has the advantage being already integrated with the Financial, Human Resources and Procurement modules. Disadvantages29 seem to be the steep learning curve, cost of training and the system costs, both initial outlay and maintenance.

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27 The intention here is, by no means, to suggest a vendor, but to provide an example of systems commonly used in the market.

28 The figure is a simplified EPM architecture solution, and it is for illustration purpose only. There are no intentions of endorsing or promoting any brands in this work, neither Microsoft, SAP nor any other.

29 Disadvantages as stated by some users based on their own experiences. Source: http://www.ganttthead.com/discussions/discussionsTopicContainer.cfm?ID=3421
2.2.3.5. Project Management Maturity Model (PM3)

A few times the term “maturity” has been mentioned without further explanation in the applicable context. In the past, companies would consider themselves “mature” in project management after a few years executing projects. Unfortunately, the simple use of Project Management, even for extended period of time, does not necessarily leads to excellence (Kerzner, 2001: 41). Many of them would make the same mistakes over and over without proper attempts to improve effectiveness and efficiency in the projects execution. What Nortel\(^\text{30}\) and Ericsson achieved from 1992 to 1998, other companies did not achieved in 20 years. The key is Strategic Planning for Project Management (Kerzner, 2001: 41). Strategic Planning for Project Management is carried out by middle-management and needs to receive the blessing from the Executive Management, to make sure it won’t affect or be affected by the corporate culture (Kerzner, 2001: 42).

The first Maturity Models started being used in software projects due to the complexity involved in many variables and unknowns, more than in projects in other industries (Crawford, 2002: 1). As software became more and more a critical piece of many high-risk applications, such as avionics and nuclear power plant controlling, the necessity of excellence in software projects became a must. Maturity models evolved and were adjusted to the needs of other industries. So, the Project Management Maturity Model (PM3) is the foundation for achieving excellence in Project Management activities (Kerzner, 2001: 42). Excellence has not only to do with successfully completing projects, but also to embed efficiency (“doing things right”), effectiveness (“doing the right things”), reusability (standardization) and repeatability (same inputs yields same results).

Companies from time to time have “stars” among their employees, i.e. exceptional project managers, software programmers, etc. Their skills are outstanding and help companies do wonders. However, without capturing these skills or expertise in some way, as soon as they leave the company, the success goes with them. So, the PM3 is also a tool to internalize and keep inside the company the best practices which can be reused by other employees to promote continuous improvement and consistent results.

Despite different authors use different terms for the 5 levels of the maturity model, they are aligned in terms of where the company stands compared to the highest level of proficiency. (Crawford, 2002: 4) adopts the 5 levels as per the Software Engineering Institute (SEI) and Dr. Kerzner (Kerzner, 2001: 42) uses his own nomenclature as listed in Table 2-11. The main characteristics of the practice of Project Management in each level are:

- **Level 1**: The organization recognizes the importance of project management, learning the basics in the area and terminologies. Each project is managed *ad hoc*. Corresponds to **Project Office**;

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\(^{30}\) Unfortunately, Nortel ceased its operations in early 2009, and apparently, not due to its Project Management practices (Vella, 2009).
- **Level 2**: Organization becomes aware of the importance of defining and using common processes to manage projects. Processes are used in large, highly visible projects to gain Top Management support and be reused later as best practices. Project centric approach. Corresponds to **PMO Stage 1**;

- **Level 3**: A common methodology with standard processes across the company is applied to all projects. Repeatability yields consistency and increased efficiency and effectiveness. More of an organizational focus. Attention starts to be given to performance measuring for project performance by collecting data. Awareness and efforts to institute convergence between project management processes and other business processes in the organization. Corresponds to **PMO Stage 2**;

- **Level 4**: Project Management processes are integrated with the corporate processes. Top Management mandates compliance. Project decision is data analysis driven. Project performance analysis is mature and allows benchmarking with project performance of other companies. It corresponds to **PMO Stage 3**;

- **Level 5**: Processes are in place to support driving improvements in the current methodology based on benchmarking against similar and respected competitors and other companies. Level 5 is achieved with the addition of a Project Management Centre of Excellence (PM-CoE) to an existing PMO Stage 3.

### Software Engineering Institute Maturity Levels

<table>
<thead>
<tr>
<th>Level</th>
<th>Maturity Level</th>
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<tbody>
<tr>
<td>Level 1</td>
<td>Initial Process</td>
</tr>
<tr>
<td>Level 2</td>
<td>Structured Process and Standards</td>
</tr>
<tr>
<td>Level 3</td>
<td>Organization Standards and Institutionalized Process</td>
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<tr>
<td>Level 4</td>
<td>Managed Process</td>
</tr>
<tr>
<td>Level 5</td>
<td>Optimizing Process</td>
</tr>
</tbody>
</table>

### Dr. Kerzner Maturity Levels

<table>
<thead>
<tr>
<th>Level</th>
<th>Maturity Level</th>
<th>Corresponds to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 1</td>
<td>Common Language</td>
<td>Project Office</td>
</tr>
<tr>
<td>Level 2</td>
<td>Common Processes</td>
<td>PMO Stage 1</td>
</tr>
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<td>Level 3</td>
<td>Single Methodology</td>
<td>PMO Stage 2</td>
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<tr>
<td>Level 4</td>
<td>Benchmarking</td>
<td>PMO Stage 3</td>
</tr>
<tr>
<td>Level 5</td>
<td>Continuous Improvement</td>
<td>PM-CoE</td>
</tr>
</tbody>
</table>

**Table 2-11**: Differences in the naming assigned to each maturity level as per Dr. Kerzner and SEI

**Figure 2–14**: Project Management Maturity progression, adapted from (Kerzner, 2001: 42)
2.2.4. Project Lifecycle and Organization

As previously mentioned, the project is a temporary endeavour, with a definite start and end. A project can be single phased or be composed of multiple phases, which can occur in parallel, sequentially, overlapped or a mixed form. The PMBOK defines a framework which specifies 42 processes allocated in 5 process groups across 9 knowledge areas. The process groups are not to be mixed with project phases. A project can have any number of phases and each phase would encompass all 5 process group. Each phase of a large complex project can be thought of as a single project.

Any project lifecycle, regardless of its type and dimension, tends to go through four distinct periods, each one with specific levels of cost and labour effort level, as per Figure 2–15:

- **Starting the project**: project is “promoted” by sponsor to gain support to be undertaken, and culminates with the Project Charter;
- **Organizing and preparing**: planning activities culminating with the project management plan;
- **Carry out the project work**: execution of plans until deliverables are produced and accepted. The Monitoring & controlling makes sure the execution goes according to plan.
- **Closing**: Project is wrapped up and project team is dismantled.

![Figure 2–15: Project lifecycle periods and respective costs and labour efforts (Project Management Institute, 2008)](image)

Also applicable to each project or phases within a project, normally there is a trade-off between the risk, uncertainty and stakeholder influence, and the cost of making changes to the project as the time goes by. Stakeholders tend to push for changes as the project progresses for many reasons, but the bottom line is that the later they are made, the more

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31 The content of this section follows chapter 2 in the PMBOK guide 4th edition (Project Management Institute, 2008: 15-33), except when otherwise stated. It is a synthesis of the relevant aspects of chapter 2.
costly it will be as changes may have a domino effect on the project, possibly requiring rework, more labour, delays and increasing risks. It is up to the project manager to accept changes and avoid scope creep that may jeopardize the project success.

As previously mentioned, projects can be split in phases, mainly to increase control by managing chunks of the project at a time, reducing risks and allowing for the introduction of re-evaluation points. Such re-evaluation points are called milestones or stage gates.

Some phases have dependencies linked to another phase, requiring the former to wait for the completion of the latter (sequential phases). In other cases, phases can proceed quasi in parallel, allowing the shortening the overall project time, known as fast tracking.

Another important distinction to be made here is between project and operational work. Operations management has to do with the continuous delivery of products and services developed or implemented previously through projects. In a Projectized company, their operations depend on carrying out projects to other companies, but also internally they probably run projects to develop and implement improved methodologies and tools to be used in external projects. In Consumer Packaged Goods (CPG) companies, projects are ways of creating new products and types of packages, developing and implementing new production methods for Operations to produce such products, which will be the source of revenue to the company.

2.2.5. Stakeholders

Stakeholders are defined as anyone (person or organization, internal and external to the organization) who may be involved in the project and have their interests positively or negatively affected by the project.
Raster Image Description

Rarely another factor has as much influence in the success or failure of a project as the stakeholders. The project manager has to be quite diligent in knowing who they are, what interests they have in the project and what influence (or power) they have to interfere in the project. The interests and power/authority levels can shift along the project lifecycle.

In a corporate project (as per Figure 2–18), there would be a project champion, who is the one who proposed the project and is fully supporting its acceptance, mostly because if it succeeds, he/she would highly benefit from. The sponsor would probably be someone in the top management, such as a CEO, who would provide endorsement and funds for the project. A steering committee would provide guidance and support to make sure the project provides the expected return and benefits as preached by the champion.

It is quite important that the project manager have advanced communication skills, good inter-relationships with the stakeholders, notions of HR and to some extend understanding psychology. There are many reasons someone could try to sabotage a project, and the project manager should know beforehand which stakeholders could be adversely affected by the project and how to convince them to help in the project even though they may be at loss if it comes through. A good example is when a company acquires another. During the integration process, some redundant positions are eliminated to accelerate gains through synergy. The project manager heading the integration process needs to try to convince the affected employees to support the project even though they will lose their jobs at the completion of such endeavour.

Figure 2–18: The various stakeholders in a project

2.2.6. Organizational Influences on Project Management

Company culture and styles, organizational structure and process assets strongly influence how projects are performed in a company, and they are unique to each organization. So the project manager ought to be familiar with those factors to ever be successful in a project.

2.2.6.1. Organizational Culture and Style

Organizational culture is defined as the shared values, principles, traditions and ways of doing things which influence the way the company members act. It is informally known as “the way we do things around here” (Robbins, 2006: 60). Culture is perceived by
employees, shaped and enforced by policies and codes of conduct and are (or at least should) be preached by its top management by “walking the talk”. Research suggests there are seven dimensions to capture the essence of a company’s culture, as in Figure 2–19.

Companies with no incentives to promote teamwork and being results oriented may suffer when projects are present. Aggressive employees tend to defeat any attempt to promote cooperation, which is vital in a project, especially in moments of difficulties when teamwork and mutual support are mostly needed.

![Dimensions of organizational culture](null)

**Figure 2–19: Dimensions of organizational culture (Robbins, 2006)**

### 2.2.6.2. Organizational Structure

Organizations tend to be internally organized in the best way to accomplish its business. While some companies “live and breathe” projects as its main business, others only deal with projects in an infrequent basis and tend therefore to have structures which don’t naturally favour project undertakings. This can be seen in the 3 most common types of structures: functional, matrix and projectized.

**Functional structures** are designed around functions (Marketing, Sales, technical support, Engineering, etc). A project manager in need for expertise in a given functional area has to “borrow” a resource with the line manager’s approval. The project manager has no or little authority to keep the resource full-time or for as long as needed, as the expert reports to his line manager only. The functional structure can also take the form of a product or geographical structure, as in Figure 2–20. The situation can be tricky when cross-divisional projects arise, as a project manager from within a division tries to secure resources from other divisions and proper management control initiatives are not in place.
to facilitate this kind of cross-divisional cooperation (transfer-prices policies, profit sharing, etc.). The situation can be improved by implementing a matrix structure.

**Matrix structure** can be of 3 types: weak, balanced and strong matrix. A **weak matrix** can be thought of as a project manager who tries to gather resources from other divisions or functional areas without proper mandate or endorsement from a superior. The project manager has basically the same weak authority as in the functional structure. In the strong matrix the project manager has a mandate and strong endorsement, for example when he is part of a PMO or belongs to the corporate level.

In a **projectized structure** each project manager has a dedicated pool of resources available at any time and there are no functional silos in the company. The project manager has total authority and the company policies and procedure are designed specifically for carrying out projects.

The literature still cites a forth type of structure, called hybrid, composite or complex structure, which is a mix of the previously mentioned types of structures.
2.2.6.3. Organizational Process Assets

Organizational process assets are defined as the processes, procedures, formal and informal plans, policies and guidelines which can directly or indirectly affect the success of a project (Project Management Institute, 2008: 32). The accumulation of “lessons learned”, templates, risk evaluation and mitigation methodologies, communication paths and documentation requirements developed for previous projects and used as tools for future projects are all part of such company-exclusive assets. Companies with good reputation in the market use such assets as a competitive advantage to differentiate from competitors in attracting companies requiring project work.

2.2.6.4. Enterprise Environmental Factors

Environmental factors are internal and external factors to the company which may influence positively or negatively the project success (Project Management Institute, 2008: 14). There are countless factors, but some of the most significant ones are:

- Government-imposed policies, industry standards, codes, incentives, regulations, political climate, etc.
- Organizational culture, styles and processes;
- Organizational process assets;
- Availability of qualified resources;
- Stakeholder risk tolerances;
- Project management automation and tooling.

Reinventing the wheel each time a project is carried out is not only a waste of time, but also costly, increases risk and don’t leverage on the previous experiences.
3. Research Methodology

Merger and Acquisitions (M&A) are complex and multidisciplinary business undertakings which became the focus of business and management research. M&A is complex because of its multi-faceted and inexact nature, in which business and management experience is paramount for successful planning, execution and results delivery. Its multidisciplinary nature requires its practitioners to have a broad understanding of several subjects as presented in the academia, however focused on the practical application in the business world.

This research falls within mode 2 and mode 3 of knowledge creation, i.e. emphasizes a context for research governed by the world of practice and the need for the production of practical relevant knowledge whilst taken into consideration the common good and implications for the society at large. As a consequence, this work is based on applied research, i.e. it is of direct or immediate relevance to managers, addressing issues they consider important and presented in a way they can act on (Saunders, Lewis and Thornhill, 2009: 6-9).

3.1 Sources of Information

A critical review of the available relevant literature was conducted. Among the sources of information are:

- **Primary**: industry reports, theses, papers and proceedings from trustable sources;
- **Secondary**: specialized books, articles from reliable online business and financial periodicals, government publications;
- **Tertiary**: search engine, abstracts, indexes and my own theoretical and practical knowledge from previous working experience.

Data, information, knowledge, wisdom and theory were gathered and utilized to extend an existing proven project management framework/methodology to help practitioners in conducting M&A projects. Given the complexity and multifaceted nature of Project Management and Mergers & Acquisitions, accessing a varied literature is crucial.

3.2 Research Methods

There are 3 main research methodologies:

- **Inductive approach**: the researcher departs from observations, samples and data arriving to visible patterns. The patterns will give rise to tentative hypothesis, which will lead to theory and generalizations with a certain degree of uncertainty (Burney, 2008);
- **Deductive approach**: the researcher departs from a theory and tries to confirm it through observations. So, it goes from more general to more specific (Burney, 2008);
• **Abductive approach**: it is a new paradigm. It seems similar to the inductive or deductive approaches, but in fact totally different. It consists of assembling or discovering on the basis of an interpretation of collected data, such combinations of features for which there is no appropriate explanation or rule in the store of knowledge that already exists. This instigates the creation of theories and explanations through mental process. (Reichertz, n.d.)

Given the nature of this work, in which empirical data and observations were used as a basis to extend the theory and existing body of knowledge by proposing a new methodology to conduct M&A projects, it characterize an **inductive approach**.

![Diagram showing deduction, induction, and abduction approaches](image)

**Figure 3-1: Deduction, induction and abduction approaches**

The research methodology can also be of two types: quantitative and qualitative. Connecting them to the inductive approach taken here, the following definitions apply (Reichertz, n.d.):

- **Quantitative induction**: consists in extending, or generalizing, into an order or rule the combinations of features that are found in the data material. It transfers the quantitative properties of a sample to a totality, extending a single case into a rule.
- **Qualitative induction**: supplements the observed features of a sample with others that are not perceived.

The use of qualitative induction analysis of data, information, knowledge and wisdom is mainly justified by the nature of the research question to be answered, the source of information, besides being conducted in an academic environment instead of a company. The complexity of the subject also contributes to choosing qualitative data analysis over quantitative. The departure of an already existing methodology to expand it by adding new features found in situations sampled from the literature confirms the approach taken in this work as being of a qualitative induction nature.

The research philosophy adopted in this work to contribute to knowledge development tends to be **pragmatic** in nature. Mergers and acquisition transactions need to be analysed
from different perspectives and motivations brought into play by the different parties involved. Answering the research questions requires the development or extension of a framework/methodology which can be considered as positivism, due to its objectivity. On the other hand, the execution of the very framework and the results of its application are strongly influenced by the personal and professional motivations of the parties involved (interpretivism). Arriving at the framework required the critical analysis of not only theory, but also lessons-learned from M&A transactions, both that succeeded and failed. Thus the focus on practical applied research, integrating different perspectives to help design a methodology which is theoretically correct whilst applicable in practice.

The strategies adopted to develop the methodology are based on:

- **Multiple case studies**: the research uses several case studies of real M&A transactions to both support the development of the framework and justify choices. The case studies may treat the organizations involved holistically or involving individual divisions within it.

- **Grounded theory**: M&A is strongly influenced by people’s behaviours, which cause business and management behavioural issues, which can in turn lead or block M&A transactions. Thus the importance of predict and explain behaviours in building the framework.

![Figure 3-2: The research onion, adapted from (Saunders, Lewis and Thornhill, 2009: 108)](image)

Figure 3–2 shows the research onion with the approaches adopted for this research, which are circled in red.
3.3 The Research methods adopted in this work

Figure 3–3 shows a summary of the research methodology adopted to develop this work. Several primary, secondary and tertiary sources of information, such as books in Mergers & Acquisitions and PMI Project Management Methodology, served as a base for the thesis in building up knowledge. Empirical data from books, theses, articles and periodicals (e.g. Financial Times) was analysed and served as input to qualitative analyses. Lessons-learned and best practices from several sources was analysed in a qualitative and interpretivist manner. All the observations were used to extend the already established PMI framework/methodology to make it more suitable for M&A projects. A case study was created to demonstrate the need for Mergers and Acquisitions, leading to the need for a methodology to execute such undertaking successfully.

Figure 3–3: The research methodology chosen by the author for this work
4. Case Study: What Leads a Company to Pursue an M&A?

During the literature review, it was quite noticeable that many authors went quite in depth into what an M&A is and suggested ways to deal with the transaction. However, very little was said about what leads to an M&A after all. There are several alternatives to implement a strategy to achieve corporate goals, being mergers and acquisitions only two of them. Besides, it is not clear why the top management in a company decides to resort to M&A as a strategic instrument instead of other options. As many readers may not be familiar with the process leading to a merger or acquisition, introducing them to an example of a prelude to M&A is a valid exercise. In the author’s opinion, it is a good complement to allow readers to have an overview over the entire M&A lifecycle, from driving factors to delivery, going through the role of Corporate Governance, strategy setting and decision making.

4.1. The Case of “A Limited”

“A Limited” (hereinafter “A”) is a medium-size company in the Food & Beverage business incorporated in the Province of Ontario, Canada. “A” has operations in Canada and European Union\(^{32}\) and reported combined revenues of over CAD$500 million in 2011.

4.1.1. Defining “A”’s Corporate Governance Structure

“A”’s corporate governance structure is displayed in Figure 4–1. Each year “A”’s shareholders meet in person or through a proxy in a general meeting where they are debriefed on the matters pertaining the company, its management, key financial figures, current state of business and issues discussed in the last meeting. This is also the opportunity for shareholders to exercise their decision-making power by accepting or rejecting proposals from the Board of Directors.

According to its Articles of Incorporation, “A” has a dispersed corporate ownership structure\(^{33}\) with one class stock and two types of shares\(^{34}\): common shares and convertible preferred shares. Each share has equal voting rights, being one share equal to one vote.

