



How Boards Can Govern

M&A Processes To Prevent Destroying Shareholder Value

Special guest:

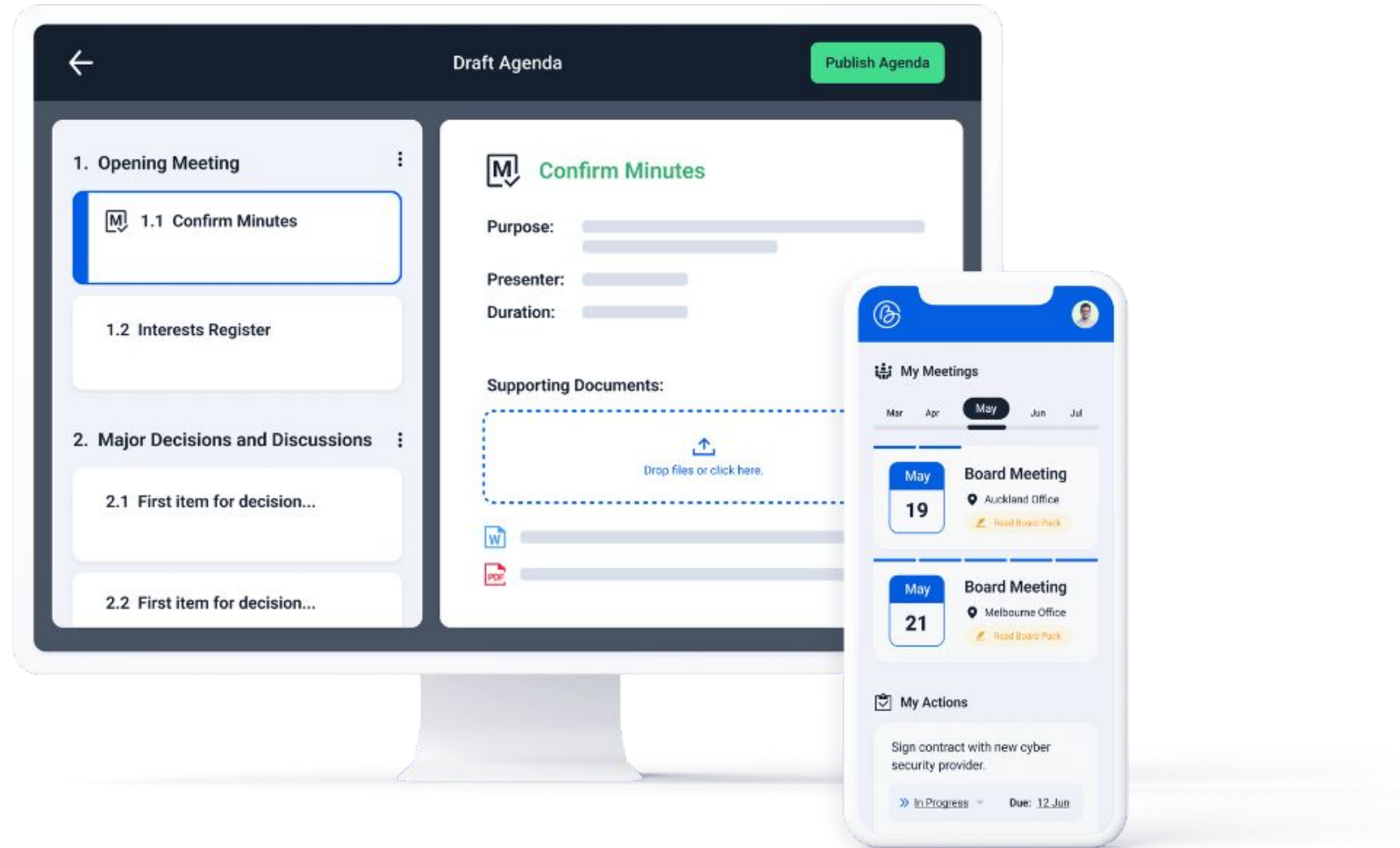
Dr Dean Blomson





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The main logo for BoardPro, featuring a large blue stylized 'B' inside a circle on the left, followed by the text 'BoardPro' in a bold, black serif font with a trademark symbol (TM) to its upper right.





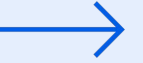
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Director
Direct Capital



Steven Bowman

Managing Director
Conscious Governance



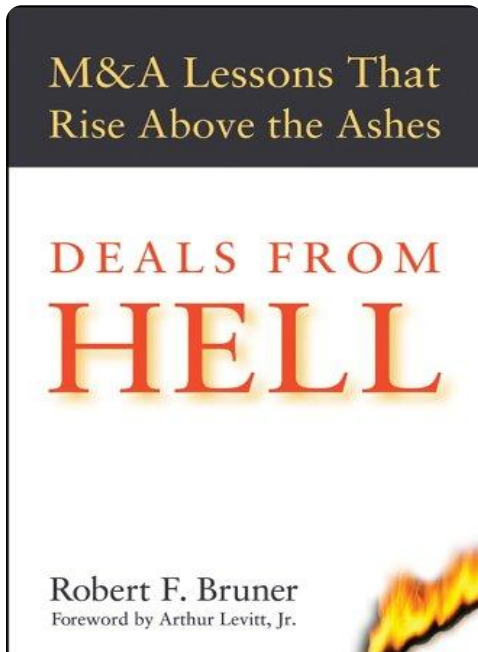
This presentation and discussion looks at what advisors and board members working on acquisitions need to be hyper alert to

