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TECHNOLOGY, MEDIA & TELECOM

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# Tying the knot? Untangle it first: successful postmerger integration in telecommunications

European telecommunications companies are on the hunt for attractive mergers-and-acquisitions (M&A) deals—especially ones that can help them boost their competitive positions in order to drive profitability and growth. But they're potentially setting themselves up for massive disappointment during the postmerger integration (PMI) process.

Why? Because the deals they're engaging in are astonishingly complex—creating Gordian knots that have to be untangled before companies can "tie the knot." Making matters worse, all too many telecoms are still struggling to master PMI basics. The upshot? If they don't act now to surmount those challenges, our calculations suggest that they could experience value destruction to the tune of €1.5 billion to €2.5 billion[1] annually after the ink on their M&A contracts has dried. Not the picture of wedded bliss that every M&A player dreams of. But it doesn't have to end up that way—if companies strengthen the quality of their PMI planning and preparation.

For M&A-minded telecom players in Europe, tying the knot today looks decidedly different from tying the knot 10 years ago. Back then, the M&A landscape saw fewer same-territory deals than today—which always come with complicated mandates handed down by competition authorities. Deal structures were more straightforward then, and the players involved faced

[1] The amount of telecom M&A deal value in Europe stands at €50 billion to €70 billion every year. Our estimates suggest that value destruction could reach an average of 1 to 3% of deal value, climbing to 2 to 5% for the largest deals posing especially complex PMI challenges—which would translate into the €1.5 billion to €2.5 billion in value destruction calculated above.

**FIGURE 1:** TELCO M&A DEALS HAVE GONE FROM 'PLAIN VANILLA' TO 'EXOTIC'

**TYING THE KNOT 10 YEARS AGO**

'Plain vanilla'

- Few same-territory deals, mostly growth focused
- Few players involved
- Simple deal structures, few regulatory hurdles

Iconic deals

- Tele Danmark acquired by PE consortium 12 billion – largest PE deal in Europe at that time)
- Cesky Telekom acquired by Telefonica (€6.3 billion)

Increasing deal complexity driven by industry maturity

**TYING THE KNOT TODAY**

'Exotic'

- Many same-territory deals and consolidation plays
- Multiple players involved
- Complex regulatory and operational implications

Iconic deals

- Three + Wind Italy (+Iliad involved) (€20 billion)
- Three + O2 (+ Vodafone and EE involved) (€13.5 billion)
- Orange + Bouygues + SFR + Iliad (€10 billion)

Source: AlixPartners

fewer regulatory hurdles. Finally, the most-iconic deals aimed at expanding geographic presence and revenues by bolting acquired companies onto their new parent organisations, and the deals involved only a few parties—typically, just two. Against that plain-vanilla backdrop, the integration of companies was fairly manageable. We're not saying it was easy (what marriage is?). And in fact, many deals failed to deliver the hoped-for value in the PMI period. But compared with the scene today, companies had to wrestle with fewer levels of complexity a decade ago.

Fast-forward 10 years to today, and it's a whole new picture: the European telecom industry has matured considerably, and companies have seen their rates of growth level off. The M&A landscape is awash in complicated, same-territory deals powered by consolidation strategies for improving competitive positions in order to drive profitability and growth. Acquired firms have to be more thoroughly integrated into their new parents to support consolidation. And more deals involve higher numbers of players. In the Three UK and O2 deal, for instance, existing network-sharing agreements with Vodafone and EE highly complicated matters. Then there was the deal contemplated among Bouygues, Orange, SFR, and Iliad—perhaps the most mind-boggling of them all, with three players sharing bits and pieces of Bouygues among themselves. Both deals failed, but the targets are still very much in play—and any new deals that emerge won't be simple to execute on. The latest complex deal, which this time has survived regulatory scrutiny, is the merger between Wind and Three in Italy. Iliad is stepping in here to create a fourth operator by picking up select assets divested by the merging companies. The watchword for today's overall scene could arguably be *exotic*.

## EVER-DEEPER ENTANGLEMENTS

Again, M&A integrations are never easy. In AlixPartners' recent survey[2] of 120 Telco executives on the theme of PMI performance, many of the respondents acknowledged grappling with "wicked problems"—challenges widely recognised as persistent and very difficult if not impossible to solve. The thorniest of them include consolidating deal partners' legacy systems, converging and cross-selling the different companies' products, and migrating customer databases. But our survey findings also show that Telcos are underperforming on PMI basics as well—particularly on validation of synergies, workforce reductions, preparation and planning, and leadership-team transitioning (figure 2). What's more, such mistakes are in capability areas that executives themselves view as critical for successful postmerger integration. This is sobering news in a world already defined by a frightening degree of complexity.