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\(^{32}\) The European Union subsidiary is in Spain, including all of its production facilities. Products are sold in Eastern Europe.

\(^{33}\) Dispersed corporate structure means that several hundreds or thousands of ordinary people and companies own small amounts of the company’s outstanding shares. Dispersed corporate structure is prevalent in the US, Australia and UK. The opposite of dispersed structure is block holding or concentrated structure, in which a few shareholders own a significant amount of a company stock, enough to have a majority stake alone or when grouped with a few others. In Sweden block holding by financial institutions is quite common (Alves, 2010: 102). Although the investigation on the reasons for such prevalence of one structure over another in certain countries falls outside the scope of this study, some studies suggest the Legal environment as one cause (Alves, 2010: 93).

\(^{34}\) Each the aforementioned structures can bear either a single class type of shares (common stocks, preferred stocks) or dual class shares (A and B shares). In the single class stock, 10% of the
“A”’s Support Unit hosts a CFO, a Treasurer and a Controller. The President and CEO are represented by the same person.

4.1.2. Defining A’s Mission, Vision and Values

The company’s mission and vision statements are normally static and should provide long-term guidance to the company. “A”’s mission and vision are:

**Mission:** “A’s mission is to serve its customers with the highest quality snacks and soft-drinks to make any occasion happier and tastier, whether in a birthday party, watching a movie, in a friend’s get-together to cheer up for your team, in a company’s function or in an important anniversary.”

**Values:** “Being part of the communities we grow in, considering our employees our biggest assets and serving customers always with a smile are part of our culture.”

**Vision:** “A’s vision is to be a well-respected and admired brand in the markets and communities it serves in the snacks and soft-drinks industry.”

The mission sets the firm’s reason for existing, which implies in defining the business it will be active in (snacks and soft-drinks), the customers to be served (kids, teens, adults and even elderly), the competences needed to strive in the market (highest quality, good taste and brand recognition). The mission can effectively provide boundaries to the outstanding stocks in the company mean 10% of the voting rights and 10% cash-flow ownership. In a dual class stocks, A and B stocks have the same ownership power, but one A stock can have 10 voting rights and one B stock only one voting right. This distinction is made to guarantee the company owners and executives keep control of the company (McClure, 2012). Companies with dual class shares can issue more stocks to raise capital without diluting control rights.

35 For illustrative purposes only. Any similarity with the mission and vision of another company is a mere coincidence.
Executive’s actions. An overly restrictive mission may hinder the Executive from taking actions that could veer the company off trouble in turbulent times, such as in the Financial Crisis of 2008-09. It can however discourage the Executive from entering into risky deals or going into areas unrelated to the core business.

The company’s values (value employees and serve customer with a smile) and, consequently, the company’s culture and expected employee’s behaviour come after the mission. The vision sets where the company wants to be in the future (be a well-respected and admired brand in the market). It provides motivation to the entire organization. Both mission and vision should provide a direction to the company for several years.

4.1.3. Defining A’s Strategic Framework

Based on the company’s mission, vision, and values, a Corporate Strategy is devised to provide direction, putting everyone working towards the same objectives. The Chairman of the Board (Executive Director) and the CEO are the chief architects of the short and long-term strategies for the company. As the CEO is the ultimate responsible for the execution of the strategy, it is valuable to have the CEO’s input in its formulation to guarantee execution reasonableness. As the Support Team (CFO, COO, etc.) and the heads of each business unit need to be engaged in supporting the strategy execution, having the strategy known to the CEO only won’t help. There is the need for speaking a common language which can be understood and used to communicate the game plan to value creation. This is the Strategy Map. Once the strategy is defined, there is the need to identify key metrics which will provide ways to provide feedback on the company’s performance and how successfully the strategy is being executed. So, the qualitative nature of the strategy will be mapped in quantitative targets, such as Return on Assets (ROA), Return on Investment (ROI), market share, profitability, operating margins, etc. The actuals will be compared to the targets defined in the Balanced Scorecard. A way to depart from the actuals and arrive at the desired targets is to have an Action Plan, which will be then used as a base to assign individual tasks to all employees in the company. Each employee will have Personal Objectives to be fulfilled, which when summed up should yield the expected results set by the Board of Directors. The Company Strategic Framework in Figure 4–2 shows the hierarchy of elements involved in the management of a company. “A”’s long-term high-level strategy has a 3-year outlook, revised yearly.

As the CEO does not have the time or throughput to manage three business units in details, the strategy execution pertaining each Business Unit (BU) is delegated to the respective Vice-Presidents. The latter are held in charge of achieving the targets set to each unit. Each BU has international subsidiaries managed locally by a management team and reporting to the respective BU VP in the Headquarters (HQ) in Canada. All strategic decisions come from HQ and percolate down the chain of command in the company.

36 The words “Strategy Map”, “Balanced Scorecards” and “Action Plan” are from (Kaplan and Norton, 2004). The explanations, definitions and use are also from the same authors.
For many years “A” was able to grow organically, by developing its products in-house and rely on some cash-cow products, both on the snacks and beverages side. “A” is a well-recognized brand due to its impeccable quality records, good prices and great taste. This has been the customer value proposition of the company, which clearly plays on the “best total value” strategy category. The presence of big names, such as Pepsico, prevents “A” from playing in the “product leader”, which requires enormous R&D budget. The presence of many other local competitors in the markets “A” operates is causing profit margins to be squeezed and “A” investors are demanding higher profitability. “A” is in need for more capital to grow in other markets, thus requiring new ideas to convince investors. So far, “A” is able to earn returns above its cost of capital.

“A”’s CEO noticed a new trend in the market: healthy snacks and beverages. “A”’s portfolio does not have any of such products, neither the tradition nor the expertise in-house. This is a niche still not extensively explored by competitors and customers are willing to pay more for healthier products, according to market studies. Some countries are already banning the use of trans-fats and other ingredients used in the manufacturing process of many snacks. Non-carbonated beverages with vitamins, minerals and natural sweetener replacing sugar are also a trend. Besides, the regulations in important markets are requiring strict controls in the food cross-contamination with allergens, such as sesame.

According to (Kaplan and Norton, 2004: 41), there are four different customer value proposition strategies: best total cost, product leader, complete customer solutions and system lock-in. In the food industry, the “product leaders” are the innovative ones, introducing product novelty first (“the trend setters”) and the “best total cost” players are the followers.
peanuts, shellfish, eggs, milk and others. The recent increase in the number of allergic people has skyrocketed and this is by itself a niche little explored, however it requires strict discipline and even new facilities when many allergen-bearing foods are produced in the same facility.

The CEO along with the Board of Directors set a new corporate-level strategy for the next campaign 2012-2014 with many new challenges to address shareholders and stakeholders concerns. The biggest one is the importance given to “innovation”, which was not stressed in the past. Also on the Operational and Corporate Social Responsibility sides, many tricky issues await to be tackled.

The Strategy Map\(^{38}\) was presented to the top-managers from all subsidiaries at the beginning of the fiscal year 2012. The Strategy Map is displayed in Figure 4–3, while the Balanced Scorecard and Action Plan are displayed on Figure 4–4. It is clear to all that challenges lay ahead, but it is also the beginning of an interesting future for “A”.

<table>
<thead>
<tr>
<th>Financial Perspective</th>
<th>Productivity Strategy</th>
<th>Long-term Shareholder Value</th>
<th>Growth Strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>What we need to deliver to our shareholders</td>
<td>Industry cost leader</td>
<td>Maintain assets usage</td>
<td>New sources of revenue</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Customer Perspective</th>
<th>Customer Value Proposition</th>
</tr>
</thead>
<tbody>
<tr>
<td>What our clients expect from us</td>
<td>Best Prices</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Internal Perspective</th>
<th>Operational Excellence</th>
<th>Innovative Spirit</th>
<th>Corp Social Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>What processes we must excel at</td>
<td>• Reduce downtime &amp; waste</td>
<td>• Introduce new flavours &amp; types of healthier snacks and drinks</td>
<td>• Sponsor celebrations in the cities where the employees live</td>
</tr>
<tr>
<td></td>
<td>• Quick line changes to introduce more product varieties</td>
<td>• Develop technologies to increase efficiency in changeovers and production processes</td>
<td>• Use biodegradable packaging</td>
</tr>
<tr>
<td></td>
<td>• Reduce inventories (and required working capital)</td>
<td>• Improve existing recipes</td>
<td>• Reduce usage of water and use energy from renewable sources when possible</td>
</tr>
<tr>
<td></td>
<td>• Excellent suppliers (good sourcing &amp; procurement practices)</td>
<td>• Create new types of snacks for health-conscious people</td>
<td>• Invest in recycling projects in the cities where production occurs</td>
</tr>
<tr>
<td></td>
<td>• Good distribution network</td>
<td></td>
<td>• Educate people about healthy eating</td>
</tr>
<tr>
<td></td>
<td>• Optimize supply chain</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>People &amp; Knowledge Perspective</th>
<th>Human Capital</th>
<th>Information Capital</th>
<th>Organisation Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>How we must develop our Organization</td>
<td>• Train employees in each production site about continuous improvement</td>
<td>• Make IT systems available to all</td>
<td>• Instil a culture of questioning, avoiding status-quo and suggesting improvements to operations etc.</td>
</tr>
<tr>
<td></td>
<td>• Educate about changeovers and cross-contamination, allergies</td>
<td>• Train employees to use the system</td>
<td>• Promote and reward teamwork</td>
</tr>
<tr>
<td></td>
<td>• Promote ideation to help create and improve products, reduce waste</td>
<td>• Develop dashboards to show in real-time amounts of waste, downtime, loss of quality etc.</td>
<td>• Develop a culture of continuous improvement</td>
</tr>
<tr>
<td></td>
<td>• Empower employees and reward performance</td>
<td>• Automate transactions down and upstream the supply chain (EDI)</td>
<td>• Allow international sites to exchange best practices &amp; knowledge</td>
</tr>
</tbody>
</table>

Figure 4–3: The Strategy Map for 2012-2014 at “A Limited”

The CEO, who is responsible for rolling out the strategy and split the actions among all affected by the changes, was aware of the following facts:

- Achieving the objectives related to Operational Excellence is not a concern. The implementation would take between 8 and 12 months to be near completion and the

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\(^{38}\) The Strategy Map, Balanced Scorecard and Action Plans framework are suggested by (Kaplan and Norton, 2004)
results would already be visible in the fiscal year 2013. Each site has enough autonomy and resources to take ownership for the objectives, implement actions and deliver results. From the HQ-level, a team of operations experts and project managers will define standards to be rolled out in each site in parallel. As it is the company policy to use the same OEMs (vendors) for the production lines, automation and Human-machine interface (HMI) systems across the sites, the remote assistance from the HQ will be greatly facilitated.

- On the IT infrastructure, the CEO envisions the expansion of the current ERP to allow extensive use of EDI and incentivise the suppliers and distributors/retailers to issue and receive purchase orders and invoices electronically. Due to tougher regulations, tracking & tracing functionality will be implemented to make recalls more agile reducing fines and liabilities related to faulty products. A Manufacturing Operations Management (MOM) software will be deployed to manage the aforementioned functionality as well as a dashboard to allow for realtime monitoring on key performance indicators (KPI) by management. These software solutions will be deployed in a phased approach to minimize risk of disruption in the normal activities of the company.

- The Human Resources (HR) at HQ will work with each site’s HR to improve teamwork, promote more team building activities, community work and promote brands through events sponsorship and samples distribution.

- The CEO will create a CSR team, responsible to support the sites in managing waste reduction efforts, to use alternative sources of energy and to investigate ways to support improving the life of poor families in the communities where the sites are located.

The CEO estimates that the aforementioned initiatives will be ready and showing positive results within 12 to 18 months. They are mostly improvements and extensions of existing policies, standards and systems already in place. However, there is one crucial point to the fulfillment of the business strategy which has not being addressed yet: the planning, development and launch of healthy snacks. The same applies to the business strategy regarding healthy beverages. His concern is founded. The entire organization will be busy implementing the changes mentioned above, which are by themselves a challenge. The production facilities are operating near the limit with the existing products. Because the new proposed line of products will also be allergens-free, simply expanding existing facilities would require extensive work on top of the already planned. Most importantly, the organization has no internal expertise in developing such products. Hiring competent personnel and building new facilities would take a considerable amount of time. Even more concerning would be to develop a new line of products, establish links to suppliers and retailers, and one crucial point to be studied: should the new line of products be launched under a new brand or the existing ones? There is the need to find out whether the customers link the current brands with “unhealthy snacks”, which would ultimately cause the new product line to fail. Reaping the benefits of such high initial investments and risky endeavour within the campaign timeline seems very unlikely.
<table>
<thead>
<tr>
<th>Financial Perspective</th>
<th>Balanced Scorecards</th>
<th>Action Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012-2014 Objectives</td>
<td>Measures</td>
<td>Targets</td>
</tr>
<tr>
<td>• Consistently achieve returns to shareholders in excess of the WACC</td>
<td>• Market capitalization</td>
<td>≥ 9% annum</td>
</tr>
<tr>
<td>• Introduce new sources of revenue (new products?)</td>
<td>• ROIC</td>
<td>≥ 8% annum</td>
</tr>
<tr>
<td>• Maximize overall assets effectiveness</td>
<td>• Market share increase</td>
<td>≥ 2.5% annum</td>
</tr>
<tr>
<td>• Increase market share</td>
<td>• WACC</td>
<td>≤ 7%</td>
</tr>
<tr>
<td>• Overall cost leadership</td>
<td>• Revenue increase</td>
<td>≤ 3% annum</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Customer Perspective</th>
<th>Internal Perspective</th>
<th>People &amp; Knowledge Perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>What we need to deliver to our shareholders</td>
<td>What processes we must excel at</td>
<td>How we must develop our Organization</td>
</tr>
<tr>
<td>• Release “limited editions” &amp; seasonal tastes</td>
<td>• Changeover time reduction</td>
<td>• Promote teamwork</td>
</tr>
<tr>
<td>• Use marketing strategies (co-op &amp; ingredient branding) to build brand equity</td>
<td>• OEE</td>
<td>• Train employees on continuous improvement, quality excellence</td>
</tr>
<tr>
<td>• Make convenient size portions</td>
<td>• Waste reduction</td>
<td>• Educate about cross-contamination, allergens</td>
</tr>
<tr>
<td>• Resalable packages</td>
<td>• Higher brand awareness</td>
<td>• Invest in IT systems, ESI, and dashboards</td>
</tr>
<tr>
<td>• # of “limited edition” and new seasonal tastes</td>
<td>• Reduction in trans-fat</td>
<td>• IT system uptime/year</td>
</tr>
<tr>
<td>• # of alliances with strong co/ingredient branding companies</td>
<td>• Transition to bio-degradable packaging</td>
<td>• Green belts per site</td>
</tr>
<tr>
<td>• % of repeated purchase</td>
<td>• Health products as % of portfolio (increase)</td>
<td>• PMP per site</td>
</tr>
<tr>
<td>• # of complaints (per 1000 units sold)</td>
<td>• ≥ 15% annum</td>
<td>• New patents per year</td>
</tr>
<tr>
<td></td>
<td>• ≥ 45% annum</td>
<td>• Amount of electronic purchase orders and invoices from total</td>
</tr>
<tr>
<td></td>
<td>• ≥ 20% annum</td>
<td>• Team building exercises</td>
</tr>
<tr>
<td></td>
<td>• ≥ 75%</td>
<td>• Community events</td>
</tr>
<tr>
<td></td>
<td>• ≥ 25% annum</td>
<td>≥ 99%</td>
</tr>
<tr>
<td></td>
<td>• ≥ 30% annum</td>
<td>&gt; 5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>≥ 50</td>
</tr>
<tr>
<td></td>
<td></td>
<td>≥ 80%</td>
</tr>
</tbody>
</table>

The CEO scheduled a meeting with the Board of Directors to discuss possible approaches to the challenge. Referring to Figure 2–2, the CEO presented his pledge that there are a few ways to introduce the new line of healthy products, however time was the most pressing issue. The usual organic, in-house strategy would not work in this case. The CEO put on the table the suggestion to either go on a joint-venture with a credible competitor (coopetition) or acquire a good company and operate it as a wholly-owned subsidiary. A merger would not be advisable as it would distract the entire organization, already “drowning” in many challenges for a quick turnaround. A Joint Venture could let us co-develop new products with a company already in the healthy-foods business and use their production facilities. Of course this could be a way to evaluate how interesting the company is for possibly acquiring it in the future. The second option would be to acquire a reputable company up-front, and operate it as-is, at least in the short run, until “A”’s management decide how successful the model is, the best approach to marketing (which brand to use?) etc. The Board showed interest in considering the proposed approaches.

4.1.4. Implementing the Strategy through the Acquisition of “B” Ltd

“A”’s management came across a really interesting company in São Paulo, Brazil, called “B” Ltd. Brazil is seen as a promising land of opportunities by many advanced economies. It has surely grown out of its shadow to occupy the centre of attentions in the corporate world. “A”’s management had intentions to enter the Latin American market to help
achieve its growth targets set in its strategy. With the raise in income of many Brazilians, expenditure with food & beverages has been increasing enormously, in excess of 10% annum in some segments compared to the slow growth seen in mature markets such as Canada and Western Europe.

Besides, “B” is a small-size family business which manufactures healthy snacks. The founder, Mr. Akamoto, is a Japanese immigrant who escaped to Brazil during the 2nd World War and opened his business in São Paulo. Today, Mr. Akamoto is 80 years old and has sadly witnessed a family feud around who will inherit the business, which has annual revenue of 100 million dollars. Mr. Akamoto is proud of his achievement and he does not want to see it fall on incompetent hands. Therefore he is looking for a reputable company to acquire his business and continue the brand.

“A”’s management, upon hearing the found opportunity, got together in an emergency meeting to decide whether to acquire the business or not. It would help the company “kill two birds with one stone”: penetrating the Brazilian market and acquire the healthy snacks business along with its knowledge in the field. It has potential to be become a great business opportunity.

“A”’s management flew to São Paulo to meet with Mr. Akamoto, who hired an advisory company to represent him in the possible transaction. Mr. Akamoto takes “A”’s management for a tour in the manufacturing complex.

“A”’s management is very excited with the opportunity. “A”’s CEO wants to proceed with the due-diligence, valuation, prepare for the formal change of control and integrating “B” to operate as “A”’s subsidiary. The CEO came to the conclusion that a Project Management methodology especially designed to conduct the acquisition is needed. So, “A”’s CEO asked the PMO to work on such methodology as it may not be the last time “A”’s goes through a merger or acquisition.
5. Project Management Methodology Enabling Successful M&A

It has been stated earlier in this work that because a merger or acquisition process is unique (no two transactions are ever identical), time-bounded, phase-driven and depends on human capital expertise to deal with a multi-disciplinary transaction\(^{39}\), then this process can be considered a project. As it could be seen, the PMI framework is generic enough to be applied in virtually any business area with the objective of increasing the likelihood of carrying out projects successfully. Nevertheless, M&A, as any other area, has its particularities requiring a tailor-made framework/methodology if the success rate of M&A transactions are to be maximized.

This chapter intends to present a practical methodology to conduct M&A undertakings. The methodology presented here is built upon the knowledge described in previous chapters including some specifics not yet introduced in the literature review as this can be better introduced in a contextualized matter.

In section 2.2.1 the concept and definitions of framework and methodology was explored. In order to set the right expectations about this work, the intended objective is to propose a methodology based on the extension of the framework provided by the PMI and introducing the structure of how to conduct M&A projects based on stages/phases and their temporal and functional relationships. Due to time limitations and the intention to develop a generic approach to M&A projects, templates, forms and other project aids will not be developed.