There are five key takeaways I intend to share and explore, that I hope will remain with you:

- 01** We need to face a few unpalatable truths. M&A is a 50/50 game – you need to beat the odds. Why are you (as a board/executives/advisers/ company) so special and so sure?
- 02** My research shows that six factors appear to matter most that boards can control or strongly influence, when it comes to delivering shareholder value through acquisitions
- 03** **'Hard' disciplines** - processes, checkpoints, procedures are really important – but soft skills may matter more espec. as complexity increases and 'bias busting' is needed
- 04** **Treat M&A like any organisational capability** – depending on how seriously you view it and whether this needs to be enduring or once-off (build / buy / rent; or a combination)
- 05** **Board members need to achieve justifiable confidence that the company can beat the odds** - and so should ask different, probing questions at each stage of the M&A/ transaction lifecycle, depending on context.



01 M&A, across all time periods and types, is a 50/50 game, at least for buyers



Studies into post merger results are notoriously complicated; so I've drawn on the seminal research by Prof. Robert Bruner.

Research has indicated that anywhere between 50% – 85% of deals fail (a) - a wide range is given as the definition of 'failure' is diverse. One KPMG study found that 83 percent of deals hadn't boosted shareholder returns(b) while a separate study by A.T. Kearney concluded that total returns on M&A were negative (c).

But specific types of deals have better results, on average:

- ▶ Cash deals > Stock deals¹
- ▶ Acquisitions > Mergers²
- ▶ Public/Private deals > Public/Public deals³
- ▶ Small deals > Large deals⁴
- ▶ Intangible-heavy deals > Hard asset deals⁵
- ▶ Related deals (vertical or horizontal) > Diversifying deals⁶

1. Shleifer, A., and Vishny, R. 2003. Stock market driven acquisitions. Journal of Financial Economics 70, 295-312.

2. Loughran, T., and Vijh, A. M. 1997. Do long-term shareholders benefit from corporate acquisitions? Journal of Finance 52 (5), 1765-1790.

3. Faccio, M., McConnell, J., and Stolin, D. 2006. Returns to acquirers of listed and unlisted targets. Journal of Financial and Quantitative Analysis 41, 197-220

4. Cooney, J. W., Moeller, T., and Stegemoller, M. 2009. The underpricing of private targets. Journal of Financial Economics 93, 51-66

5. Do Acquisitions of Private Targets Create Higher Value? The Role of Intangible Assets Acquired. Prof Thomas Lys, Northwestern University, unpublished research

6. Fan, J., and V. Goyal. 2006. On the patterns and wealth effects of vertical mergers. Journal of Business 79, 877-902.

1. (a) Moneywatch, 2012

2. (b) KPMG 1999, 'Unlocking Shareholder Value: Keys to Success'

3. (c) The Drivers of Success in Post-Merger Integration, Rice University 2016



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02

Six Findings Have Emerged From Qualitative Research Which In Combination May Hold the Key To Successful M&A Results

1

Clear Strategy Upfront

- ▶ Board is co-joined with Management on strategic direction and about where and how to grow the business – well before the action starts

2

Early Preparation And Planning

- ▶ Board needs to know that Management has established a M&A Philosophy, Parameters, Process and Planning upfront - expectations and boundaries are clear
- ▶ Board and Management are aligned on the key aspects of the 4 P's

3

Proper Understanding Of Culture

- ▶ Board knows, before the deal is done, that Management
- ▶ has accurately assessed the compatibility of the target company's culture,
- ▶ really understands what it will take to achieve successful integration

4

Rigorous Testing Of Business Case

- ▶ Board has to be confident in financial and commercial due diligence
- ▶ in Management's rigour; and
- ▶ that Company can fund it without financial duress under differing scenarios

5

Effective Monitoring Post Transaction

- ▶ Board must be satisfied that Management has a robust plan for synergies, the target run-rate and realism on what it will take to achieve the intended gains²
- ▶ Board then keeps the spotlight on benefits' tracking

1. Attitudes, behaviours, leadership style, reward systems, decision-making

2. Resources, skills, funding, management time, operating model impacts



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Well-chaired Board with constructive challenge

- ▶ Perhaps the best guarantor of M&A value delivery - and protection for shareholders – lies where:
 - the Chair encourages healthy scepticism and insightful debate; and
 - Board members have strong enough relationships to challenge each other and Management constructively

“The boardroom isn’t designed to be a comfortable and harmonious place. It isn’t – or at least it shouldn’t be. Rather, it should be a challenging forum for lively debate and decision-making.”