Meanwhile, new regulatory requirements M&A players face are deepening the levels of complexity even further, turning PMI negotiations and execution into Gordian knots nearly impossible to untangle. To pull off an M&A deal today, companies may have to extricate assets out of network-sharing deals or retail partnerships; carve out operations or assets; swap towers, fibre, or retail stores; or build a new business (for example, by creating a new mobile virtual network operator or network or committing to infrastructure investment)—all to satisfy regulators bent on ensuring fair competition (figure 3).

[2] AlixPartners Telecom Executive Survey, conducted in association with ResearchNow.

**FIGURE 2:** TELCO STRUGGLE TO MASTER SOME OF THE ESSENTIALS OF PMI


- It's an accepted wisdom that persistent 'wicked problems' keep Telcos from getting the full value of M&A, e.g.
  - Legacy systems difficult to consolidate
  - Products difficult to converge and cross-sell
  - Customer bases difficult to migrate
- However, Telco executives admit that they are even challenged on some of the basics, e.g.
  - Leadership team transition
  - Validation of synergies
  - Work force reduction
  - Preparing well during pre-closing
- What's more, the most common PMI mistakes made are in areas that Telcos themselves see as key for successful post-merger integration

Source: AlixPartners survey of 120 Telco executives (in association with ResearchNow)

## THE SPECTRE OF MASSIVE VALUE DESTRUCTION

If you're thinking, "This sounds like a tall order," you've read our minds. Tie together wicked problems with underperformance on the basics and then weave in many players and regulatory-driven negotiation and execution challenges—and you've got complication of unprecedented magnitude. And as most executives know, complexity kills. Indeed, some deals today don't even reach the PMI stage; instead, they crumble under the weight of their overly complex structures.

According to research undertaken by certain academia and management consultants for deals that do manage to make it into PMI, more than half fail to deliver the hoped-for outcomes, including cost savings. And some—especially the biggest, most-complex deals—end up even destroying value. In fact, AlixPartners estimates that the European telecom industry could collectively see annual value destruction reaching as high as €1.5 billion to €2.5 billion because of badly executed and increasingly complex M&A deals.[3]

## THE WAY OUT

Clearly, telcos have to take action. To tie the knot successfully in any M&A deal, they'll have to first untangle the complexity knots. But how? Merely picking at the most-visible, most-accessible threads at the outer edges of the knots won't be enough. As Liberty Global CEO and master deal-maker Mike Fries put it, "You are going to have to go in with a much heavier toolbox...I don't think the consolidation game is over—it's just different."[4]

With Mike's advice in mind—and drawing on our own PMI toolbox—we herewith offer two tips for tying the M&A knot successfully under today's hypercomplex conditions: move faster and prep better.

## MOVING FASTER

We see PMI as similar to a military campaign in many respects: to have any hope of succeeding, you have to plan thoroughly, prepare as if your life depended on it, and move as fast as possible. In PMI, those actions are especially crucial when it comes to accelerating decisions about organisational redesign and speeding up the validation of potential synergies.

[3] See footnote 1.

[4] Daniel Thomas, "EU favours competition over deals in telecoms sector," Financial Times, October 22, 2015.

### ACCELERATING ORGANISATIONAL-DESIGN DECISIONS

Let's talk about organisational-design decisions first. Whether an M&A team uses a rapid organisational visualisation and prototyping tool or takes another approach, it has to swiftly experiment with design options, including each scenario's associated costs. Using rapid prototyping, teams can envision overlaying two or more deal participants' current organisations to compare them at the full-time-equivalent, department, and business-unit levels. Thus they can build a picture of what the current companies look like now and then explore options—including those associated costs—for what the combined entity might look like after PMI execution.

The goal is to map (1) resources used for similar activities, (2) duplication of functions, (3) discrepancies in spans of control, (4) inefficient organisational structures, (5) high and low performers, and (6) misalignment in remuneration and incentive levels. The process helps M&A teams quickly identify unusual organisational features and high cost areas and thereby uncover redesign options that could deliver new efficiencies and capture previously invisible synergies. For instance, the analysis might suggest the need for such moves as reducing organisational layers, decreasing head count in specific parts of the newly integrated entity, or decreasing costs by aligning salary bands.

What's more, the analysis can help reduce time to result—which is the amount of time it takes to design the combined new entity and identify organisational synergies—our experience suggests by a factor of five. And that can translate into more-informed and better decisions.