5.1. Defining the Structure of M&A Projects\(^{40}\)

One of the propositions of this work is considering an M&A transaction as multi-phased, carried out through one or more projects and possibly under a Program. Figure 5–1 presents six stages containing the 9 main activities, starting at the strategic decision & project definition through to the state in which business continues after the normally turbulent integration period. The 9 main activities each comprise a set of tasks needed to successfully conduct a merger or acquisition. It is important to bear in mind that the 9 main activities are associated to best-practices identified by M&A experts. Some projects may not need all of them.

The steps presented below are generic enough to be applicable to most M&A projects, where unnecessary steps can be bypassed or adjusted to fulfill specific needs and requirements.

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\(^{39}\) The term “transaction” refers to the full extent of the merger or acquisition operation, from the time the need of a merger or acquisition is acknowledged in the corporate strategic plan to the time the “deal” is finished. As it will be further explained later, the “deal” is not simply the act of both parties signing the papers agreeing on the merger or acquisition, it is much further down the process. Signing the papers is a mere formality. An M&A “deal” normally fails after the papers are signed... More details will follow.

\(^{40}\) Project in this context can also mean program.
The 9 main activities are then sectioned into 6 stages:

- **Stage 1 – Strategic Planning & Decision Making:** This phase takes place at the Management Board, Portfolio and Program Management levels. Decisions such as to merge, acquire or go on a Joint Venture with the target company is normally made in this phase, but refined after suitable targets are found. Based on the company or sector strategic plans, a project or program is launched under a portfolio, which will implement a portion of the Action Plan related to the merger or acquisition. The case study presented in chapter 4 illustrates what happens in this stage.

- **Stage 2 – Search & Screen Target Companies:** Based on the project/program charter, a project team will be responsible for screening the market in the selected geography and sector looking for suitable target companies. The ones which are considered of interest will be further scrutinized before any contact to the company is made. Such steps are first undertaken with in-house staff as secrecy at this stage is of utmost importance. Leaked information can lead to inside-trading, affect the target company value, and possibly even lawsuits.

- **Stage 3 – Go-no-Go Decision:** This phase involves 2 main activities: approach the company to show interest in a possible deal and further due-diligence to check whether the company has pending lawsuits and to support a more accurate valuation. The same way a company may show interest in the transaction, they can also decline the deal. Then the acquiring company has to decide the next steps – hostile takeover or walk away and try the next target.

- **Stage 4 – Pre-CoC & Integration Planning:** Once the company either accepts the takeover or is subdued in a hostile manner, the integration process needs to be planned before the papers are signed. Why before and not after the formal takeover or merger agreement? The planning process is critical and much lengthier than the usually short Change of Control (CoC) event. Some call it the “Change of Control Weekend”, as an indication that this step is indeed short.

- **Stage 5 – Deal Formalization (CoC):** Both parties sit down to sign the paperwork, which has already been printed and negotiated. This is by far the shortest step (NOT to be understood the easiest or least important step though).

- **Stage 6 – Integration Execution:** Once the formalization is done, it is a race against time to integrate both companies to keep costs down, resume normal business as soon as possible to realize the promised synergies and curb the risks of a failed integration.
Each stage encompasses one or more activities and the stages can overlap as in Figure 5–2. The overlap and length in time shown are just illustrative, as they may vary significantly depending on their complexity and preparation work required.

It is worth mentioning that the approach adopted in this work differs from the ones suggested by other authors consulted in the literature, such as (DePamphilis, 2011) and (McGrath, 2011). It reflects the author’s opinion and rational analysis yet utilizing the experience and advices provided by experts in the area as the aforementioned ones.

**Figure 5–2: Temporal representation of the 6 stages and their implementation through 4 projects phases**

### 5.2. Portfolio, Program, Project, Phases: Which to Use?

In Figure 5–2 the terms “Program”, “Project” and “Phase” appear and may cause confusion. The decision of the structure to be adopted should come from the Portfolio level. When Management decides to pursue a merger or acquisition, the magnitude and nature of the transaction will suggest the structure required to support the implementation of the strategy. In simple deals, such as a domestic company (e.g. a local supermarket) willing to acquire another company (e.g. an existing supermarket in another city) as an expansion plan, a project structure may be more than enough. The project would involve phases 1 through 4 under one project manager and small teams of one or more people. In complex deals, when a multinational intends to acquire or merge with another large-scale company (e.g. Daimler Benz and Chrysler) operating in different countries, the use of a program to coordinate projects tends to be a safer arrangement. A program manager would support the project managers in executing each stage, while managing complexity and risk by coordinating the projects and sharing resources to complete the transaction successfully. The use of a program manager and multiple project managers can significantly increase the costs and management complexity associated to the transaction. However, the extra costs and management efforts may be greatly offset by the increased likelihood of success through increased control and visibility.
In this work, the use of project-phased structure will be adopted for being simpler and yet sufficient for most needs, besides being the building block to more sophisticated program-based approaches needed for complex transactions. The division of stages in phases as in Figure 5–2 is justified by the expertise areas and skills needed, and the relative interdependence among the activities. For instance, the search process must be followed by the early due-diligence to narrow down the possible targets and identify the most promising ones.

5.3. The Role of PMO in M&A Projects

In section 2.2.4 a comprehensive discussion about the different competences, structures and mandates a PMO can fulfill within a company was given. Companies which business depends on project execution excellence would almost certainly have a PMO already implemented. A simple example is an infra-structure construction company, such as SNC-Lavalin. However, the fact that SNC-Lavalin’s PMO is not prepared to conduct an M&A project is perfectly expected, as this is neither their core business nor they deal frequently with a merger or acquisition to justify the costs involved in having the PMO ready for such risky projects. Investment banks and consulting firms may have their own PMO in-house especially setup for M&A projects. Therefore, the message is that the presence of a PMO does not mean a company can run an M&A project. There is the need to have in-house experts in the knowledge areas required for such projects. There are companies such as Siemens Management Consulting, which supports many of the acquisitions Siemens does worldwide. Siemens has already a mature PMO, which has been equipped to support M&A projects besides the construction, IT and other types of projects run by the company worldwide. Given the size of the organization and the number of acquisitions executed each year, the running costs of having in-house M&A experts and processes are much less than hiring external advisors and consultants for such transactions.

5.4. The Proposed M&A Project Management Framework

Figure 5–3 represents the proposed M&A Project Management (PM) Framework, one of the main contributions of this work. The proposed framework is built on the existing PMI framework, adding the areas which are critical to a successful M&A project Management. The three process groups remain the same as proposed by the PMI:

- **Core Functions**: the basic processes and knowledge areas in a project, more technical-oriented;
- **Support Functions**: processes and knowledge areas with strategic importance to the project, involving more soft-skills and managerial experience;
- **Integration and Coordination Functions**: integrative processes which “glue” together the outcomes from core and strategic processes allowing the coordinated delivery of the project.
For the new M&A PM Framework, 6 new knowledge areas and corresponding processes were added:

- **Marketing Management**: It is a strategic knowledge area covering aspects related to branding and how to deal with the customer’s brand perception and brand loyalty after a merger or acquisition: should the new company bear the acquirer’s brand, the target’s brand, both, or create a new name and new logo?

- **Legal Aspects Management**: a core area mandatory to any M&A project. It deals with the regulatory aspects related to M&A, which changes for each country in several facets, for example how strict and bureaucratic they are.

- **Budgeting Management**: A strategic role involved in determining the size of transaction the acquirer can afford without jeopardizing its viability.

- **Valuation Management**: Involves managing the processes involved in the appraisal of the target company in the (early) due diligence stage(s). Valuation will determine whether the target company fits the budget defined for the acquisition.

- **Financing Management**: After valuing the deal and coming to an agreement with the target company, the next step is finding the cheapest ways to raise capital without jeopardizing the future of the company with excessive leverage.

- **M&A Tactics Management**: In the negotiation step, the project leaders must be prepared to deal with surprises along the way. M&A is quite notorious for a series of tactics used by both acquirer and target companies in the negotiation: friendly and hostile approaches used by the acquirer and takeover defenses used by the target to fend off hostile takeovers.

The six extra knowledge areas are added to the existing PMI framework. Besides, the Integration and Coordination Functions also need some increased focus on the Issues and Dependencies Management Functions. Such functions are vital to the success of the project, but unfortunately they are not explicitly discussed in the PMBOK.

![Figure 5–3: The M&A Project Management Framework](image)

Table 5-1 complements Table 2-8 adding the proposed knowledge areas to the original PMI framework. Both tables should be used together. Particularities and the meaning of
each knowledge area for M&A will be described in the following sections. The intention of this section is not to repeat what is already stated in the PMBOK. Instead, the particularities of each knowledge area specifically for M&A projects will be mentioned. This also fulfills the aim of this work of providing complete and relevant information for M&A project practitioners. Therefore, it is a complement to the PMBOK and not a substitute.

<table>
<thead>
<tr>
<th>Knowledge Areas</th>
<th>Project Management Process Groups</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Initiating</td>
</tr>
<tr>
<td>Legal Aspect Management</td>
<td>Identify market for M&amp;A; investigate respective legal framework</td>
</tr>
<tr>
<td></td>
<td>Planning</td>
</tr>
<tr>
<td>Marketing Management</td>
<td>Devise marketing plan (branding management)</td>
</tr>
<tr>
<td>Budgeting Management</td>
<td>Define range of target values for target company; Run simulations to determine effects of budget in company’s financing health;</td>
</tr>
<tr>
<td>Valuation Management</td>
<td>Select valuation methods to be used under different conditions and phases; Plan for synergies valuation; Plan for valuation of different assets (tangible &amp; intangible)</td>
</tr>
<tr>
<td>Financing Management</td>
<td>Plan for instruments to raise the budgeted capital; plan to deal with lenders and investors; plan for acceptable concessions during negotiations</td>
</tr>
<tr>
<td></td>
<td>Executing</td>
</tr>
<tr>
<td></td>
<td>Deal with legal requirements and resolve issues; collect approvals</td>
</tr>
<tr>
<td></td>
<td>Monitoring &amp; Controlling</td>
</tr>
<tr>
<td></td>
<td>Monitor resolution of legal issues</td>
</tr>
<tr>
<td></td>
<td>Closing</td>
</tr>
<tr>
<td></td>
<td>Document the results</td>
</tr>
<tr>
<td></td>
<td>Execute marketing plan</td>
</tr>
<tr>
<td></td>
<td>Monitor progress and feedback from market studies to revise plan if required</td>
</tr>
<tr>
<td></td>
<td>Apply marketing changes</td>
</tr>
<tr>
<td></td>
<td>Compare with valuations and act on</td>
</tr>
<tr>
<td></td>
<td>Revise plan in the event of changes in conditions;</td>
</tr>
<tr>
<td></td>
<td>Document results</td>
</tr>
<tr>
<td></td>
<td>Run valuation methods for early diligence; Run valuation for final firm appraisal; Value synergies; Appraise for other value drivers</td>
</tr>
<tr>
<td></td>
<td>Compare valuation with market values, past transactions and reliable references; Compare with budget;</td>
</tr>
<tr>
<td></td>
<td>Document the entire process</td>
</tr>
<tr>
<td></td>
<td>Collect funds, paperwork and document all</td>
</tr>
</tbody>
</table>
### M&A Tactics Management

| M&A Tactics Management | Define actions plan for the different scenarios; Define the attack tactics to be adopted in each scenario; Define reactions to defenses from target (continue, change tactics or walk away) | Execute action plan; Implement attacks according to plan; React to target’s defenses as planned Decide which reactions to the defenses and implement them | Revise plan for unforeseen scenarios Measure the efficacy of tactics and results Manage expectations and media coverage Monitor risks of each attack/defense | Document the entire process in case of litigation |

### Integrated Change Management

| Integrated Change Management | Plan change management model | Log requested changes Analyse changes Implement approved changes | Monitor and control Changes | Archive changes |

### Issues Management

| Issues Management | Plan issues management model | Identify issues Resolve issues | Monitor issues resolution | Archive issues |

### Dependency Management

| Dependency Management | Map dependencies | Enforce dependency integrity | Monitor and control dependencies integrity | Document process |

**Table 5-1: Process groups and knowledge areas in the new M&A framework**

## 5.5. Core Functions (Basic Diligence)

Core functions are the base supporting a project: scope, cost, time and quality management. Another three extra areas were added to the core functions to better suit the handling of M&A projects: Legal aspect, Finance and Valuation management. As M&A transactions are very dependent on laws and regulations of each specific country the transaction touches, expertise and careful planning in the area is needed. Regardless whether the costs, scope, time and quality are outstanding, if the securities regulator or Court raises an injunction, the project is put on hold and may not ever be completed. So, it is a knowledge area which deserves attention and diligent planning. Finances Management deal with the way the transaction is to be financed after the target company has been valuated using one or more of the valuation methods described in section 2.1.4.

### 5.5.1. Scope Management

The project scope management processes deal with the work required to fulfill the project objectives. The **Project Charter** provides high-level requirements and scope information on the project level. The requirements state what the customer (i.e. the management) wants, taking into account the constraints (e.g. budget) and the goals and targets which must be met for the project to be considered successful. The detailed **requirements, scope** and **activities** are set for each phase individually. As it is proposed in this work, the phased
Development of a Project Management Methodology for Supporting M&A

approach is milestone-driven and the project does not progress unless dependencies and goals are met.

Scope management entails three main components: requirements, scope and activities as stated in the original PMI framework:

- Project requirements are collected, a requirements management plan is set and a traceability matrix is used to track the progress in the fulfillment of each requirement in the respective phase. For example, before screening for the target company, the requirements related to the company business line, industry, price range etc. are used to filter down targets with the required characteristics. In the go-no-go phase, information such as acceptable EBITDA multiplier for the final price, maximum leverage to commit to the purchase etc.

- A project scope management plan will outline the deliverables of each phase, detailing the acceptance criteria for each one, along with explicit inclusions, exclusions and assumptions. Scope Control procedures are relevant to avoid scope creep.

- The Work Breakdown Structure (WBS) converts the scope specification into work packages, each containing one or more activities. Activities are atomic items in the project, to which resources, time and costs are associated to.

5.5.2. Time Management

The next step is to estimate how much time and how it will be allocated to complete the project. A schedule is created sequencing all activities, taking into account the dependencies among them, constraints in resources availability and other assumptions.

The activities sequencing is carried out assuming the logical relationships among them and the milestones. The addition of leads or lags can be used to build contingencies and make the schedule more realistic. After that, activities resource estimation is conducted. The required resources are compared with the existing ones and their availability. Unavailable resources need to be procured. Once the resources are accounted for, they can be assigned to the activities and their execution time adjusted accordingly.

The schedule is then developed by setting a start date, finding the critical path with the allocated resources and checking whether the end date is acceptable (this is known as the critical chain method). Schedule management plan should also be devised to deal with changes in resource availability and many other unforeseen factors along the project lifecycle.

5.5.3. Cost Management

Cost management for M&A projects should follow standard procedures for estimating, budgeting and controlling costs as described in the PMBOK (Project Management Institute, 2008: 165-188). It is important to bear in mind that changes in scope, time, resources, risks and assumptions can easily add up along the project lifecycle.
Companies with ERP systems tend to integrate cost management procedures within the project management module (for example, in SAP PM). This practice facilitates the generation of reports, however reconciliation of work delivered and invoicing may be offset. Sometimes the old excel spreadsheet may be handy.

M&A projects tend to incur fees payment for work realized by investment bankers and consultants, for example, hired to do due diligence, valuation, paperwork and legal clearance for the Change of Control phase. Investment bankers charge a fee once the deal is consummated, and it is normally a percentage of the deal value, such as 2%. So, such costs should be accounted for either as project costs or as part of the Budgeting Management, were funds to cover such fees are borrowed as part of the financing.

It is worth mentioning that Costs Management deals with the costs incurred by the project along its lifecycle. The amount needed to finance the transaction (the price to be paid for the target company) is dealt with separately in the Financing Management function.

5.5.4. Quality Management

Quality in a project is related to how well the deliverables match the requirements they were set to fulfill. In an M&A Project, quality is expressed by:

- How suitable the selected targets are in relation to the requirements;
- Negotiating with the target in a way to secure the overall best price without exploitation;
- How well the due-diligence was run to uncover all facts allowing precise assessment and valuation of the deal;
- Effectiveness in completing the Change of Control and complying to the legal requirements;
- Planning and completing the integration in the least time, costs and disruption to the normal operations of both companies.

5.5.5. Legal Aspect Management

The legal aspect in merger and acquisitions may be the single most complex area in any medium to large deal in the author’s opinion. One of the main reasons is the different legislations and procedures in each country. As most of medium to large deals are international in nature, consulting different governmental bodies and preparing the required documentation and data to each individual authority can pull the brakes in the negotiation and cause the deal to lose momentum.

Mergers and acquisitions are highly regulated economic transactions in most developed economies (McGrath, 2011: 21). And the regulations are complex, mostly due to its reliance on the legal framework found in each country. Conducting cross-border deals mean complying with each and every country’s regulations, which may differ significantly. Besides, the regulatory framework is dynamic, what requires being abreast of changes. Deregulation in the banking systems, such as in US in the late 90’s, led to a wave
Development of a Project Management Methodology for Supporting M&A

of mergers and acquisitions among banks. Despite the advantages of such practices, such as economies of scale and scope and higher risk diversification, many condemn such practice as banks increase excessively in size causing risks to consumers due to monopolistic-type of practices and possibly destabilizing the financial system. The latter was a major factor in the 2008-2009 crises. Organizations become too big to be properly audited encouraging bad practices which lead to catastrophic results, which we still face years after its occurrence. The conclusion is that, even though regulations are a burden to be complied to, they are there to protect all citizens against condemnable practices.

For exemplification purposes, let’s briefly discuss the legal framework applicable to mergers and acquisitions in the European Union, Canada and Brazil. This description is, by no means, exhaustive and is intended to highlight the differences in M&A regulations among countries.

5.5.5.1. European Union (EU) Legal Framework for M&A

Because so many deals occurring across Europe and the need to deal with multiple regulators, incurring significant costs and delays for companies, the European Commission established a two-tier regulatory system. Deals which may cause pan-European impact are approved at the European Commission level. If it is a domestic transaction, only national regulators are involved (McGrath, 2011: 22). The EU regulation, based on the Treaty of Rome (1957) has 2 articles: Article 85 condemns any collusion between enterprises that distort competition, and Article 86 which prevents companies from abuse their dominant position. The EU policy uses the term “concentration” to refer to M&A where the acquirer owns 20% of the target´s shares (i.e. has controlling but not majority interests). The European Commission (EC) has exclusive jurisdiction for approval if the following conditions at met (McGrath, 2011: 26):

- The concentration has community wide reach;
- The combined worldwide turnover of the companies exceeds €5 billion;
- The aggregated EU turnover of at least two firms is €250 million or more;
- Each of the concerned companies achieves more than two-thirds of its total EU turnover within the same EU member state.

Many exceptions still apply as the EC keeps trying to develop a uniform policy for the entire EU, but it keeps bumping into obstacles.

5.5.5.2. The Canadian Legal Framework for M&A

The Canadian Legal Framework follows the Common-Law system, the same used in US. Nevertheless, Canadian and US M&A regulations are not to be thought of as identical. Precedent cases in US are normally not applicable in the Canadian Law. One example is the amount of accumulated securities a company possess of a possible target, called a “toehold”. In US, the company has to notify the SEC (Securities Exchange commission) if it holds more than 5% of the target’s shares, being forced to disclose whether the company has intentions to acquire the target. In Canada this threshold is of 20% (McIntyre et al.,
2011). All ten provinces and 3 territories in Canada have their own securities regulations. So, laws at the provincial and Federal levels apply to M&A transactions. Ontario has the most comprehensive takeover regulatory regime, the Part XX of the Securities Act, administered by the Ontario Securities Commission (OSC) (Armstrong and Graves, 2003). Depending on the nature of the M&A transaction, provincial and Federal level corporate legislations, such as the Competition Act, and stock exchange approvals are required (Braithwaite and Ciardullo, 2004).

