M&A Integration - How Much Pre-Close Planning is Appropriate?

A Metre22 Article

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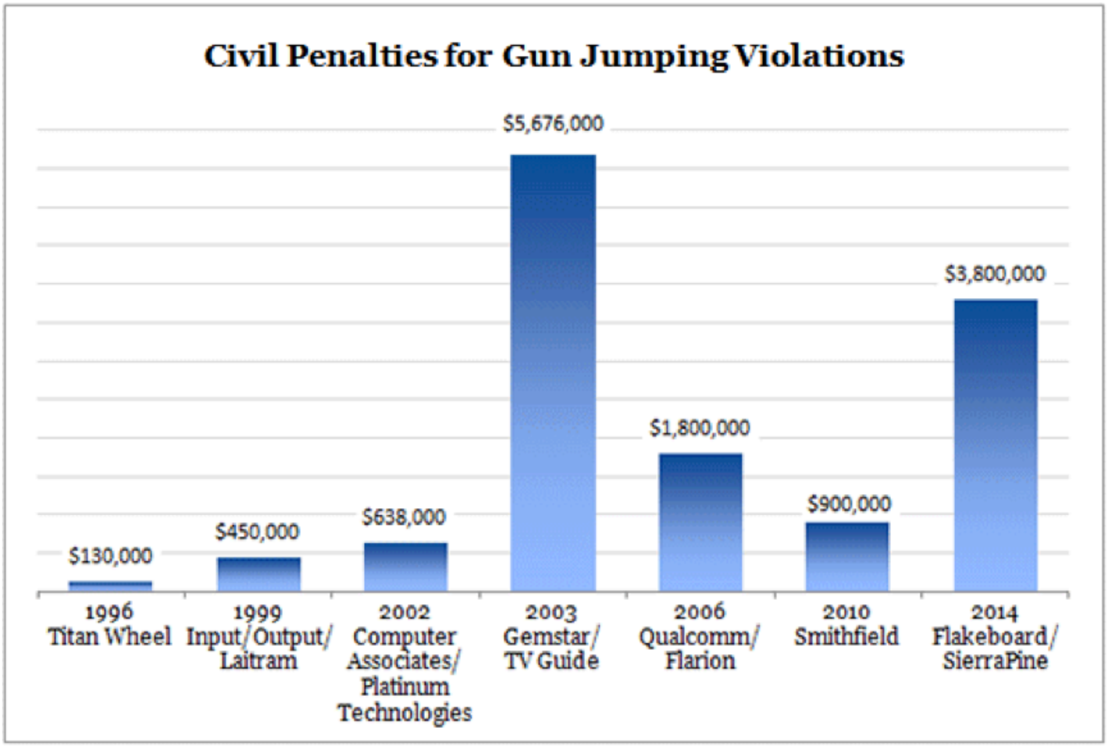
Numerous studies, executives and consulting pundits have extolled the virtues of planning for the integration of a merger or acquisition as early as possible. But what exactly does that mean from a practical perspective?

In our view it is not a matter of *"if"* integration planning should be done prior to transaction closing, but rather a matter of *to what degree?* In our view, the decision regarding the degree of integration pre-close planning efforts needs to include the consideration of three factors.

Factor 1: Will integration planning in a certain area significantly increase the risk of "gun jumping" behaviors?

In the U.S., the Department of Justice and Federal Trade Commission require a pre-notification filing for qualifying transactions 30-days prior to deal completion, with the possibility of this period extending to 60 days. Generally speaking, the DOJ and FTC allow for companies contemplating a combination to share information with each other prior to a transaction for two purposes: A) Due Diligence and B) Integration Planning. What the agencies do not want is for companies to change their behaviors in the market – particularly the degree to which they compete – because of a pending deal. Doing so is commonly known as "gun jumping" and, even if the deal eventually passes regulatory muster, gun jumping can result in penalties. The chart below shows selected penalties levied by the DOJ for gun jumping.



While gun jumping won't prevent a deal from going through, it is critical that integration planning efforts do not affect how the companies behave in the market. See the insert for a simple example of how early-planning can lead to gun jumping.

In our experience, if there is a fair degree of confidence that the deal will go through, the benefits of *contained, well-governed* pre-close integration planning outweigh the risks. The key is to ensure:

- Integration planning is limited to a focused group of resources
- All involved in the integration planning effort receive a full briefing on permitted and non-permitted behaviors
- Exchanges of sensitive information which could tend to influence market behaviors, even if inadvertently, should be vetted through counsel before sharing. This includes items such as:
    - Detailed product pricing, product margins, planned price changes, or trade promotion spending
    - Customer insights, creditworthiness, revenue details, contract terms, product launches or specific customer information
    - Product specifications or the identity of suppliers

An Example of Pre-Merger "Gun Jumping"

Two merging companies have software products with similar capabilities and functionality. During early integration planning, it becomes clear that the design and underlying architecture of Company A's product are superior and a decision will likely be made to discontinue Company B's solution post-merger. A member of the product integration planning team shares this information with a sales executive at Company B, who then instructs her sales team to redirect their sales efforts away from the likely discontinued software product and to focus on other solutions.

Factor 2: How much competitive advantage do we maintain by keeping certain information a secret?

Every company has confidential information that is an important asset and provides competitive advantage. That information asset could be significantly devalued if improperly disclosed during integration planning prior to the closing of a merger or acquisition. Sometimes, in the heat of the negotiations to close a deal, executives can forget that not every deal that has reached LOI stage is actually consummated. We've seen many deals come apart for a variety of reasons – interloping third parties, failed shareholder votes, rapidly changing economic factors, and regulatory agencies blocking deals. Because of this risk, we think it important to refrain from directly exchanging any information that is competitively sensitive prior to deal close. Examples of competitively sensitive information might include:

- Product roadmaps
- R&D pipeline information
- Unique manufacturing or other processes that provide a competitive cost advantage
- Proprietary pricing algorithms
- Sales/prospective customer pipelines and pending proposals

Again, we still believe a contained and well-governed pre-close integration planning effort has benefits that outweigh the risks of exposing confidential information. The process just needs to be managed tightly with involvement from counsel. One way to further manage this risk yet make progress on integration planning pre-close is to use a "clean room" approach. In this approach, sensitive information is fed from both companies to a third-party such as a consulting firm. The third-party then performs analysis on the sensitive information and reports back findings in the aggregate to support integration planning. For instance, the third-party could analyze current customer lists or sales pipelines and report back on the degree of overlap in the overall customer base or pipeline and even breakdown overlap by region – information that could be useful for salesforce integration planning.

Factor 3: To what degree might integration planning discussions have a negative impact on our ability to negotiate a deal?

The final factor executives should consider before determining the degree of integration planning to take on pre-close relates to the status of deal negotiations themselves. This is especially relevant in situations where the purchase agreement has limited recourse for one party or the other backing out of the deal. Integration planning discussions inevitably surface some very touchy issues. Depending on where the companies stand on those issues, integration discussions can become contentious as the picture of how things will play out after the deal is closed takes shape. Occasionally, conclusions about how the post-deal integration will unfold can actually cause the board and executive team to abandon the deal and choose another path to create value. A rare occurrence? Yes. But we've seen it happen. This situation can be managed by taking certain decisions off of the table until after deal close.

All told, the value of early integration planning – typically kicking off post announcement, but prior to deal close – is significant. Integration success depends on getting decisions made quickly and executing with breakneck speed. Having a well-governed process in place and educating those involved in planning on the risks above can ensure that the deal gets closed, legal issues are avoided and the integration is successful.