### SPEEDING UP SYNERGY VALIDATION

But accelerating organisational-design decisions isn't in itself enough to help M&A teams move faster. Teams must also speed up their validation of potential synergies the deal on the table could capture. To do so, teams can visualise and compare similar costs in two or more organisations, identify high-cost areas and overlaps, and plot where specific costs are highest in each organisation. As a result, they can more easily spot unusual patterns, such as costs that are being incurred in unexpected parts of the companies. And they can use the resulting insights to test the validity of synergy assumptions made earlier in the deal process. Thus, companies would spend less time modelling the deal and more time ensuring high-quality analyses. And they can thereby avoid a major pitfall our PMI survey respondents identified: overly optimistic synergy estimates.

We estimate there is potential

# €1.5 billion to €2.5 billion

annual value destruction in European telecom industry due to underperformance in executing increasingly complex PMIs

### PREPPING BETTER

In a telecom PMI—as is true for all important endeavours in life—careful preparation can spell the difference between success and failure. Accordingly, we offer three preparation don'ts that, properly respected, can save you considerable heartache further down the M&A line.

**Don't wait for the deal to close**

When an M&A team submits a potential deal to the competition and regulatory authorities, those authorities' processes of required review and negotiation of remedies can drag on for as long as a year. But that doesn't mean you should wait for the deal to close before sinking your teeth into the nitty-gritty, detailed work of PMI preparation. In fact, we maintain that you can thoroughly prepare for many aspects of the PMI's military campaign well before closing.

Yes, you'll have to wait for approval from the authorities, but remember: time is money. Investing in effort to prepare for PMI while the regulatory and competition approvals are in process pays big dividends. Specifically, it'll help you execute transformation of the merged entity more quickly—and start realising anticipated synergies sooner. Moreover, it will improve your negotiation capacity on remedies.

What if the deal ultimately fails? The cost of prepping won't make a huge difference to the big picture. Imagine investing a few hundred thousand or a million dollars in robust preparation early on. If the deal breaks up, the costs you've already incurred along the way could easily reach as high as tens of millions. And if the deal goes through, you could end up saving even more. The money used for prepping starts looking like a drop in the bucket in this scenario.

For all of those reasons, we would usually recommend *overinvesting* in prep during the preclosing period.

**FIGURE 3:** TELCOS ARE FACING HYPER-COMPLEX PMI EXECUTION CHALLENGES


Source: AlixPartners

Using a clean room can help. Clean rooms are especially important when bidders in an M&A deal require highly sensitive information in order to assess key transaction issues, such as those involving customers, organisation, employees, suppliers, or R&D. A clean team—comprising neutral, third-party professionals—is bound by strict impartiality and confidentiality protocols. Team members consolidate and sanitise the information provided by each of the merging parties, they analyse it, and they convey only relevant conclusions to the parties. If the deal falls apart, the parties don't have to worry that sensitive information they've disclosed during due diligence will be made available to the other party or get out to the marketplace.

**Don't assume that wicked problems are unsolvable**

You can also use the preclose period to start tackling those wicked problems we described earlier. Take the especially tough nuts, like how to combine previously separate—and conflicting—legacy systems, how to migrate customers to your new entity's offering, and how to converge products and services from the different companies. Technology—and a hefty dose of courage—can help.

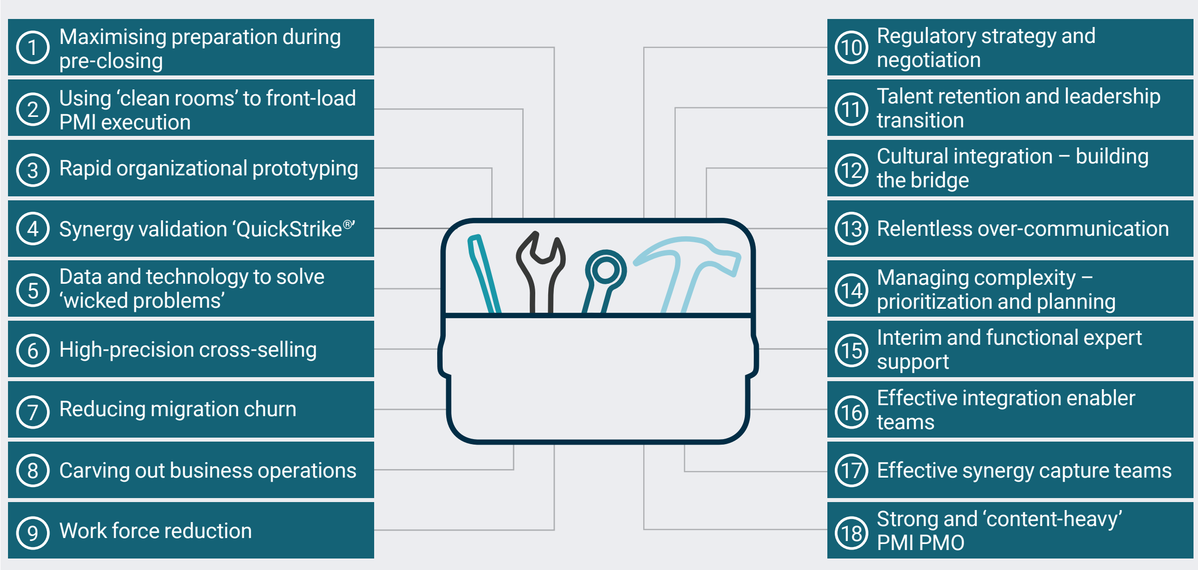
When it comes to legacy systems, for example, today's plug-and-play, software-as-a-service technologies can help you quickly move to a next-generation, fully integrated information technology platform, possibly hosted in the cloud, during the PMI period. You can choose to have your entire new system operate in parallel to the old legacy systems before migrating, or you might want to build parts of your system based on standardised modules. This can help you clean out inefficient or expensive legacy systems and leapfrog the competition with cutting-edge processes and services.