5.5.5.3. The Brazilian Legal Framework for M&A

The main authority in M&A anti-trust compliance is Sistema Brasileiro de Defesa a Concorrência (SBDC), composed by (Brazilian Federal Department of Justice, n.d.):

- CADE (Conselho Administrativo de Defesa Econômica), the antitrust court linked to the Federal Department of Justice;
- Secretaria do Direito Econômico (SDE), linked to the Department of Justice;
- Secretaria de Acompanhamento Economico (SEAE), linked to the Ministry of Finance.

The Brazilian Civil Law system is adopted and most of M&A-related regulations are at the Federal level, with a few applicable laws at the provincial level. The complicated tax system may require the support of external experts, especially for foreign companies with no operations in Brazil (Bevins, 2010).

Recent changes in the regulations, power and staff of CADE try to make the system more efficient and reduce opportunistic exploitation of the economy, including mergers and acquisitions. In December 1st 2011 the President Dilma signed a law requiring M&A operations to be submitted for approval before the companies sign the deal. Until then companies could sign the deal first and then ask for approval. If not approved, the companies, which could have been already fully integrated by the time the decision is made by CADE, would have the deal voided. Many could then only with significant efforts undo the integration (Ricardo Martins Bastos and De Marino Oliveira, 2012). A good example is the Garoto’s acquisition by Nestlé in 2002. After signing the deal, Nestle submitted the papers to Cade, which decided to veto the deal in 2004. By then, Nestlé was already operating Garoto, with a chocolate coating market share of 88%. Nestlé was ordered to sell Garoto in 2004. Nestlé appealed of the decision and continues operating Garoto 5 years after being ordered to divest thereof (Basile and Cunha, 2009). The new law aims at discouraging such situations.

Before the new law got enacted, companies had 15 days after the Change of Control to file with CADE, SDE and SEAE, if either company had revenues above R$400 million or 20% market share in Brazil. Each of the aforementioned institutions will give their vote either to approve or deny the transaction with the reasons to do so. With the new law, the submission has to be done before the Change of Control if the acquiring company has revenues above R$400 million and the target R$30 million or more. The market share condition was abolished due to the difficulty in estimating such figure. Failing to comply
Development of a Project Management Methodology for Supporting M&A

may subject the parties to fines from R$60,000 to R$60 million and a voided deal. CADE had up to 330 days to judge the case, after which the deal would be automatically approved. With the new law, the latter no longer applies and deals may be on ice for months, if not years.

5.5.6. Financing Management

The capital markets are quite creative in devising financial instruments. Needless to say, many of such instruments are used to finance M&A transactions. The objective here is not to explore all of them, but just to mention some of the most common and when they are used. Most of this section is based on (DePamphilis, 2011: 195-213).

One of the first steps before deciding how to find the transaction is to put together a balance sheets, income and cash flow projections of the combined company. This is an extremely valuable tool to:

- Convince investors and lenders that the future organization will yield more value than having them running separately, as well as worthwhile to investors in terms of returns and safe to lenders to in terms of honouring debts;
- Estimate the future capital structure of the combined company, whether it is acceptable, as well as the risks and rewards of such structure on the company;
- Calculate whether the future performance of the combined business yields a return on investment higher than other options, and what can be done to improve it.

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Table 5-2: The different ways of financing an M&A transaction

Retained earnings should be the first choice for the few companies with cash and equivalents available to be put to work to the company. Apple has been making acquisitions of promising small companies with technologies and patents which can be sued in their flagship products (smartphones and tablets). And all acquisitions are in cash. This way the company is not restrained in any way by affirmative and negative covenants or other onerous conditions imposed by investors and lenders.

Another option is to free up funds by divesting of non-strategic assets. As mentioned before, Siemens AG sold their tier 1 automotive parts supplier to Continental AG at the
height of the business cycle just before the signs of the 2008-2009 crisis appeared. The funds allowed Siemens to acquire UGS to complement the Industrial Software division portfolio, more strategically aligned with Siemens and its “Digital Factory” concept.

Equity would be the next advisable financing option. Issuing more shares to raise cash is a double edged sword. At the same time that the funds belongs to the company and to the shareholders, the cost of capital required to attract new shareholders is frequently higher than the one required by lenders (debt) and it dilutes the ownership of current shareholders. So, issuing more shares is worthwhile if the proposed merger or acquisition has a return above the cost of capital. Besides, no profit is shielded from taxes. Some companies, such as Google, have different share classes to avoid diluting voting rights as well. Google owners issued new common shares to raise capital with no voting rights, so management is free from having their decisions challenged by shareholders. Preferred shares normally behave similar to common shares, except that they are senior (have priority) over common shares in case the company liquidation.

When the seller is interested in closing the deal with the current buyer and latter is short of cash, the seller may finance a portion of the transaction, accepting deferred payment as cash flow or other financing options arise. This schema also shifts the risk to the seller in case of default, so that the debt is backed by assets.

Alternative sources of equity are venture capitalists, angel investors, hedge funds, private equity investors, pension funds, investment banks, among others. These sources of funding tend to either impose excessive returns (VC) or demand control or at least influence management.

Debt is the most common way to raise funds for the transaction. It is important to understand the terminology used for the different financial instruments:

- **Secured**: the debt is collateralized by assets. In case of default, the lender has claims on the assets, such as machines, facilities, real estate, accounts receivable and inventory. Which assets are used as collaterals is defined in the security agreement.
  
- **Senior/Junior**: a debt is senior when it has priority in payment in case of default or liquidation of the company. The most junior debt is the common shareholders.

- **Subordinated**: the debt is subordinated to another one when it is junior to the latter.

Unsecured debt has higher costs (rate of return) demanded by investors or lenders due to the increased risk of default. Mezzanine financing is the typical type of unsecured debt, including junk bonds.

Debentures are considered hybrid as the debt can be converted to common shares (equity) if not paid. Debentures are unsecured as no lien is placed against assets, but it is secured by equity, although it is the most junior among all debts as explained before.

5.5.7. Valuation Management

Valuation is becoming more of an art than a science. In the knowledge based economy, most of the company value comes from intangible assets. Therefore there is the need to
understand the value drivers and how they influence the valuation. There two main types of value drivers: financial and operational. Financial value drivers provide information based on the past financial performance of the company, whereas the operational provide insights in the future success of the company (Frykman and Tolleryd, 2010: 102-103).

Contrary to what many may think, what matters in the valuation of a company is the future performance. So, to “predict” the future the valuator needs to consider the factors which affect this performance, such as intellectual capital, patents and management’s calibre. Past data is history, which can only help seeing how the company has been doing, but not support alone how it will perform in the future.

There are 3 important principles to take into consideration when applying valuation:

- **Valuations are subjective**: depending on the inputs given to a chosen model, including the experience level and opinion fed as inputs;

- **Different parties have different motivations**: the target’s Board has the fiduciary duty to sell for the maximum and the acquirer wants a bargain. So, it boils down to negotiation.

- **The arguments and assumptions used in the valuation are critical**: inputs can be manipulated to yield a desired result. So, be prepared to justify and properly document the choices made in valuing the company.

There are several methods to estimate the worth of a company, some of them were presented in section 2.1.4. As any algorithm, the quality of the output will rely on the quality of the inputs. Therefore, a thorough underlying analysis based on the relevant value drivers will both deliver a fair valuation and support justifying the value you arrived at (Frykman and Tolleryd, 2010: 115).

The Discounted Cash Flow method requires the estimation of free cash flows for the explicit, hyper-growth and terminal periods. Arriving to reliable figures is a challenge. There is the need to quantify the impact of internal and external value drivers and the strategy used to capitalize on both. Looking at the strategy map for “A”, Figure 4–3, the value drivers in each perspective should be valued:

- **Human Capital**: the talents in the company who add value in R&D, marketing & sales, operations, and how the company manage and incentivize them to extract even more value. It also includes managerial talents.

- **Information Capital**: infrastructure in IT to manage knowledge, patents and the creation thereof, capturing them to retain within the company even after the employees leave;

- **Organizational Capital**: the culture, values and the policies that make employees feel good about working in the company (empowerment, enrichment, be part of decisions);

- **Processes the company excel at**: operations, innovation capability, corporate social responsibility, etc.;

- **The customer value proposition**: how the company responds to the customer’s needs, producing what customers want to have;
• **How management intends to grow the company (financial perspective):** capital structure, type of strategy (cost leadership, customer solutions, product leadership), etc.

What other factors that should be considered:

• **Brand strength, recognition and reputation in the market;**

• **The products and services the company offer and their degree of maturity and differentiation:** Using the BCG matrix, for example, the acquirer can determine which to keep (cash cow and star products/services) to generate cash flows and the ones to divest off (question mark and dogs) to help pay off the debts;

• **Industry structure in the market:** the use of Porter 5 forces analysis can help determining how interesting the market is for the company. For example, entry barriers to open a new business or subsidiary in Brazil are very high, besides the exorbitant taxes on imports if the products are not produced in the country. This factor alone has a great weight in justifying acquiring an existing business for the local market. Rating the competitors, the growth rates of similar businesses, the industry rivalry through the degree of consolidation, etc.

• **Macroeconomic factors:** which affect the ability of doing business in the country, such as credit availability, inflation, infrastructures (roads, rail), GDP growth, taxes, interest rates, exchange rate, governmental subsidies, etc.

All of the aforementioned factors need to be evaluated and taken into account when feeding information into the model (calculating the WACC, growth rate, profit margins and how it should behave into the future).

However, the value drivers and other factors to be taken into account in the valuation should be chosen according to the intentions the buyer has for the acquired company. If the purpose of the acquisition is to invest for future growth, which is commonly the reason for management buyouts and mutual/hedge funds, then all the above factors are important. If the purpose is to have access to a promising technology, patent or knowledge, what is typical for pharmaceutical companies to fill up their drugs development pipeline and acquire customers, then the valuation should focus on the determining the value of such assets and any other value generation item (synergies, R&D capabilities), and value the remaining items towards what they could fetch by selling them in the open market. If the balance between the overall valuation and what the seller is asking is positive, then the acquisition has a positive NPV and should be undertaken.

### 5.6. Support Functions (Strategic Diligence)

Three new knowledge areas were added to the PMI framework to support M&A projects: Marketing, Budgeting and M&A Tactics Management. Following the same approach as to the Core Functions, the existing knowledge areas will be explored only to highlight particularities to M&A projects, which are not dealt with (or only superficially) in the PMBOK.
5.6.1. Human Resources Management

The project human resource planning and building is composed of four main steps as proposed in the PMBOK:

- **Develop human resource plan**: the project manager should document the roles and responsibilities associated with the required skills to successfully fulfil them, reporting lines and a basic management plan suitable for managing internal and external resources.

- **Acquire resources**: Locate and acquire resources with the required skills and availability to fill the roles in each project phase. The project manager may need to go to investment banks and M&A consulting firms to find critical resources.

- **Develop resources**: Even experts may need focused support in some areas as no transaction is ever the same. Team building and environment is also part of the process.

- **Manage resources**: Devise a plan to deal with team members departing and joining the group, facilitate interactions and information exchange, resolve issues and manage changes.

When it comes to human resource acquisition, external resources may need to be temporarily hired from consulting companies and investment banks, most likely in the go-no-go and integration planning and execution phases. As part of the acquisition the overall costs should be compared with the budget to check for the need to request fund increase early on. Another factor to be considered is the viability of using virtual team members to have access to key internal resources over the internet.

5.6.2. Communication Management

Communication is directly related to the outcome of stakeholder analysis and how they are classified in terms of interest and power as described in section 5.7.2. Communication plans are then devised to fulfill the needs of each group of stakeholders, so as to gain and retain their support and trust along the project lifecycle. The communication plan will include the venues or means to deliver the content of the communication: email, intranet, meetings, etc. Automating the communication processes with help of an intranet site and document repository can increase the communication efficiency and timeliness (as discussed in section 2.2.3.4), besides releasing the project manager from time-consuming tasks such as versioning and controlling access.

Communication planning should cover the requirements for two very distinct phases: **pre-deal** and **post-deal announcement**. Pre-deal communication is normally kept within the project boundaries, being of two main streams: pertaining project manager and top management (confidential information related to strategic decisions) and between project manager and project team members (communication needed for the project activities). A much more complex and sensitive task is planning and implementing a communication plan for announcing the deal to all affected parties: employees and shareholders of the
acquirer and target companies, customers, suppliers, the media (which will convey a message to competitors) and the communities where the companies are located and whose survival may depend upon. The communication has to be absolutely tailored to each target group, addressing their concerns, questions and doubts. For internal employees of both companies, the information should address their fears of layoffs, changes in roles, locations, structures and how they will be affected. This is very important in the efforts to reduce the turnover and losing important talents and resources, which are part of the value to be paid for the target company. The suppliers and customers need to be assured they will benefit from the process and not suffer from the change in ownership. The communication vehicles should be appropriate to each group. As mentioned, using intranet, assigning an HR person to answer questions to employees and a public relations (PR) company to help in crafting a flawless message to the public at large are ways to cover the post-deal communication task.

In hostile takeovers, two types of communication services could be procured to help in the task. Public relations firms are used to deliver a very convincing message to the target company’s shareholders that the takeover will generate more value to them than the current management in power, so that to facilitate putting pressure on the Board of Directors. Proxy solicitors would track down the target company’s shareholders to purchase their shares in an attempt to gain control over the company.

5.6.3. Risk Management

One of the reasons for adopting a project management methodology to conduct a merger or acquisition is to reduce risk. An organization going through an M&A is being forced to operate at a different rhythm, outside its comfort zone for some time. Being in business in the same industry for some time creates awareness of the risks involved, which become known through “lessons learned”, industry best practices and theoretical knowledge. When the company faces a new situation, such as being involved in a merger or acquisition, the company is operating in unchartered territory.

A research made by A.T. Kearney suggested the failure rates in the different phases in M&A are (McGrath, 2011: 85):

- Strategy development, screen target, due diligence: 30%
- Negotiation and closing deal (CoC): 17%
- Integration: 53%

Why most failures happen in the integration phase? It is fairly intuitive to see that most unknowns are faced in the integration phase. Once the papers are signed, there is no way back, unless the company wants to bear huge losses: stakeholder’s loss of trust in the company’s management, loss in market capitalization and loss in confidence for pulling through a next attempt.

As for any project, risk management should be done in a systematic way. The PMBOK (Project Management Institute, 2008: 273-311) presents a 6-processes framework, which
will be used as a reference with inputs from other M&A specific sources and this work’s author input.

It is worth mentioned that the main objectives of conducting risk management are:

- Identifying the major risks this specific project may face, rated according to their likelihood of happening (probability of occurrence) and impacts to the different knowledge areas, qualitative and quantitatively;
- Devise ways to mitigate such risks as much as possible and make the team ready to respond in case they materialize.
- Understand the team risk behaviour, which is the behaviour exhibited when making decisions under conditions of uncertainty. The risk behaviour is influenced by the risk propensity (the desire to seek or avoid risks) and risk perception (judgement of the riskiness of a risk) (Sitkin and Pablo, 1992).

One of the first steps is planning risk management. It is important to define the infrastructure to be used for this purpose. By infra-structure it is meant selecting those involved in the process, their roles and responsibilities, the tools to be used (spreadsheets, database, etc.), methodologies for risk identification, risk management lifecycle to deal with new risks which are identified along the project, among others.

Next, the selection of a risk identification methodology is crucial. (McGrath, 2011: 85) suggested a method called Cognitive Risk Identification and Measurement (CRIM), which has been extensively tested in the industry.

The expert panel should be formed by internal and external resources. External consultants, even though they may have a great deal of experience in M&A, they are not familiar with the company’s unique circumstances, business processes, environmental factors and risk behaviour. Documentation includes records from past projects, process
assets and others, such as internal business process knowledge base. As part of the
documentation, inputs from scope, costs, time, stakeholders and communication plans are
of indispensable. Industry best practice can be sourced from specialized consulting
companies and business research (ARC, HBR). The use of the CRIM framework is
described in great details in (McGrath, 2011: 80-105).

Outputs of the CRIM which will be used along the project are:

- **Risk Breakdown Structure**: similar to a work breakdown structure, where all risks
related to technology, knowledge/expertise, organizational and project management
are categorized.
- **Define impact** of each risk to the project objectives, cost, time, scope and quality.
- **Rate probability of occurrence** of each risk.
- **Make a qualitative analysis** based on impact and probability to filter the ones which
pose the biggest threats to the project.
- **Make a quantitative analysis** of the high priority risks of their impact on the project,
for example in financial terms using tools such as decision tree.
- **Devise strategies to respond to risks**, such as ways to avoid risks with high impact,
transfer risks to a third party, mitigate their impact or probability of occurrence and
accept the risks which have low impact or low probability of occurrence.

The next step is to implement such results and during the project monitor and control the
risks, updating the information, adding new risks which are identified and applying
changes as required.

Each project has its own unique risks besides the basic inherent risks that any project has.
Clarity on the project objectives, commitment from top management to the project and
familiarity with the project all affect the inherent risks’ probability of occurrence and
impact.

Some of the unique risks that M&A projects can face:

- Management normally won’t take into consideration the impact of integrating
companies with very different business processes and IT systems. Many companies,
especially private ones, still use legacy systems which can be integrated with modern
ERPs only with huge efforts, “dirty” workarounds and costs. Such integrations can
cause costly interruptions to the operations, cause employees to become frustrated
with the changes in their way of doing things and lead to loss of productivity and need
for costly trainings. Such risks are often overlooked and can add significant costs and
even cause the project to fail.

- Financial times published an interesting article about the consequences many
managers don’t consider when acquiring or merging with companies oversees.
Lenovo, a computer manufacturer in China, acquired the laptops division from IBM,
in US. Both units (in China and US) were kept, however the corporate language was
changed to English to allow employees in both companies to collaborate. Older
employees in the Chinese division were caught off-guard by the decision. Gina Qiao,
Lenovo’s talkative HR manager, expressed her frustrations naming it “the toughest time of my whole life” (Clegg, 2012). She is now speechless in meetings as she is unable to express herself or understand the fast speaking American colleagues. Changes such as this may cause key people to leave the company after an M&A. It has a cost involved and is part of the risks to be managed beforehand and mitigated by providing proper opportunities for employees affected by such changes.

- Cultural incompatibility is also often not considered by management as a factor, however after many failures due to such cause project managers are taking it more seriously into the project practices and risk management.

- Marketing is not a topic you come across when researching about M&A. It is left for last, but as it will be discussed in section 5.6.5, it does count.

### 5.6.4. Procurement Management

The most common type of assets to be procured in an M&A project is services. M&A is a labour intensive project heavily based on brain power, which is an intangible asset. Companies with all the required in-house expertise will have little procurement to be conducted. Otherwise, expertise would be bought from consulting companies, investment banks, and accounting and law firms specialized in M&A regulations. Other types of procurements are licenses and royalties paid to software vendors for integrating systems of the acquirer and target companies and transfer of ownership of existing software from the target to the acquirer.

**Investment banks** provide strategic and tactical advice and acquisition opportunities, screening of potential buyers and sellers, making initial contact with contact with a seller or buyer, negotiation support, valuation and deal structuring support. Investment banks also keep track of costs for recent transactions, used in providing the so-called **“fairness opinion letters”**. Such letters are normally requested by the Board of Directors as a legal defense to shareholder’s lawsuits against them and provide an opinion on what price range the company should be bought or sold for. Such institutions either have enough funds to finance the deal or good contacts to get funding from (DePamphilis, 2011: 99-100).

**Lawyers and accountants** are involved with structuring the deal, evaluating risks by investigating legal issues and auditing the books respectively; negotiating tax and financial terms and conditions for the deal, drafting and reviewing the terms and conditions for purchase or sale, prepare financial statements and support due diligence (DePamphilis, 2011: 101-102).

**Consulting companies** would provide support in the integration phase to handle the integration of IT systems, production facilities, ERP and SCM business processes alignment and other types of functional integration.

Besides, other much smaller expenses could be to rent hotel conference rooms, so off-site meetings, negotiations and change of control can be done without disturbance or eavesdrops.
5.6.5. Marketing Management

The marketing aspect of a deal has to do with the brands of both companies involved in the transaction. At the project planning phase not much can be decided before knowing the target company, its reputation (brand equity), the transaction type, specific conditions set by the target company to accept the deal, among other determinants. As an example, in the Anheuser Busch acquisition by InBev in the US in 2008, a condition to close the deal was that the “new” company would bear the target company’s name. InBev accepted then be renamed to Anheuser Busch (AB) InBev (Howard, 2008).

Marketing does play a role in the corporate strategy by aiding in the choice of the most effective way to implement the strategy. In Figure 2–1 besides merger and acquisitions, asset and business associations are valid ways to lead to achieving some objectives. Strategic alliances and joint ventures are cooperations entertained at the corporate level and they involve sharing key resources, such as R&D and production facilities or exchanging an asset for another one (patent for money). However, Strategic Brand Alliances are also means of implementing strategies by leveraging the intangible value of a brand and many alliances do lead to future mergers or acquisitions. Building brands is an expensive business which takes years and much investment and hard work. The right brand architecture can lead to impact, clarity, synergy and leverage (Acker and Joachimsthaler, 2000). Acker proposed an interesting brand architecture scheme called “Brand Relationship Spectrum” which is used by companies in mergers and acquisitions to decide on how to position both brands. Figure 5–5 shows a simplified version of Acker’s Brand Relationship Spectrum architecture and some key examples to be explored in the context of mergers and acquisitions. “Merged Brands” is highlighted because it is an addition to Acker’s original model.

Procter & Gamble (P&G) is a notorious house of brands and since its creation (which was a merger of a candle and a soap maker) has always acquired strategic brands to add to its business units. Gillette is the latest acquisition. As usual, Gillette is shadow-endorsed by P&G. Many don’t even know that Gillette is owned by P&G, which is exactly the brand strategy adopted by it. Unilever has the same approach and similar history to P&G. Companies are acquired and divested without ever touching the mother ship.

Figure 5–5: Brand Relationship Spectrum architecture with examples. Adapted from (Acker and Joachimsthaler, 2000)
Development of a Project Management Methodology for Supporting M&A

In Brazil, Siemens acquired Chemtech, a respected systems integration and consulting company. Different from the bigger majority of acquisitions, which are absorbed by Siemens, Chemtech kept its original name due to its great reputation in the country, helping Siemens increase its own reputation. At the end, the company is called “Chemtech, a Siemens Company” through token endorsement.

In some cases, after the acquisition or merger the brand of the new company is a concatenation of the acquirer’s and target’s brands. This is the choice of most “merger or equals”, such as the merger of Glaxo Wellcome and SmithKline Beecham forming Glaxo SmithKline. In other cases, the name’s concatenation happens as a requisite to accept the merger, such as in Anheuser Busch’s takeover by InBev in 2008. Among other conditions, Anheuser Busch (AB) requested to be part in the new company name, called AB InBev (Howard, 2008).

AMD (microprocessors manufacturer) has tough times competing with Intel, requiring tactics to constantly innovate and look for an edge to be explored. This is what motivated AMD to acquire ATI (graphics chip manufacturer). ATI is second to NVidia the same way AMD is to Intel. As a way to differentiate from its competitor, AMD may want to develop chips with advanced integrated graphics capabilities, which makes the acquisition of ATI a strategic one. However, because AMD has a much higher brand equity in the market, AMD decided to drop the ATI and just keep the sub-brands under it, for example, AMD (ATI) Radeon (Tarun, 2010). AMD also wants to capture the market share owned by ATI to increase penetration with its microprocessors.

In the “branded house” concept, such as BMW and Mercedes-Benz, strategic acquisitions are kept as subsidiaries, or wholly owned by the acquiring brand. Mercedes-Benz owns Smart and operates it separately, as joining the brands would not deliver any benefits as the value propositions of both companies are different (Mercedes-Benz stands for luxury, Smart stands for fuel economy and easy parking in congested cities). A similar concept applies to BMW and Mini.

It is essential to decide early in the process what means to achieve the aimed goals. Strategic (brand) alliance is cheaper, faster and offer risks than full-blown mergers or acquisitions, but they may not suffice in implementing the strategy. Therefore, the application of marketing tools in the decision making is highly advised. Marketing should be revisited again in the negotiation step and reflect in the change of control papers.
5.6.6. Budgeting Management

Before anyone even gets into a store for a new purchase, a basic step should precede: decide what to buy and how much can be spent without risking too much the credit worthiness. When a company is planning for acquiring new assets (tangible or intangible), developing a new product line or any expenditure which will generate benefits for years to come, the company will run a capital budgeting task. It will help the company determine how much can be spent without compromising the company’s finances and whether the new venture would pay off such an investment. Budgeting for the acquisition of a target company is not different. Even before launching the M&A project, management need to have a range of values it is willing to spend, so the screening process (phase 2) can eliminate the ones beyond the means of the acquiring company.

In the project planning, it is important to establish an “optimal expenditure range” and an upper limit, which must not be surpassed. The latter is based on the strategies and capital structure of the company. As the company may well get into a bidding war for the target acquisition, having an upper limit set from the onset helps preventing management from going beyond their means and putting the acquiring company into financial distress.

The budgeting process involves determining how much the company can afford and how much the management is willing to spend. The budgeting information will be used for filtering the results of the search in the due diligence after valuation. Once the company has been selected and the negotiations are under way, the financing management processes will be used to raise capital for the transaction. Financing and valuation management are described next.

5.6.6.1. Company’s Financial Leverage vs. Management’s Ambitions

The biggest majority of companies worldwide rely on some type of debt to both conduct its day-to-day operations and capital expenditures. A few exceptions such as Apple and Microsoft do not need to worry about interest coverage measures for being highly liquid and debt-free. For the remaining companies, the level of leverage they carry in their balance sheets must be carefully taken into account when determining how much the company can afford in an acquisition. The strategy set by management and the operational vs. financial risk are good sources of information. Technology based companies, such as Apple, due to the high risk involved in their operations, should balance it out with lower financial risks. Commoditized product companies, such as steel, as long as they hedge against excessive increase in fuel and ore prices, their operations are considered of low risks, so they can feel more comfortable in carrying large amounts of debt on their balance sheets. So, management should have this fact reflected in the strategies they devise for the company. And they should not be tempted to engage in a bid war which would cause the price paid for the company to go above the limits set. The lure of higher entrenchment and power management may get through a big acquisition may speak louder than the strategy they set themselves.
5.6.7. M&A Tactics Management

The biggest majority of takeovers are of a friendly nature, through which the acquirer approaches the target company and negotiate a takeover. The target company would show interest in the deal and both sign an agreement, in which the target would conduct its internal due diligence (e.g. present the offer to its shareholders, hire an investment bank to provide a fairness opinion letter to avoid litigations and class lawsuits from the shareholders) and the acquirer agrees not to purchase any shares from the target at least while the agreement is valid. Negotiations are kept confidential until a deal is reached or if one of the parties decides to break the silence. The acquirer may prefer to bring the takeover attempt public, so the shareholders become aware of the offer (and a possible premium) and put pressure on the Board to accept the deal. On the other hand, the target may bring it public to attract other bids and buy time until a decision is reached.

A hostile takeover is more about taking the target company by surprise, either through an unsolicited bid, or by convincing the target’s shareholders to force the Board to sell the company or acquiring 50.1% or more of voting shares to take control of management. There are several “attack” and “defense” tactics used in this game by acquirers and targets, respectively. Therefore, as part of the project intelligence, a good understanding of such tools is mandatory. And again, which tools are allowed or not depend on the countries and company’s By-Laws.

Market analysts are predicting a rise in hostile takeovers in 2012 due to certain conditions, such as lots of cash in corporate balance sheets and low interest rates. Management does not have many options in generating value to shareholders in such slow growth environment, other than paying out as dividends or acquiring companies (Farrell, 2011).

5.6.7.1. Attack Tactics

Some of the “attack” tactics used against target companies:

- **Bear hug**: an old practice of sending an unsolicited bid to the target putting pressure to accept the takeover. The target company has 2 options, either recommending the takeover (accepting it) or using defense tactics, such as attracting more bids. In 2011, of all M&A deals, about 29% started with a bear hug which was made public before the actual transaction. From these 75% had the transactions consummated (Evans-Cullen, 2012). A target recommendation is likely if the premium over the market price is substantial.

- **Proxy Contest** (in support of a takeover)\(^{41}\): It is a practice intended to get control of the company by replacing Board members, even without having 50.1% of shares. If

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\(^{41}\) There are 3 types of proxy contests. One is a group of dissident shareholders trying to gain representation in the Board of Directors and remove the current management due to poor performance or put a new one which supports the dissident’s position. A second one is forcing the Board to take a particular action, for example sell the business or pay out dividends. The third type is explained above (DePamphilis, 2011: 57).
the acquirer is a shareholder, then it may try to call for a shareholders’ meeting or present its proposal/bid in the meeting. This may be preceded by a strong public relations campaign to convince shareholders to vote in favour. The acquirer normally has no access to shareholder’s contact information, as most shares are unregistered. Such tactic can be very expensive, as the acquirer has to cover all costs, including lawyers, while the target company can defend itself using corporate money and have access to each shareholder. Proxy contests can be cheaper than a tender offer and generally as source of abnormal returns to the target’s shareholders even if it fails (DePamphilis, 2011: 58).

- **Pre-Tender Offer Tactics**: Before a hostile tender offer, the acquirer can purchase small amounts of the target’s shares at a time in the open market (to avoid raising suspicions). Once it has a certain amount of shares, it becomes cheaper to place a tender offer to purchase the remaining amount of shares to gain control. The acquirer must be aware of the Anti-takeover regulations in the country in question to avoid penalties from the authorities. For example, in US acquiring more than 5% of the outstanding shares forces the acquirer to inform the SEC what intentions they have, whether it is for investment purposes or future takeover. In Canada and EU the same rules apply for 20% of the outstanding shares.

- **Hostile Tender Offer**: The acquirer tries to gain a controlling interest in the target’s by purchasing shares directly from shareholders at a premium. Once the acquirer has 50.1% of shares, they can replace the management and take control of the company.

- **Multi-tiered offers**: The acquirer offers a premium for the target’s shares if sold in the first instance up to the amount enough to take control. When the target company is taken over, the remaining shares are bought by the acquirer at a significantly lower price, so force the shareholders to sell their shares at the beginning. In some countries this practice is not valid by anti-takeover legislations.

- **Contractual tactics**: these are not for “attack” per se, but to prevent a friendly takeover from going to a hostile one. Examples are: **Letter of Intent** (to prevent the target from backing out of the deal), **no-shop agreement** (target may not solicit other bids), **breakup fee** (paid if transaction is not completed), **stock lockup** (to allow the acquirer to purchase the shares at a negotiated price) (DePamphilis, 2011: 65-66).

“Attack” tactics have a few advantages, among them avoiding abnormal returns with the public announcement of the deal, what makes the acquisition pricier and avoiding the target from having time to raise defenses against the takeover. However, such tactics are very ineffective for block holding type of structure and family members as major shareholders.

### 5.6.7.2. Defense Tactics

Defense tactics were first seen in the 80’s in response to corporate raiders and many hostile takeovers. There are many different tactics, some imposed by anti-takeover legislations to make a hostile takeover more difficult. Such defenses can be declared in the company’s By-Laws. Some claim this is used my incumbent management to protect their
perks or to protect shareholders by requiring higher bids to close the deal (DePamphilis, 2011: 73). In any case, advance planning and strong financial performance are the best defense. Large public companies review their defenses, monitor the stock accumulations and changes in ownership and price movements that may indicate an imminent takeover attempt.

Pre-Offer defenses are used to buy some time for the target’s management to study their options or prevent an unexpected unsolicited bid. There are 4 main types (DePamphilis, 2011: 73-85):

- **Poison Pills** are a type of securities issued by the target company triggered by the acquirer purchasing a certain number of the target’s shares. For example, if the acquirer purchases more than 15% of the target’s shares, the company’s By-Laws allow shareholders to buy one target’s share for each one owned for half the market price (called flip-in poison pill). Flip-over poison pills are the same but for purchasing acquirer’s or the resulting company’s shares. This tactic makes the purchase more onerous to the acquirer, both for cash-for-share and share-for-share exchange, due to acquirer’s ownership dilution.

- **Shark Repellents** are some types of defenses implemented by amending the Corporate Charter or By-Laws. Staggered Board Election is one defense, in which the Board is composed of classes elected in different years. In a board of 12 members and 4 classes, and one class can be replaced at a time. So, even if an acquirer is a majority shareholder, it would need to wait 3 elections (3 years) to gain control of the board. Cumulative voting rights are implemented to maximize the minority shareholders representation, whereby each shareholder is allowed to cast one vote per share multiplied by the number of directors. For cause provisions specify the conditions to remove a member of the board, limiting the flexibility and reasons to let the acquirer replace directors. Advance notice provisions are used to restrict the shareholder’s actions and prevent any changes to the Board before prior notice, sometimes with months in advance. And super majority rules prevent a merger from taking place unless a big majority of shareholders (e.g. 80%) have approved it.

- **Reincorporation**: the target company decides to reincorporate in another state where the antitakeover defenses are stronger.

- **Golden Parachutes** are severance arrangements triggered by change of control in the target company. Whenever a new party is a majority shareholder, management employees who are most likely to be fired must receive big severance pay, making the acquisition more costly.

Post offer defenses are applied after the unwanted “attack” has taken place. Some of them are (DePamphilis, 2011: 86-90):

- **Greenmail**: Basically, the target pays the acquirer to leave it alone. The target offers to buy its shares back from the acquirer at a premium, whereby a standstill agreement is signed forcing the acquirer to sell all target’s shares and not initiating a hostile takeover.
• **White Knights**: When the target is in play mode and it wants to escape a bidder, it looks for another company which would have more favourable acquisition terms. Such white knights are chosen by the Board and they must be willing to accept conditions such as keeping the current management in place. White knights are offered options in case of bid wars, so they can either acquire the company at a fix price or sell target’s shares to the acquirer at a premium, making the acquisition less interesting.

• **Employee Stock Ownership Program**: Management encourage employees to hold investments in the company’s shares (retirement funds). Employees enrolled in such programs are more likely to support current management in case of a hostile takeover.

• **Leveraged Recapitalisation**: The target company incurs substantial amounts of new debts by borrowing to its capacity, so becoming highly leveraged and making a takeover less attractive as the acquirer may hope to use the target’s borrowing capacity to fund the takeover. Despite the high leverage, shareholders may benefit by receiving large dividends or capital gains from share repurchase. Besides, the company can defer a large amount of the taxable income and management may feel obligated to work hard to improve performance.

• **Share Repurchase**: The target company may spend the funds from leveraged recapitalization to buy back shares which would be floating (available in the open market) and could be bought by a raider. This makes the takeover by buying 50.1% of shares harder due to the substantial premium needed to be paid to the remaining shareholders. This tactic also burns through the free cash reserves of a company.

• **Corporate Restructuring**: It involves taking the company private (management buy-in), selling attractive assets, major acquisition or liquidating the company and paying liquidating dividend to the shareholders.

• **Litigation**: The target may seek an injunction from Court alleging violation of antitrust laws by the acquirer, mostly to buy time until other defenses are erected.

It is very important for the project manager to have at least a basic understanding of the implications of each type of defense mechanisms, because each one can seriously affect the outcome of the project, if it is ever completed:

• **Risk management**: many of the considerations and assumptions made in qualifying and quantifying risks as well as the mitigation plans may be defeated by the target’s defense. So the project manager should revise this area. When attacking the target, the risks increase mostly as the target won’t give you access to internal books to do the due diligence, and so you will acquire it “in the dark”.

• **Costs Management**: extra resources may be needed to fight the injunctions and other plots the target may come up with. So, specialized lawyers and litigators may be needed on top of the ones hired previously. The same applies when an attack is devised, as more experts may be needed;

• **Time management**: When defenses are used, mostly likely they will delay the negotiation and due diligence phases, requiring changes in the schedule, extending
contracts to resources hired externally and risking losing internal resources that may be idle;

- **Scope Management**: Scope changes may also occur, as more activities are needed due to defenses. When attacking, changes in scope are also likely needed;

- **Communication Management**: Shareholders need to be convinced that despite the resistance imposed by the target, they are still interesting to the company’s strategic plans to avoid extensive drop in share prices. It is a trend that the target’s shares will surge by 10 to 30% (abnormal returns) while the acquirer’s remains slightly negative;

- **Legal Aspect Management**: As previously mentioned, courts and security authorities may get involved, so the process may get more complicated;

- **Finance Management**: The planned financial arrangements to acquire the target may completely change, as bid wars and post-attack defenses may hugely increase the costs of the takeover. Higher leverage cause bondholders to get unhappy as expected rate of returns go higher than what they have currently. Shareholders may think the company is trying to bite more than it can chew and so causing the share prices to fall.

So, the project manager should understand the issues to be able to engage the right resources to help revising all the affected areas as cited above. Even though the decisions on how to react to the target’s defenses or attack will come from top management, the project is affected negatively and the project manager should be ready to react accordingly.

### 5.7. Integration and Coordination Functions

All activities and processes belonging to each knowledge area from both core and support activities should be integrated and coordinated as an orchestra to deliver the project successfully. The project will be as weak as its weakest link. A weak risk management will invariably increase the probability of failing to accomplish the project objectives. A poor cost management may put the project in “insolvency”, running out of funds to allow its completion. Poor scope management may cause scope to increase, get more complex and fail to deliver what the project was created for. Having the best talents in the team does not guarantee success if the processes in the other knowledge areas are not well managed.

The integration and coordination processes are common central to the project and depend on the deliverables of the processes of each knowledge area to work. The main processes are described in this section: define Project Charter, manage stakeholders, integrated change management, issues and dependencies management.

#### 5.7.1. Project Charter Definition

The Project Charter officialises the project by bearing the sponsor’s approval, committing resources and funding to get the project off the ground. As a master document, it is the single point of reference for the entire project. Elements of a Project charter are:
• **Statement of Work (SOW):** It describes the deliverables of the project (e.g. merger, acquisition, joint-venture), the business or organizational needs to be realized by undertaking the project (e.g. access to strategic technologies or product lines to increase market share) and the scope thereof. The SOW should demonstrate clear alignment of project and strategic plans.

• **Business Case:** Describes the benefits and reason for the project from the business point of view. It normally develops a cost/benefit, ROI, NPV analysis based on the business needs (market demand, technological advance).

• **Environmental Factors** which influences the project (section 2.2.6.4). The organizational culture and processes, governmental regulations related to mergers and takeovers, existing human resources, credit availability, etc.

• **Process Assets** affecting the project (section 2.2.6.3). The presence of a PMO and an existing M&A methodology, project Management IT systems, guidelines, policies, templates and past M&A experience.

Expert judgement is applied on the inputs to generate the Project Charter. Such expertise can be found in internal and external consultants, other divisions, professional associations, PMO, subject matter experts.