What about customer migration and product convergence? Here advanced data analytics can save the day by helping your newly merged business gather valuable insights about customers and tailor your offerings accordingly. For instance, through rapid data mining in a clean room, you can identify early in the prep phase certain microsegments in the merging customer databases according to how—and how much—each customer uses a smartphone and broadband line for voice calls, over-the-top apps, or entertainment downloads. Then you can design the right mix of features in your service offering in order to persuade customers to rapidly migrate to the new offering after the integration. This could help you reduce migration churn from the often-observed 15 to 20% levels down to roughly 5 to 7%, which the best in class achieve.

**Don't fear structural remedies**

Let's be honest: all too many telcos adopt a rather cavalier attitude when it comes to the structural remedies that regulators impose while reviewing a deal—though the tough stance recently taken by European Union and national regulators has had a sobering effect. When M&A teams present business

**FIGURE 4:** A COMPREHENSIVE TOOLBOX IS REQUIRED TO DEAL WITH TELCO PMI COMPLEXITY




Source: AlixPartners

cases for particular deals to their board, the cases tend to be overly optimistic about deals' potential benefits—such as in the area of cost savings. Then the structural remedies come along—and the picture doesn't look quite as pretty. As a result, the deal ends up looking much less attractive after the regulator has imposed a set of remedies more severe than expected.

But that doesn't mean you have to fear remedies. Instead, beef up your remedy-scenario-planning skills. Using game theory, financial modelling, and seasoned regulatory experts, treat the remedy situation as a chess game, where you figure out who's going to make which moves, when, and how you'll respond. Understand ahead of time the potential economic impact a particular remedy might have on your deal. That way you won't overestimate the value you'll get out of the deal if it gets executed. By doing all of this work up front, you'll become able to enter the remedy negotiation process from a well-informed and confident position.

Carve-outs especially aren't for beginners or the faint of heart. Evaluating, planning, and executing them requires quasi-military precision. So, good prep work is critical here. We would usually recommend that you set up a dedicated team focused solely on the carve-out and invest effort in a solid pro forma earnings-before-interest-taxes-depreciation-and-amortisation and cash model of a potential carve-out's impact on your deal. The team members should have extensive experience with similar situations and possess a broad array of relevant skills—from operations to finance, to legal. By evaluating potential carve-outs early in the deal process, you'll stand a much better chance of swiftly and effectively responding to remedy negotiations—and skilfully implementing a carve-out if the deal comes down to that.

## CONCLUSION: AN OUNCE OF PREVENTION IS WORTH A POUND OF CURE

PMIs have never been easy for European telcos—even in the supposedly good old days of 10 years ago, when M&A deals were simpler in many respects. Today new complications piled on top of persistent, wicked problems, plus telcos' ongoing struggles with PMI basics, have created a hypercomplex M&A environment. And failure to unsnarl the complexities in that environment before tying the knot could doom deals—leading to value destruction that's frightening to shareholders in its potential magnitude.

Thankfully, telcos can take steps to avoid that scenario. The antidote requires considerable investment in planning and preparation that get carried out early in the deal-making process. But the payoff is well worth it: a more accurate picture of a deal's potential value and risks. That picture can help a telco make better M&A decisions, gain a stronger negotiation position with business partners and regulators, capture synergies faster during the PMI period, and build a new entity that delivers the promised advantages. **A**

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