The Project Charter will bear the following information keeping the S.M.A.R.T. concept in mind:

• Project purpose and high-level description: what the project is about
• Executive summary: reason for supporting the project, what strategies it is based at;
• Project scope: goals and objectives
• Measurable project outputs and success criteria
• Project phases and milestones schedule
• Summary budget by phases or milestones
• High-level requirements: what the ideal target is, where to look for, what industries
• High-level risk assessment
• Project assumptions, constraints, interdependencies
• Resource planning
• Communication and reporting requirements: stakeholders management
• Project approval requirements (what constitutes a successful project & who signs off)
• Project manager, his authority level, responsibilities
• Project sponsor(s) and signature

The project charter should be written in a way which minimizes the need for changes along the project lifecycle. As the project is multi-phased and many unknowns still exist at this stage, the Project Charter should be reviewed at the start of each phase for accuracy and to keep the project focused on its primary objectives.
5.7.2. Stakeholders Management

The next step is to identify the stakeholders. As explained in section 2.2.5, stakeholders are anyone (people or organizations) whose interests are negatively or positively impacted by the project. Since the onset the project manager should have a clear understanding of each stakeholder. Having access to an updated CV or bio is a good starting point. Knowing the current position, possible motivational factors, aspirations, skills and personality is important to classify the stakeholder and use the appropriate communication strategy. Obviously the project manager won’t always have plenty of information about everyone. Effort should be focused to those who yield the highest impact. Attention should be given to those who can negatively influence and therefore adversely impact the project. Target company employees who fear for their jobs after the acquisition are the ones most likely to offer great resistance to integration, a critical step in the process. Finding ways to have them on your side is difficult but worth the effort.

Once the stakeholders have been identified, they should be rated in four dimensions (Project Management Institute, 2008: 249):

- **Power**: level of authority
- **Influence**: active involvement in the project
- **Stake/interest**: level of concern on project outcomes
- **Impact**: the ability to change (positively or negatively) the course of the project

A communication strategy should be selected and a plan devised. The communication plan will set the content and format of the communication (details and aggregation levels), the means (intranet tools such as SharePoint, emails) and the frequency. Each stakeholder or group thereof will be assigned a communication plan to tailor their needs given their power, influence, stake and impact. For example:

- **Monitor**: post update on intranet once a week or upon request, no sensitive details. Geared towards those with low overall impact (low power, low interest)
- **Keep informed**: Dedicated intranet page updated twice a week with some more details on specific developments. For those interested in the process but little power or impact.
- **Keep satisfied**: provide relevant information regularly on intranet or whenever requested through email with tailored responses and details. Those with high power and little interest, but with potential impact if not handled appropriately.
- **Manage closely**: be ready to provide information as much and as often as needed through scheduled reports with key performance indicators and other aggregated data but also in great details if requested. Personal attention.

The CEO, program and portfolio managers of an acquiring company sponsor the project, having strong power and high stakes. Therefore they should be managed closely. The shareholders have interest in the project outcome as it affects the share price, but no power and are normally satisfied with general updates. They are considered indirectly impacted.
Government and regulatory agencies should be kept satisfied as they are the ones approving or blocking the deal.

It is important to consider that stakeholder management is continuous and the strategy should be reviewed frequently as in each phase new players join or leave the project. The project Manager can compile a stakeholder register which can be accessible internally and an extended version, where details and remarks of each stakeholder can be kept for the project manager’s own consultation. The latter should be stored safely and password-protected.

5.7.3. Integrated Change Management

Change management is required in any project, regardless of nature or size. However, M&A projects pose special challenges. Normally, project scope can be set from the beginning and changes along the way are minor, with major changes as exception. For M&A projects major changes are almost a rule, or at least surprises on the way are quite common, especially when risks and assumptions were not well explored from the onset. A few examples of changes that may happen in the different phases of the project:

- Sudden changes in the economic landscape and business conditions (e.g. 2008/2009 crisis) can force companies to change strategies and shift priorities, abandoning the project altogether or putting it on hold;
- What seemed a perfect target, actually is trouble after an in-depth due diligence;
- The perfect target does not want to merge or being acquired, using tactics to make a takeover more expensive (explained later);
- Information leaks during negotiation, causing competitors to bid in an attempt to make your deal go sour;
- The acquirer and target companies are pleased with the deal which seems perfect, but once announced the shareholders and financial community get sceptical causing market capitalization to tumble. A notorious example is the HP-Compaq merger, which for whatever reason received strong opposition. The New York Times and IDC Analysts joined the crowd in condemning the deal (Rosen, 2008).
- Regulatory bodies don’t approve the merger, or the conditions imposed make the deal not as interesting anymore;
- Regulatory approval is taking too long, so that the project loses momentum and go cold (resources get dispersed shifted to other projects, other issues pull management’s attention away from the project);
- The deal gets signed, and integration gets hairy due to unexpected IT integration problems, loss of morale among the target company’s employees leading to departure of key people;

Therefore implementing a robust change management process is essential, as flexibility is needed despite the need for discipline in managing change at all phases of the project.

The key components of such a process should be:
• Identifying and assessing the impact on cost, schedule, quality and risks;
• Assign roles and responsibilities and a clear “change lifecycle” to manage handling all changes, documenting them and deciding whether to approve, reject, escalate decision to a higher level (program/portfolio steering committee), request more funding etc.

5.7.4. Issues Management

Issues can be defined as the materialization of risks, identified or not, which can negatively affect the project outcomes. Issues can sometimes also be positive events, presenting themselves as an opportunity to those who capture them to increase the project success. The focus here is placed on the negative issues.

Issues management is dealt with in a similar way to risks, by:

• Selecting people and assigning them to roles and responsibilities (e.g. issues manager, issues management board, etc.) to deal with the issues that happen along the project lifecycle;
• Defining and documenting a process to handle issues appropriately;
• Selecting proper tools (e.g. automated spreadsheets, documents in SharePoint) to standardize and record all issues for the current and future consultation.

5.7.5. Dependencies Management

Within each phase there are several activities depending on the execution status of other activities, internal or external to the project, to proceed. There are 4 dependency types used in project management software (such as Microsoft Project) to organize the sequencing of activities: start-to-start (SS), finish-to-start (FS), start-to-finish (SF) and finish-to-finish (FF). Further explanation on each type of dependency can be easily found on the internet.

The project manager needs to have strong management of tasks ownership, due dates and what is affected if due dates are extended, especially those external to the project. Knowing beforehand how long it takes for critical activities such as regulatory approval and financing to be completed is vital to avoid delays and loss of momentum in the project, especially after the negotiation with the target company. Regulatory approval in Brazil, for instance, can go from 2 months to 2 years in very complex cases. So, contingency must be built to deal with such uncertainties.

5.8. The M&A Project Phases

As described in Figure 5–2, the project will have 4 phases:

• **Phase 1 - Project Definition & Planning:** The strategic decision to pursue a merger or acquisition as a means to achieve an objective is reflected by the establishment of a project. **Clarity** is the most important asset in this state, as this sets the reasoning behind the decision and requires getting everyone aligned in the same direction.
Understanding how the industry is developing and which direction it is heading is critical, as a company can be a good fit in the present, but it may not add strategic value in the future.

- **Phase 2 – Search & Screen Targets:** This phase entails the search, screening and due diligence to select the targets which are aligned with the strategy adopted in the project definition. Clarity has direct impact in this phase.

- **Phase 3 – Go-No-Go Decision & CoC:** The negotiation and in-depth due diligence will decide whether the deal will be consummated. A big portion of the Change of Control (CoC) stage will also be conducted in this phase, such as the paperwork and formalities. Regulatory approval is decisive in this stage as it may block the deal from happening after all.

- **Phase 4- Integration Work:** The integration planning and execution is critical to the success of the deal. The synergistic gains which helped sell the project are dependent on how well the integration takes place. Two key factors in this phase are **capacity** and **speed**. Having capacity refers to having the ability (financial, skills, experience) to make the deal successfully happen, throughput (physical and operational) to deal with the extra work involved in the integration of both companies, and strong and focused leadership to help the team overcome hurdles. Speed gives momentum to the project avoiding it from stalling when facing obstacles.

As any project faces constraints, such as budget, time and resources availability, the project manager should evaluate which constraints to give attention to in each project phase. Figure 2–8 shows the triangle of competing constraints, where ideally all constraints would be treated equally. Unfortunately a trade-off must be reached as in some circumstances a constraint is more important than others. Table 5-4 displays the constraint trade-off for each project phase.

<table>
<thead>
<tr>
<th>Phases</th>
<th>Constraint of Focus</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Project Planning &amp; Definition</td>
<td>X</td>
<td>Selecting the right strategy and how to implement it along with diligent planning will dictate how successful the project and the company post-integration will be.</td>
</tr>
<tr>
<td>Phase 2</td>
<td>X</td>
<td>Quality in selecting the correct target can save time and costs during and after the project.</td>
</tr>
<tr>
<td>Phase 3</td>
<td>X</td>
<td>Negotiating a fair price for the target and making sure all formalities and regulatory approvals are ironed out before integrating the companies is paramount.</td>
</tr>
<tr>
<td>Phase 4</td>
<td>X</td>
<td>Integration speed and diligence are key factors to the success of the resulting company.</td>
</tr>
</tbody>
</table>

Table 5-4: The tripe-constraint consideration for each project phase.
Adapted from (McGrath, 2011: 110)

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42 Clarity, capacity and speed were mentioned in (McGrath, 2011: 57-77).
Any merger or acquisition is a change-triggering event, so the use of a project methodology is intended to allow changes to happen in a controlled manner to reduce the risk of project failure. Planning makes the project prescriptive in nature. Nevertheless, all members should be ready to embrace unplanned changes along the way in an emergent approach.

5.8.1 Project Phase 1: Project Planning & Definition

One of the reasons mergers and acquisitions fail is a poorly designed or inappropriate business strategy. Management may think of M&A as a strategy in its own, but according to successful acquirers, it is a means not an end (DePamphilis, 2011: 123). In addition, regardless of being a means, it can be the inappropriate means to implement a given strategy. As discussed in sections 2.1.1 and 2.1.2, there are many different strategies, for different objectives and risk appetites. The first task is to define the right corporate or business strategy and then to select the most appropriate means for implementing them. The choice of one means over another will depend on whether short or long-term gains are sought. Short term targets achievement can drive acquisitions based on the “P/E magic” principle (as explained in section 2.1.1), for example to buffer a weak fiscal year and complement the CEO’s bonus. As long-term strategies, such as create a new products or technology through R&D investments, require longer periods to yield results compared to the acquisition of a company with the same products or technologies. More and more companies are resorting to acquisitions as ways to innovate.

Let’s assume the portfolio includes the decision to pursue a merger or acquisition, and the company adopts the projectized structure for implementing such business objectives. The overall project planning should occur in this stage for its entire lifecycle.

5.8.2 Project Phase 2: Search & Screen Target Companies

Once the planning for the project has been prepared, the search for suitable companies will take place. Based on the strategy decided on the management level, the search will focus on a given market, sector, industry and many other parameters, which will be used to screen the best candidates. Some of the screening parameters are:

- **Type of transaction**: it is important to list what options are sought or acceptable, as it is difficult to decide at this stage. While a company acquisition is the initially preferred choice, great opportunities in other forms may present itself in the process, such as a joint venture or acquisition of patents and product lines from a target company;

- **Industry sector (niche)**: it is important to narrow down the type of industry and specialty to make the search more efficient. For example, food & beverage ➔ infant nutrition products.

- **Geography**: what market to investigate (country and region);

- **Ownership structure**: deciding whether public or private is preferred also impacts the screening process. Finding information of public companies is much easier than for private companies, whose finances are not disclosed;
• **Tangible and intangible assets:** Most likely the acquiring company is going after a company which is in possession of tangible (e.g. production plant in a given market) and/or intangible assets (e.g. brands, technology, patents), human capital (engineers, scientists, management talents) and other assets, which supports the strategy implementation;

• **Overall Budget:** the budget would have two main components, the target company price range (in case of an acquisition) and the project budget (valid for both acquisition and merger projects). The target company price range would provide a ballpark to filter the candidates in the search process. The project budget is a preliminary number just to provide guidance as it is highly dependent on the target size, culture, legal expenditure, consultancy needs, etc. The project budget is a sum of the estimated costs to be incurred in each phase and broken down further on its constituent elements;

• **Characteristics of the target:** Certain financial indicators can be further used to screen targets, such as the cost of capital through the company bond yields, capital structure (equity and debt levels), revenue, EBITDA, nature of lawsuits, etc. Such indicators can provide key figures to help management select and rank the most interesting targets from the list.

• **Other soft aspects:** reputation in the market, brand awareness, how the customers may interpret the merger or acquisition of both companies, etc.

There might be other parameters to be considered, depending on the industry.

As part of the early due diligence is the value range estimation for the screened company. As explained in section 2.1.4, there are several tools available for valuation. Nevertheless, in this stage the estimation is just for screening purposes, therefore the methods which offer a quick valuation should be used. There won’t be enough information to run a full DCF valuation, as the valuation needs to rely on public information only. Ratio-based tools are advised due to its simplicity and quick results. For public companies, access to the company market capitalization is easy and a multiplier for similar companies can be obtained from public sources. For private companies, specialized websites provide information such as sales of such companies and records from past transactions of similar companies so that multipliers can be obtained and valuation of the private company carried out.

The short-listed companies are presented to management for selection and approval, accomplishing the milestone for this phase.

### 5.8.3 Project Phase 3: Go-No-Go Assessment & CoC

Once the shortlist is ready, management will rank them in order of preference. It is worth remembering that it is fairly common for a CEO to bypass the search & screen phase altogether, going for a company he/she came across him/herself. The CEO can also ask for a given company to be screened and depending on the outcome the company becomes a target. Another alternative, less common, happens when a company approaches the CEO
or the board showing interest to either merge or being acquired. It means a merger or acquisition opportunity can present itself instead of being pursued actively.

5.8.3.1. Approaching the target company

The next step is approaching the target company. According to (DePamphilis, 2011: 161-163), the manner in which the approach takes place will depend on whether the company is public or private, its size and the time frame available. Owners or heirs of private companies are very defensive towards their business and may pose strong resistance at first. So, if time is not an issue, building rapport with the owner and/or heirs first can be beneficial. They may be receptive to a price which “feels right” not what a valuation reports. Also be prepared for demands such as “we can sell the business but I (the owner or son) will remain in the management”.

A small company can be approached directly, either through a letter or phone call. It is important to show knowledge and appreciation for the target’s business and stating why a partnership makes sense to both. Precisely and succinctly introduce the options, including an acquisition. If interest can be noticed, request a face-to-face meeting. For medium to large companies the best approach is to use mediators, such as the target’s accounting firm, member of the Board of Directors, investment banker. Secrecy and discretion are a must, as rumours can cause the target company to get into a downward spiral of loss of confidence from suppliers and customers due to change in ownership, employees lose focus due to imminent layoffs, competitors exploit the situation to convince the best target’s employees and customers to switch, etc.

The way the target is approached is an important element on how it will react to it. An aggressive approach showing too much interest up front in acquiring it and not entertaining a possible alliance first, can give out signals that may induce its management to think they are “a good investment for a takeover” and start deploying defenses, such as detailed in section 5.6.7. Once defenses are in place, any negotiation is very difficult. Approaching smoothly first with benign intentions such as joint cooperation can help putting the target’s guards down. Keeping the approach confidential prevents other bidders from bidding, market speculations and increased acquisition costs. The acquirer should refrain from mentioning any estimated value at first, as it is difficult to walk away from it once put on the table. So, at best just mention a range.

In case the target decides to implement defenses, then the acquirer’s management has to decide whether to continue through implementing counter-defense measures, bid war or walk away from the deal. It is important to understand the regulations of the place in which the target is located. For example, the “Brazilian poison pill” requires a shareholder holding 10 to 30% ownership to place a bid for the remaining stocks at a significant premium price. The shareholders, who try to remove the by-law provision, are obliged to place a bid for all the outstanding shares (Armour, Jacobs and Milhaupt, 2011: 279-280).
5.8.3.2. Negotiation

The negotiation step is often the most complex aspect of the acquisition process (DePamphilis, 2011: 173). The negotiation can be broken down to four major steps:

- **Refining the valuation** obtained in the screening process (or early due diligence);
- **Deal structuring**;
- **Due diligence** to look for any other issues (e.g. litigations);
- **Financing plan**

Often all of the aforementioned activities occur concurrently, which justifies the complexity of the negotiation. Both parties need to come to terms on the many decisions regarding the interests each party has and the risks they are willing to share. As in any fair negotiation, both need to be willing to sacrifice and make concessions to make the deal fair to both.

Once negotiations start and before any non-publicly available information is exchanged, both parties sign a *non-disclosure agreement* (NDA), also called a *Confidentiality Agreement*. The agreement is mutually binding, whereby the acquirer asks for as much information and data as possible and the seller has the same right, so both can check each other’s financial, legal and business state. This is a great opportunity for the seller to understand the financial situation of the acquirer, whether they have means to pay for the acquisition and their legal situation in terms of litigation. The acquirer can conduct the due-diligence to estimate the value of the company using valuation methods such as DCF (section 2.1.4.2), which also considers the impact of the capital structure in the enterprise value through the WACC. The acquirer would also determine whether the company is a defendant or plaintiff in any litigation or lawsuit.

Another must-have document is the *Letter of Intent (LOI)* which sets firmly the terms and conditions of the deal, what information both parties are agreeing on sharing, the price range for the deal, how it will be paid (cash, stocks, bonds), how much liability the buyer will take over from the seller, who will pay for the transaction fees (legal, consulting, regulatory), etc. The LOI may be terminated in case conditions are not met by a certain date, such as having regulatory approval, financing in place, arrive to a mutual agreement on the deal, among others.

Refining the valuation and the due diligence should go hand in hand as many of the assumptions made earlier based on limited available information can be checked. Having access to the installations and archives allow revising the historical financial information. 3 to 5 years-worth of data should be normalized to eliminate the non-recurrent gains/losses and expenses which behave as “white-noise” in the true business performance. Selling tangible and intangible assets should be eliminated and important figures, such as EBITDA, cash flow from operations and expenditures should be calculated year-after-year as a percentage of the revenue. This method gives insight on the behaviour of the business
affairs. Increasing levels of expenditures and stagnant revenues may signal troubles ahead, for example.

The due diligence provides invaluable inputs to the valuation and to determine whether any of the conditions set in the Letter of Intent has been breached. The LOI is not a replacement for a well-run due diligence, as it is practically impossible to cover all aspects in one document. By looking into the assets, tangible and intangible, strategic, operational, financial, human capital and others, the buyer is able to determine synergies which would help justify the acquisition price and present to lenders the reason why the acquisition is worthwhile undertaking. As previously mentioned, due diligence can be undertaken by the buyer (most common), the seller and the lenders, who want to determine for themselves whether the deal is worth the risk. Having both the buyer and the lenders scrutinizing the seller can be a great burden on the seller’s resources, so expect the seller to try to reduce access and time to complete the due diligence as much as possible. Equally, the seller wants to limit their exposure as this open up opportunities to the buyer to find loopholes which can be used to bargain the acquisition price.

The deal structuring covers the details related to the distribution of risks among the parties, identifying the most pressing objectives of each party, the legal and tax considerations of the transaction, the pre- and post-transaction organizational framework (corporation, joint venture, partnership) and forms of payment (DePamphilis, 2011: 173-179). Both parties (especially the buyer) need to have a clear stand on accounts receivable, accounts payable, salaries, health benefits, pension and other obligations before and after the transaction takes place. The use of an escrow account holding a portion of the transaction value is a good way to guarantee financial obligations of the seller incurred before the transaction are paid after it with their resources and not the buyer’s. Employees shortly after the transaction is confirmed tend to increase health benefits expenses as a natural reaction to fears of layoffs and the stress caused by it. Salaries and non-compete agreements for key employees need to be negotiated before the transaction to avoid them from going to competitors and avoid expenses such as “golden parachutes” (section 5.6.7). A more controversial practice sometimes imposed by the buyer is called earnout. Basically, the seller has to achieve a certain performance (e.g. sales, profit) to receive a portion of the acquisition price. This may be an effective way to make sure the seller remains focused in the business. However, it is a serious impediment to an effective integration, as the sales forces of both companies cannot be joined for performance measurement purposes. This may signal lack of trust and cause the integration to fail.

The financial plan determines how the transaction is to be financed. For this, the buyer needs to update the cash flow and income statements to reflect the transaction costs and a contingency for presenting to lenders and investors.

5.8.3.3. Change of Control (CoC)

The Change of Control itself is a short period when both parties sign a pile of paper to consummate the deal. It can normally be done over a weekend. However, the pre-CoC is critical and requires diligent planning ahead of the CoC and hard work to fulfill all
requirements. Filing for regulatory approval may need to take place months ahead. In Brazil, it could take from one to two years for a highly complex deal to be cleared by securities, antitrust and national/regional laws. In case of cross-border deals can require the same approvals from different countries, making the task even more complex and prone to delays. The seller needs to get approval from all shareholders to avoid class action and other legal issues. Sources of financing need to be in place (lenders and investors). The multitude of the documents and clearances required can be daunting. Besides the documents already mentioned, others equally important to get cleared are intellectual properties, royalties and patents agreements especially abroad; commitments and contracts with companies and employees nationally and internationally; insurance and certifications (seals); legal and environmental issues resolved or being resolved; and acts of incorporations, by-laws and similar (DePamphilis, 2011: 186-187).

In the preparation for the transaction, the seller has contracts and other business agreements with suppliers, partners and customers. Such contracts cannot simply be assigned to the buyer without prior approval from the other party. Suppliers and customers may use the opportunity to renegotiate contracts to yield them more leverage, as they know the buyer is in a vulnerable position. Software vendors may demand royalty fees to transfer critical business-related software licenses to the buyer.

The merger/acquisition agreement is the cornerstone of the transaction (DePamphilis, 2011: 183-184). It sets out the rights and obligations of all involved parties, the method of payment (in case of non-cash acquisition, the price ratio between the seller’s and buyer’s shares need to be established, so all seller’s shares are exchanged by the buyer’s). The price allocation needs to be agreed upon as it has tax implications. The price paid can be allocated to tangible and intangible assets, through which the difference between the price allocated and the updated book value is the goodwill, which can be depreciated reducing taxable income. The M&A agreement also holds what was initially set forth in the LOI regarding the covenants, closing conditions, indemnification and assumption of liabilities. Any known and unknown past or present wrongdoing from the seller’s part will be of the buyer’s responsibility when the takeover occurs. Material adverse changes clause should be set to prevent the deal from being consummated in case the situation changes due to financial crisis such as the one in 2008/2009 and force majeure events (DePamphilis, 2011: 182.187).

Some advices and facts which should be given attention during the negotiation process leading to the CoC, adapted from (DePamphilis, 2011: 187-190):

- The overall Pre-CoC is very dynamic and range from boring activities to highly demanding and stressing ones. Trust among the parties involved can be of great help in minimizing confrontation and allow sharing tasks;
- The size of the transaction is not a good indicator of the complexity of the deal. Small transactions in terms of value can be a nightmare as several parties are involved, where trustworthiness may lack and cross-border approvals are required (some from highly bureaucratic and corrupt countries).
• High-priority issues should be tackled first, as towards the end the parties may be running out of steam. So, leave the easier and less polemic ones to the end, but not to the last minute, as stress may turn inoffensive tasks look like beasts;

• Negotiation is an art. Both parties need to have their lists of objectives and goals, so each one is aware of what would be a deal breaker and what they can give up on to gain something in return.

• The key in negotiating is being able to support each move with well-founded arguments, which makes offensive moves harder to implement. Try to instigate a win-win negotiation, where both are able to achieve at least partially each other’s objectives. Don’t forget you are buying the person’s business and you may still have to deal with this person for many year. A resentful outcome will only makes damage relationships and any monetary gains in the transaction may be quickly lost during integration or later when operating the acquired business.

5.8.4 Project Phase 4: Integration Works

The Integration Works phase is composed by an integration planning and integration execution stages. The integration planning happens in parallel to the Pre-Change of Control (Pre-CoC), and the Integration Execution starts as soon as the integration planning is done and the CoC is completed. In reality, there might be no integration at all after the CoC. It will all depend on the objectives and motivations the buyer had with the acquisition or merger. An investment bank would acquire a manufacturing company with the intention of flipping the company (i.e. cut its workforce, reduce R&D spending and sell assets to make it “grow”) to sell it for a profit, regardless of whether it has long-term sustainable prospects. They normally sell it to companies whose CEOs are attracted to the “P/E magic” or corporate raiders. Hedge/Pension funds and management buy-in/out tend to acquire the company to have direct control and influence on the seller’s management, as they see good long-term prospects, still without any integration. Partial integration, such as the example of EMC and VMWare, the buyer has 100% control over the seller, however they seller operates as a subsidiary, with little interference from the buyer, and the integration is limited to cross-selling and marketing synergies. In some cases, especially mergers, there is total integration to the point in which it is difficult to distinguish what belonged to one or another company. In such cases, reversing the integration is virtually impossible, as operations, IT, marketing and management are seamlessly mingled. So, “integration” can range from none to total.

The integration planning and the pre-CoC have many interdependencies and therefore should run in parallel. While in the pre-CoC the search for synergistic elements are input into the valuation process, in the integration planning the same synergies are used to determine what redundancies will be eliminated, for examples deciding who to layoff and assets to divest off. HR would be involved in this as there is the need to analyse the positions within the company to be acquired and who occupy them to determine whether to keep the employee. If some assets for whatever reason cannot or should not be divested
off, the integration planning team would notify the pre-CoC team that they should reconsider and not count in as synergy, changing the valuation results. Therefore, even though both processes are run by different teams, they must interact and work together for effective results.

For those whom the integration planning team decides they should be retained, HR needs to establish packages and conditions to keep the employees. So, the contracts developed in the pre-CoC to retain key management employees from the target company are done with the help of the planning integration team.

A very interesting passage in the book “Good to Great” from Jim Collins (Collins, 2001: 52-53) shows how to walk the fine line between being rigorous and ruthless when it comes to consolidate an acquired company’s personnel. The passage in the book refers to the acquisition of Crocker Bank by Wells Fargo in 1986:

“(…) what was unusual about the Wells-Crocker consolidation is the way Wells integrated management or, to be more accurate, the way it didn't even try to integrate most Crocker management into the Wells culture.

The Wells Fargo team concluded right up front that the vast majority of Crocker managers would be the wrong people on the bus. Crocker people had long been steeped in the traditions and perks of old-style banker culture, complete with a marbled executive dining room with its own chef and $500,000 worth of china. Quite a contrast to the Spartan culture at Wells Fargo, where management ate food prepared by a college dormitory food service. Wells Fargo made it clear to the Crocker managers: "Look, this is not a merger of equals; it's an acquisition; we bought your branches and your customers; we didn't acquire you." Wells Fargo terminated most of the Crocker management team - 1,600 Crocker managers gone on day one - including nearly all the top executives. (…)

On the surface, this looks ruthless. But the evidence suggests that the average Crocker manager was just not the same calibre as the average Wells manager and would have failed in the Wells Fargo performance culture. If they weren't going to make it on the bus in the long term, why let them suffer in the short term? One senior Wells Fargo executive told us: "We all agreed this was an acquisition, not a merger, and there's no sense beating around the bush, not being straightforward with people. We decided it would be best to simply do it on day one. We planned our efforts so that we could say, right up front, 'Sorry, we don't see a role for you,' or 'Yes, we do see a role; you have a job, so stop worrying about it.' We were not going to subject our culture to a death by a thousand cuts.'

To let people languish in uncertainty for months or years, stealing precious time in their lives that they could use to move on to something else, when in the end they aren't going to make it anyway—that would be ruthless. To deal with it right up front and let people get on with their lives that is rigorous. (…)"

This passage refers to an extreme case of an integration of two companies with similar business but completely different cultures. As mentioned before in this work, while it is not advisable to acquire or merge two companies with diverse cultures due to foreseen
Development of a Project Management Methodology for Supporting M&A

problems in the integration phase, in some cases they are strategically interesting. In such cases, radical measures such as the ones undertaken by Wells Fargo may be required to make the integration viable. However, this practice should be avoided, as so many employees are dismissed in a clearly win-lose transaction.

Some of the key points to be borne in mind in relation to the overall integration works are the following, adapted from (DePamphilis, 2011: 215-218):

- **Financial return:** The premium offered by the buyer over the market value is linked to the buyer’s ability to recover that through synergies. For example, for a company valued at $10M, the buyer agrees in paying a 25% control premium given the estimated synergies. At a 10% cost of capital, if the integration takes one year to be completed, the buyer needs to generate $27.5M in the first year by operating the seller ($25M + $25M*0.1). If it takes 2 years to integrate, the gains required are $30.25M ($27.5M + $27.5M*0.1). So, the longer the integration, the higher the costs that need to be realized or the lower the premium offered for the business. This in turn may cause other bidders to win the deal.

- **Employee turnover:** some businesses are valued mostly based on their human and knowledge capital, such as consulting and innovative companies with strong R&D activities. If employees are not pleased with the change in ownership, they may leave the company and take with them most of the value of the company. So, planning how to make the employees to stay is no easy task, but part of the integration planning. Not only the employees leave with the knowledge, the new ones hired to replace them need training and cannot add value right away, which also add costs to the acquisition. So, this highlights the importance of a strong HR team and proper retention packages.

- **Suppliers and customers increased churn rate:** the change in ownership may cause transient disruptions in operations (delivery of orders) or payment of invoices for goods purchased due to the changes in IT systems and employee turnover, which in turn cause suppliers and clients to think this will be the rule due to the ownership change. So, churn rate may increase, adding costs to gain new customers or bring the lost ones back and qualify new suppliers.

- **Pace of Integration:** As discussed above, the level of integration can vary depending on the business, on the disparity among the many systems within the company, culture differences and much more. Some synergies are critical to be achieved as soon as possible, especially the ones with the biggest potential returns, while others can be done later also to avoid business disruptions. So, the integration team manager needs to decide whether a phased approach to integration makes more sense. Doing all at once can be overwhelming to the team, to the seller’s employees, and repercussions to suppliers and customers operations.

- The integration works is composed by 2 teams: the Integration Management and the Integration Execution Teams. The management team should be composed by managers from both companies and are responsible in setting a plan to carry out the integration, give continuity to the business and monitor the performance of the integration done by the execution team, which should also be formed by employees
from both companies and possibly external ones such as consultants and investment bankers.

- In a friendly merger or acquisition, both the managing and execution teams should be formed by employees from both companies. In a hostile takeover, cooperation and information sharing coming from the target should not be counted upon. So, integration tends to be more challenging than in a friendly one.
- Communication management (section 5.6.2) is essential to a successful integration and it can strongly impact its results.

### 5.8.4.1. Integration Planning

The integration planning is pivotal in determining the foundations for a successful integration. Its objectives are mainly related to laying out plans to integrate both businesses and preventing, or at least dealing with, issues as discussed above: identify the synergies which offer the biggest gains; sequence them; set a pace for the integration; make the process as smooth as possible to curb the natural increase in suppliers/customers churn rate and employees turnover whilst carrying the day-to-day operations of both businesses.

It is highly advisable to either have a representative from the negotiation team embedded in the integration team or have the integration team manager be part of the negotiations from the onset, so there is understanding about the reasons for choices made which influence the integration planning and execution. In any case, the Integration Management Team will drive the planning for the entire integration execution with inputs from the Pre-CoC Negotiation Team.

Depending on the integration level, a new company needs to be created altogether. In a merger of 2 companies, for example the merger of SAB Miller and Molson Coors in the US in 2008 creating MillerCoors, a new organization with a new structure and culture is the result of the merger. In such cases, planning for the type of company structure to adopt based on the business needs (section 2.2.6.2); the needed staffing with the proper compensation, skills and schedule needed, as well as defining the company culture and style to be adopted (section 2.2.6.1). Besides, detailed planning is needed for the integration of the various primary and supporting functions of both companies (Operations, Marketing & Sales, Manufacturing, IT, HR, R&D, Procurement, inbound and outbound logistics with suppliers and customers respectively). Such integration will drive most of the synergies identified in the company valuation.

### 5.8.4.1. Integration Execution

Once the integration planning is completed and the Change of Control consummated, the next step is a race against time to integrate some or all functions as much as possible whilst at a pace which will not hurt the business, the morale of both company’s employees and the objectives of the overall M&A project.
The functions to be integrated are highly dependent on the current business of both companies and what the new business should be moving forward. The acquirer needs to decide what functions or contents within functions to be terminated, sold or modified to add value to the new business. For example, both companies may have projects (planned or in execution) which are redundant, or which are no longer aligned to the new business plans. Resources need to be redeployed to projects that will support the business and justify the synergies that lead to the merger or acquisition in first place.

5.8.4.1.1. IT Integration

Some manufacturing companies are quite advanced in the use of IT connecting production to the business systems. For example, many companies use Manufacturing Operations Management (MOM) to manage production linked to the business management layer: ERP, SCM and CRM systems to mention a few. The integration of such systems, especially if they are from different vendors and vintages (technological waves) can be quite a challenge, increasing the likelihood of business disruptions and the more the business is dependent on the IT infrastructure, the higher the potential losses due to failures. So, careful planning the IT integration is needed when the consequences are costly. Decisions such as to run both systems in parallel for a while and integrate them in phases, or to replacing the target’s IT system with the same one used by the acquirer are good approaches. As important is determining if the costs of such migration is within the scope and budget of the acquisition. ERP projects tend to last years and cost upwards of millions of dollars, besides its high failure rate, which are very detrimental to the business. The industry is full of such stories. Nike’s i2 Project, which intended to improve the supply chain management portion of the business based on SAP ERP, lead the company to lose more than $100 million in sales and 20% of its market capitalization besides many class-action lawsuits after a software glitch (Koch, 2004).

5.8.4.1.2. R&D Integration

Some mergers and acquisitions are mainly justified by the R&D capabilities of the target company, its patents, intellectual properties and especially its human capital. Integrating R&D facilities mean selecting the projects, either planned or under execution, which will support the business strategy of the new company. Redundancies must be eliminated to save towards the premium paid as synergies. Two main challenges to be overcome are the cultural differences in the R&D environment between the acquirer and seller, and the geographic locations. A good example is the case of Siemens’ acquisition of Orsi Automazione S.p.A in Genova, Italy and Compex in Ninove, Belgium. Siemens Simatic IT software product, formed as a fusion of the portfolio of both companies, required both R&Ds to be located under one roof to facilitate the integration of products based on different technologies. After deciding to transfer the R&D from Belgium to Italy, many crucial professionals from Compex didn’t accept the change imposed by HQ, leaving the company and taking with them precious expertise needed to recoup the investment in the acquisition. Besides the relocation, the cultural differences (Italian vs. Flemish) were apparently an important factor in their decision to leave the company as well.
5.8.4.1.3. Purchasing Integration

The gains due to economy of scale through consolidation of the purchasing functions from both companies can be substantial. According to (CHAPMAN et al., 1998), Purchasing and Supply Management can reduce the total costs of goods and services by 10 to 15%, which in turn can represent more than 50% of the control premium paid in the acquisition. So, big payoff is achievable by good purchasing management integration. As both companies may purchase goods from different suppliers, the merger may increase the buyer’s bargaining power in negotiating new prices. As mentioned, this is not an easy task as some suppliers, such as software and royalties, may charge a lot for transferring the ownership from the target to the acquirer, especially if the good involved is crucial to its business.

5.8.4.1.4. Manufacturing (Operations) Integration

Manufacturing capacity and capabilities from both companies need to be rationalized. Excess capacity needs to be reduced by selling assets with lower efficiency. Another source of savings is having assets which spare parts are common, so maintenance costs and spare parts inventories can be reduced. Relying on a single vendor is good in this sense, however care must be exercised to avoid becoming trapped and not being able to negotiate prices. As spare parts are not bought in large quantities, volume is not a way of saving, but the ability to buy such parts from different vendors. More and more IT is penetrating into the operations layer, increasing the complexity in integrating facilities with different IT ecosystems, as mentioned in the IT integration section.

5.8.4.1.5. Inbound and Outbound Logistics Integration

A merger or acquisition can also offer opportunities to re-engineer the inbound (supply) and outbound (distribution) logistical networks. As an example, consider two fictitious companies, the acquirer and the target as in Figure 5–6. Both work in the same business (food production). Each company produces two different products (P1, P2, P3, P4), one product in each plant. Four suppliers (A, B, C, D) deliver raw materials to warehouses belonging to each plant. Before the merger, both companies were competitors and could not share facilities. With the merger, many savings through synergies can be realized:

- The number of suppliers was reduced to gain in economy of scale by renegotiating contracts;
- One plant in France was kept and got extended by relocating production from the closed plant. This allowed economy of scope in labour, reduction in fixed costs and the closure of one warehouse;
- The 2-echelon distribution network was streamlined by eliminating transit points and improving the existing warehouses in Germany and Spain to supply the customers in UK, Poland and Italy, while compensating the closure of the warehouses in France and elaborating the distribution of goods from each plant to the existing warehouses.
5.8.4.1.6. **HR Integration**

In a merger or acquisition, HR functions are rationalized, redundancies are eliminated and certain tasks, such as recruiting, are outsourced. Payroll, benefits and other related tasks are centralized in the acquirer company as soon as possible. IT integration of HR systems may be delayed and so both HR systems and employees may need to remain in place until the integration is completed.

5.8.4.1.7. **Marketing & Sales Integration**

The possibility of cross-selling is a significant synergy that should be explored by the combined company. All selling staff should be at least familiar with the entire portfolio and whom to contact in case customers need assistance. Distribution channels need to be informed about the merger, the changes in products, brands and economies of scale exploited. CRM systems (part of IT integration) should be merged to better support the customer and allow effective cross-selling opportunities.

Marketing is a critical matter as it was mentioned in section 5.6.5. The marketing plan should be executed, whether to keep target’s brands, phase them out over time or stop selling their products altogether. Marketing should also entail the decision regarding the company name.
5.8.4.2. Building a New Company Culture

Company culture is a set of values, traditions and beliefs that influence management and employee behaviour within a firm (DePamphilis, 2011: 235). Much of the culture is a legacy from its founder(s) and goes beyond the code of conduct or how the office is decorated, reflecting on the way employees relate to each other and with customers. Some companies value teamwork and collaboration whilst others instil competition among employees. There is no “right or wrong” culture, the same way there is no right or wrong language, all have advantages and disadvantages. There are mainly 3 outcomes from a merger or acquisition regarding the company culture, which are also a reflection of the size of the companies involved:

- **The acquirer imposes its culture on the target:** This is the least advisable course of action, as it tends to create resentment among the target’s employees, creating hurdles to the integration. If a large company acquires a small one, it is virtually impossible to create a new culture each time a new acquisition occurs. For example, Siemens acquisition of companies in Brazil, Italy, Belgium, Germany. The name Siemens swallows the acquisition’s culture, with very few exceptions, such as ChemTech Brazil, which managed to retain its identity. Others, such as Orsi and Compex ceased from existing from day one.

- **The merger of two companies creating a new culture:** the new company is created with a new culture, based on the best of both cultures or an entirely new one to avoid bias. One good example is MillerCoors;

- **The acquirer let the target company retain its culture:** In this case there is no real integration, as the acquirer benefits from the access to information, patents and other assets, but there is no significant cooperation. It is similar to a joint venture, where both partners are comfortable with each other and don’t worry about sharing information with each other. An example is the EMC-VMWare acquisition.

Management should give much attention to how culture is handled. Management should preach a shared vision, a set of core values and behaviours deemed important to senior management (DePamphilis, 2011: 237). It is unrealistic to expect the culture to be assimilated overnight. It may take years to “stick” to the employees’ day-to-day life in the company. And full integration will not happen unless both companies’ employees share common space, so they can mingle and build rapport with each other.
6. Results and Discussion

During the extensive literature review that laid the ground to this work, the author found that some equally critical aspects to a successful merger or acquisition were missing in nearly, if not all, literature sources. Some of such critical aspects missing or not well explored were:

- **A clearly defined framework for M&A projects:** one of the major contributions of the PMI to this work was its framework and the way it neatly states the knowledge areas and processes which may be involved in a project. In no occasion a single clear, straightforward picture of the expertise areas involved in undertaking such type of project was ever found in the revised literature. Therefore, departing of an already proven framework, one of the major contributions of this work is to define such a framework specifically for M&A projects. This can be seen in Figure 5–3. The existing PMI framework received 6 new knowledge areas.

- **The “forgotten” knowledge area:** One interesting fact that has come to the author’s attention was the almost complete disregard in relation to the marketing knowledge area. Especially nowadays due to the critical role brands play in customer loyalty, the merged branding aspect is crucial to how the new company will be perceived by both customer bases. Before a merger, both companies need to independently assess the customer reaction to the change. In the marketing world, 1 + 1 may yield 3 but also 0. Therefore, in the proposed framework, proper attention was given to the marketing topic, geared towards mergers and acquisitions.

- **Why did we go into this mergers by the way?** As anything in the business world, no action should be taken without founded reasoning. No one goes out shopping for a company because of an “Eureka” moment. Both mergers and acquisitions are risky business decisions. Another gap identified in the literature was the reasoning behind the decision of merging with or acquiring another company. Authors such as (DePamphilis, 2011) and (McGrath, 2011) are experienced in the M&A field as they participated in multiple projects. Nevertheless, a beginner should not only know about what M&A is and what is involved, but also understanding the why one goes for that is equally important. This is a gap filled by this work as well by introducing the reader to a case study illustrating clearly the process of finding the why before the how or what. This is done in chapter 4 using the outstanding strategy maps and balanced scorecards proposed by (Kaplan and Norton, 2004).

- **Extending the framework into methodology:** After introducing the framework with the 6 new knowledge areas, each new area was extensively explored and the existing PMI standard areas were also discussed when a new approach or focus was needed compared to what was originally in the PMBOK. So, there was no intention to repeat what was already available in the literature. Besides, a temporal dimension was added by splitting the project into phases and corresponding stages where the knowledge areas are applied, as shown in Figure 5–1 and Figure 5–2. This sequences the events in an M&A project, giving the reader an understanding of when a given knowledge area is needed and their dependencies in relation to each other. This portion of the
work was partially based on the practical insights given by (McGrath, 2011). Given McGrath’s practical experience in M&A projects, it is prudent to depart from his approach to limit risk in this portion of the work as well. The modifications added compared to McGrath’s approach are a consequence of the understanding captured in the literature review and the author’s critical thinking and judgement.

- **Focus on the practical approach:** Since the beginning of this work, the author aimed at developing the work in a way it could be used by practitioners and project managers. Templates and documents were not developed due the limited time available to do such. Besides, (McGrath, 2011) makes some templates available which are quite helpful as a starting point.

- **Plenty of recent and relevant examples as a learning and motivation enabler:** The use of relevant examples along with theory is not only a good way of making the idea stick to the reader’s mind, it is also a good motivator, as it shows the theory the reader is spending time on can be used in practice.

Section 5.8.4.1 was written only with practical aspects in mind. Much of the author’s experience in IT projects prior to the masters and the contents learned during the masters were of great importance to write this section as comprehensive and practical as possible.

Another important contribution of this work is delivering all the basics about M&A projects in one place. In reality, depth and breadth cannot be satisfied concurrently due to several constraints (time, expertise, etc.). By offering the basic knowledge and options available with sufficient coverage (breadth), the reader can look for specialized literature in a given topic (company valuation, marketing etc.).

The author benefited enormously from this work 2-fold by:

- Acquiring knowledge around the topic of project management, mergers & acquisitions and how the former can be used to increase the likelihood of success of the latter;

- Contributing to the current state-of-the-art in M&A, advancing its knowledge, practice and helping provide a high-quality open-source of information to those willing to learn about this fantastic topic.

### 6.1. Limitations

The most significant limitations in this work as identified by the author are:

- **Validation:** This was a limitation already foreseen from the outset of this work given the restricted time and access to experts in the area. This could be validated against existing methodologies in use by consulting companies, however having access to such proprietary materials is a complicated matter. Another source of validation is consulting experts and professionals active in M&A. By looking at the methodology proposed here and how it is approached, professionals could provide reputable
opinions on its strength and weaknesses. Unfortunately having access to and time
with such professionals was not possible with the available timeframe. So, a next step
in this direction would provide more credibility and possible suggestions on
improvements for this work.

- **Development of templates, documents and other tools:** No such tools were
developed due to time limitations and to fulfill the purpose of this work as being a
generic methodology adaptable to different M&A projects. However, (McGrath,
2011) provides some good templates which can be used as a starting point. As
expected, such tools are somewhat dependant on the industry.
7. Conclusions

The area of Mergers and Acquisitions has been receiving continuous attention due to its strategic potential in making companies more agile in delivering innovative products and services instead of relying solely on organic growth. At the same time M&A is considered an extra tool in the management’s strategy portfolio with significant potential rewards, it also bears many risks and pitfalls which must be known and dealt with when applied. One way of unlocking the potential of mergers and acquisitions whilst reducing risks by is applying a solid and carefully selected project management methodology. For beginners in the area of M&A, it is very difficult to get acquainted with the topic without reading several books, some of which exposing contradictory views. Therefore, this work sets forth the goal of developing a Project Management methodology tailored to M&A projects, for both practitioners and beginners willing to learn about the topic.

At first, an extensive literature review was conducted in both the M&A and Project Management literature.

Mergers and Acquisitions were defined, their variations presented and the role of Corporate Governance was discussed. The role and importance of due-diligence in M&A was discussed as well as the concepts needed to conduct it, such as corporate valuation techniques. Readers are also brought abreast of the reasons CEOs resort to a merger or acquisition of another business and why such undertakings fail so often.

The concepts related to project management were explored. The choice of the PMI project management methodology over others was justified and the PMI framework was introduced. Project, Program and Portfolio Management were defined. The role of a Project Management Office (PMO), the different types and level of maturity were also explored as well as the different factors which influence the project management practice within companies.

A case study was introduced in chapter 4 as a way to demonstrate how and why the top management within a company decides to adopt a merger or acquisition as means to achieve their strategic objectives.

Using the background provided in the literature review and the case study, the proposed project management methodology for M&A projects is presented. The framework with the additional six knowledge areas is presented: Marketing, Budgeting, M&A Tactics, Legal Aspect, Financing and Valuation Management. Each one of the six newly defined knowledge areas is discussed in details, both related to what they entail as well as the activities involved in each area. For the existing knowledge areas as per the PMI framework, they are adopted as-is, except when particularities in the context of M&A projects calls for changes or amendments to the existing knowledge. References to real cases of mergers and acquisitions related to the knowledge area were added to facilitate the understanding of the topic.

In addition to the framework, the M&A project structure is set by defining the phases and its constituent stages:
• Phase 1 - Project Planning & Definition: Strategic Planning stage;
• Phase 2 – Search & Screen Targets: Search and Early Due-Diligence stage;
• Phase 3 – Go-No-Go Assessment & COC: Negotiation & Due-Diligence, Pre-COC and CoC stages;
• Phase 4 – Integration Work: Integration Planning, Post-CoC Integration and Business Continuity stages.

Each phase was discussed in detail, providing the reader with enough content to understand what each phase is about, what to consider and watch out for.

7.1 Recommendations for Future Research

The field of mergers and acquisitions is extensive and very dynamic. Each M&A wave brings about different motivations and strategies in the field. The concept is applying project management methodologies in such undertakings is not new, however the publicly available methodologies geared towards such area are few. The methodology developed through this work is generic, being suitable to use in most M&A projects.

Given the limited time available to dedicate to this work, developing a comprehensive methodology including templates, documents and other tools for the project management task was not possible. This work intended to provide a solid background in the topic, yet letting project managers adapt it and develop their own templates and tools to support their work. As always, this methodology can be further improved and complemented.

Therefore, the following recommendations for future research can be made:

• Consult experts in the field requesting their opinion on the robustness, completeness and applicability of the methodology developed in this work;
• Develop forms, templates and other tools to make this methodology more tangible and ready-to-use;
• Validate the methodology by applying it to real cases and make a gap analysis of what is missing to make it more complete, effective and efficient methodology;
• Develop on the content of each process on Table 5-1.
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Appendix A: Strategy Setting Toolkit

In section 4.1 the case of “A Limited” was explored. The mission, vision and values of the company were defined. Management knows the mission (the purpose of A’s existence, what markets and sectors the company plays and what it intends to bring to its customers), the vision (what the company intends to become or mean in the future) and the values (principles, beliefs and organizational conduct with all stakeholders). The strategy provides guidance directing the next step towards the vision. There are 2 types of strategies: corporate and business strategies. Corporate strategy concerns the entire enterprise or holding company, such as conglomerates, multi-products and multi-sector companies. The strategic plan addresses which business units deserve investments, which should be divested, markets with better prospects to grow within, etc. The business strategy is devised by each business unit’s management in a corporation to fulfill each unit’s requirements as set by CEO. The combined results from all business units will yield the corporate results placed upon the CEO by its stakeholders through the Board or Directors. Each business then would devise their own tactical plan (short term) and operational plan (day-to-day operations).

Reflected in the mission and vision of the company is the strategy type adopted by the company, which in turn will guide designing the strategic Plan. Each strategy level has its own purpose and should be treated separately. As discussed, such strategies affect the entire company and percolates down to the lower divisional and business unit levels strongly influencing their business strategy plan. Examples of common corporate level strategies are, as per (DePamphilis, 2011: 138-139)

- **Growth strategy**: focus on consolidating revenue, profit and cash-flow growth.
- **Diversification strategy**: Diversify current business by entering new related of unrelated sectors and areas. A good example was “A Limited” planning to enter into the healthy food business.
- **Operational Restructuring strategy**: This is seen as a turnaround or defensive type of strategy in response to threats. Selling subsidiaries, product lines partially or in its entirety, downsizing and selling unprofitable or non-strategic facilities, bankruptcy protection and liquidation.
- **Financial restructuring strategy**: aims at changing the company’s capital structure (debt equity ratio) to improve the cost of capital, for example. Excess cash (something rare these days) can be used to acquire companies, pay dividends or repurchase shares back from the capital market. Apple downloaded US$45bn from its US$100bn cash pile into the market in March 2012 in form of dividends and share repurchase (Waters, Nuttall and Bradshaw, 2012). Some investors see Apple’s strategy as a sign of losing steam in its innovation business strategy, as paying back dividends cannot be invest in R&D. But Apple’s CEO claims “the decision will not close any door on us” (Rubin, 2012).

Business strategies are related to how the company will achieve its objectives considering the time and resources constraints/availability. The strategy is presented in the strategy
map in the 4 perspectives (Financial, Customer, Internal, People & Knowledge). The 4 common business strategies are (DePamphilis, 2011: 138-141):

- **Cost or Price Leadership Strategy**: the main focus is to compete in price, keeping quality and availability acceptable. There are different ways to achieve cost advantages. Some tools, such as the Experience Curve and the Product Lifecycle Factors introduced by The Boston Consulting Group (BCG) shed some light in this strategy. In short, the Experience Curve Factor refers to the costs reduction achieved by streamlining the production processes over time. This principle works well for commodity-products companies, with economies of scale playing a role in the reduction of costs by spreading fixed costs over larger production volumes. Increase of market share also helps in the cost leadership, as long as not many competitors try to lower the prices as much, otherwise it turns into a self-defeating tactic through ever lower profitability and no differentiation. According to the Porter 5-Forces analysis, early entrants in a market enjoy lower cost-related barriers and competition, as the experience curve and market recognition keep late entrants at a cost disadvantage. New products at its infancy require heavy investments which cause negative operating cashflow. Early entrants have advantages such as strong sales growth, market share and experience, which cause costs to fall to levels which a new entrant cannot operate at as sales won’t be as strong as for the early entrants. There are many pricing strategies (Figure A-1) that companies can use, however care should be exercised because some of the strategies are illegal in some countries (such as predatory prices). Low cost airlines, such as Ryanair for long started using yield management to take advantage of marginal cost pricing.

- **Product Leadership Strategy**: Based on competing through differentiation, such as brand image and product features. Apple products sell at a premium relying on its image and for being either the first or the first to make the difference in the market. Smart phones exist since early 90’s, but no company did a better job than Apple in marketing the iPhone and requesting an outrageous profit margin. It shows that consumers don’t mind paying extra to have what they want. This advantage will erode over time as more and more competitors enter the business. Software companies lure customers in upgrading existing software by releasing features the customer may want. Banks issue credit cards from the same provider (Visa, Master Card), but attract customers by offering higher credit limits, insurance service, etc.

- **Customer Solution Leadership Strategy**: The Company offers commodity to the customer by providing a one-stop shop to fulfill their needs. The key point of the strategy is attracting and keeping customers with high lifetime value, use different ways for up-selling and cross-selling to increase profitability whilst keeping the customer satisfied. A supermarket that delivers groceries for free at home for those without a car tend to keep the customers from going to other shops even after competitors open stores closer to the customer’s home. A cable company such as Rogers in Canada which provides cable TV, internet, cell phone, video rentals (to compete with stores such as Blockbuster) can find ways to keep the customers. For
such companies, having all stores and businesses connected by a well-implemented CRM system is a key factor of success.

- **Lock-in Strategy**: This strategy works for both B2B and B2C, in which the switching costs are made (artificially) high to prevent customers from going to competitors. Cell phone companies are well-known for this strategy. The customer is lured into signing a contract (from 1 to 3 years) in which the cell phone device is sometimes “free”, but the customer pays a heavy breach of contract fine when switching to another provider. Service providers or so-called partners to companies such as Siemens, GE, Rockwell, have to spend large amounts to be accepted as a “certified partner”, including training and fees. Switching to another company means throwing this investment away, what prevents such practice to the advantage of such big companies.

- **Focus or Niche Strategies**: The company focus its efforts and resources in a given product line, target market, geographical area and customers segments by understanding the customer needs better than the competitors and targeting the right customers (DePamphilis, 2011: 140). RedBull is a classic example: the company has mainly one product (energy drinks) and its success is attributed to aggressive marketing campaign by sponsoring sport competitions and other exclusive events.

- **Hybrid Strategies**: a combination of the aforementioned strategies.

![Pricing Strategies](image)

Figure A-1: Pricing Strategies (Biz/Ed, 2004)

The selection of the strategy, both at the corporate, sector and business unit level will then drive the selection of the critical processes and objectives in each of the 4 perspectives to develop the strategy map:

- **Financial Perspective**: what will deliver long-term shareholder value;
- **Client Perspective**: what the value proposition is that will ultimately drive the customer to buy from us instead of from competitors;
• **Internal Perspective**: processes which will support providing a winning customers value proposition. Processes in the Operations, Innovation, customer management and Regulatory & Social;

• **Human & Knowledge Perspective**: The pillar to the entire strategy development, sustainability and achievement – Human, Information and Organizational Capital.

Other tools and frameworks which may help refine the strategy:

• **SWOT Analysis**: As part of the strategy setting process, it is essential being familiar with the external environment where the company operates by being aware of the opportunities and threats, as well as being realistic about the internal strengths and weaknesses the company currently possesses.

• **Porter 5-Forces Analysis**: Framework used to create awareness on the forces to which the company is subject, affecting the choices for markets, products, target customers, sourcing and purchasing policies, profit levels, product lifecycle span, etc. The 5 forces are: bargaining power of suppliers and customers, barrier for entrants, threat of substitutes, industry rivalry. When using this framework of deciding to open a subsidiary in Brazil, for example, you realize the entry barriers are unusually high in that country. It was ranked the 127th in the world in terms of ease of doing business. Consulting firms such as KPMG advice companies with plans to have operations in Brazil not to try to open a branch, but to open a new company, due to the complicated tax rules, compliance with the law and lengthy approval processes (Bevins, 2010). In such cases, a faster option is to acquire a local company and use their already established framework to avoid headaches with the local authorities.

• **Value Chain Analysis**: Evaluate the company’s processes and how much value each one adds to the company business. This is an effective way to understand where internal links can be improved to maximize synergies among the different functions. This is especially useful to find weaknesses to be resolved and strength to be leveraged on. Acquisitions can be of help to strengthen areas such as R&D and operations.

![Figure A-2: Value Chain Analysis](image)

• **BCG Matrix**: framework which supports the decision to divest or acquire product lines or entire holdings based on market share and industry growth rate. The strategy associated with this tool is to hold stars, harvest cash cows (or cash flow), build question marks and divest dogs. The funds from cash cow business should help funding stars and build question marks while dogs are divested to prevent from dragging the other businesses down (Tuck School of Business at Dartmouth College,
1999). For example, the Siemens Supervisory Board approved the sale of Siemens VDO to Continental AG in July 2007. Siemens VDO was a leading automotive parts manufacturer (Tier 1) which was in great shape financially before the global crisis in 2008. Siemens managed to sell the division at its peak value, possibly foreseen the crisis in the automotive sector coming with the global crisis starting in the same year. With the proceeds from the sale of this “future dog”, Siemens AG acquired UGS (Unigraphics) to enter in the Product Lifecycle Management (PLM) software business, which has seen increased adoption among many companies worldwide (a “question mark” with potential to become a “star”). So, the strategy adopted was to focus efforts in key areas, such as industrial software by freeing up resources from areas with uncertain horizons (automotive sector).

![Figure A-3: BCG matrix]

- **Strategy Maps and Balanced Scorecards**: Excellent framework to put on paper in a neat way the strategies, objectives, measures, targets and action plan. It has been explained in detailed in section 4.1.3.

- **Synergies**: This is not a tool *per se*, but it is very helpful in analysing the potential of M&A to the business. Considerations include acquire competitors in the same business to grab market share and increase production levels of commoditized products to spread the fixed costs over higher production volumes to gain economies of scale, penetrate new geographic regions, obtaining better management skills, etc.

With all these tools, management is ready to craft their strategies at the corporate, sector and business unit levels and set objectives in each level. Building a strategy map at this stage is highly recommended. The Business Scorecards and Action Plans should follow the Strategy Plan. The Action Plan will support the strategy execution. Among the defined actions there could be investment of US$ X in R&D, open a new plant to increase output by X%, and establish a Joint Venture to co-develop a new product to target a given market niche, etc. Therefore it would be at the actions level that a merger or acquisition would be listed, as a means to achieve a certain target, not the other way around.

Either at the corporate, Sector or Business Unit level, a project portfolio would be defined to implement what was set in the Actions Plan. One of these projects can be the acquisition of a company. For example, within the corporate portfolio one could find projects to build new factories in low wage countries to shift production from high wage countries, marketing campaigns to fight competitors. Acquisition projects would very likely be part of the portfolio. And the M&A plan is the project plan.
Appendix B: Contacting the Author

This thesis is one of my latest “pearls”. It was carefully crafted in a topic I chose and pursued on my own. It encompasses much of my professional experience to date and a significant portion of the content presented in the International Masters in Industrial Management. Besides, a great deal of self-study in the area of Mergers & Acquisitions took place to provide enough background to write this work. Of course, there are many areas in which you may have a different point of view. I’d be glad to hear your opinion, improvement suggestions and even constructive criticism. I am available for consultations as well. In LinkedIn you can find me under my name.

My email is: fabiosc@kth.se

Skype: fabiosottili

With kindest regards,

Fabio Sotili Chaves, P.Eng.