(Crainer & Dearlove, “Boards of deflectors”, 2008)

Net, focus on soft systems as much as hard ones

- ▶ Hard factors or tangibles (structures, documents, processes) are an ingredient but not a sufficiency
- ▶ Address the Intangible factors
 - Shore up the skills and experience of the Board and Executive
 - Focus on the behaviours and mindsets of deal team and reviewers
 - Be clear upfront on decision-making rights and processes and boundaries for involvement
 - Monitor the dynamics

None of these themes should be surprising - but like all self-evident truths, these are often overlooked or assumed; and the impact lies in the quality of execution



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03

The Failures In Acquisition Success, More Often Than Not, Can Be Sheeted Back To Human Failings



My research pointed me to what could be termed the 'seven deadly sins' of deal-makers and those governing over deals:

- 1) Naivety (or unfounded optimism)
- 2) Hubris (arrogance or pride)
- 3) Complacency
- 4) Undue haste (and fear - FOMO)
- 5) Greed
- 6) Deal myopia and
- 7) Deal fever.



Bias in different forms runs across most of the previous seven human frailties. The four most common forms:

- ▶ **Loss aversion** – tendency to go to great lengths to avoid possible losses (sunk cost fallacy, loss aversion bias)
- ▶ **Value attribution** – inclination to imbue a person or a thing with certain qualities/status based on initial perceived value (halo/sunflower effect, overconfidence effect)
- ▶ **Confirmatory (diagnosis) bias** – blindness to all evidence that contradicts our initial assessment of a person or situation (availability/recency heuristic, congruence bias)
- ▶ **Over-confidence** - discounting others' experiences and over-estimating yours (planning fallacy, projection bias, optimism bias)

"If you're asking the question 'is there one item in all of it that stands out?' I think absolutely. It is, and you might want to put this more elegantly than I'm going to say it, but it is "don't believe your own BS".

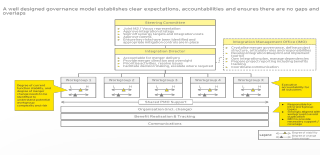


03

As a deal progresses, a range of 'hard and soft' enablers should be assembled and aligned in order to support post-deal planning and execution

Soft Systems

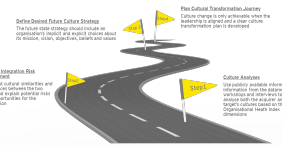
Hard Systems



Leadership and Governance



Integration Philosophy, Guiding Principles



Integration Roadmap and Teams



Investors, Staff, Suppliers, Customers' Engagement



Target Operating Model

Speed and certainty of post-deal outcomes

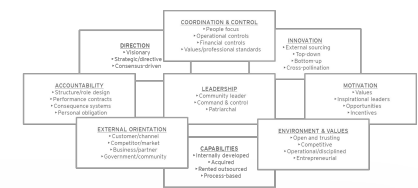
Benefits Realisation

What strategy is being pursued...	How will this be achieved and by who...	What if we are successful...
Synergy Description and Levers <ul style="list-style-type: none"> Cost synergies: operational efficiencies, process, systems, technology, real estate, etc. Revenue synergies: cross-selling, new products, etc. Financial synergies: tax, financing, etc. 	Synergy Driver and Influencers <ul style="list-style-type: none"> Operational Financial Technology Human Resources 	What are the potential benefits? <ul style="list-style-type: none"> Cost savings Revenue growth Financial strength
Why is this benefit not achievable now? <ul style="list-style-type: none"> Highly siloed current structure Fragmented processes Complexity 	Activities to achieve <ul style="list-style-type: none"> Identify synergies Develop a plan Execute the plan 	Risks and constraints to achieve <ul style="list-style-type: none"> Integration risk Operational risk Financial risk Human Resources risk
Assumptions / Dependencies <ul style="list-style-type: none"> Accurate data Clear communication Strong leadership 	Resources and KPIs <ul style="list-style-type: none"> Financial resources Human Resources Technology 	Information required <ul style="list-style-type: none"> Operational data Financial data Human Resources data

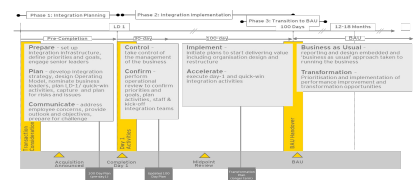
Programmatics Coordination and Tracking

DIMENSIONS	TARGETS CULTURAL PRACTICES	ACQUORER'S CULTURAL PRACTICES	ALIGNMENT LEVEL
LEADERSHIP	Strong indication of paternalistic leadership	No dominant practice, but indications of a hierarchy-oriented, delegating style	Low alignment
DIRECTION	Company direction set top-down, both long and a vision and offering specific guidance	Dominant practice: clear, top-down specifics for achieving company direction	Medium alignment
ENVIRONMENT & VALUES	Open, trusting, and collaborative environment for employees	Some weak indications of a processor and efficiency-driven environment	Medium alignment
ACCOUNTABILITY	Implicit personal obligation drives responsibility, backed by clear roles and responsibilities	Strong performance culture, with positive and negative consequences	Low alignment
COORDINATION & CONTROL	Clear indication that company manages its people systems and a values-based code	Some signs of a management style focused on targets and metrics, along with a values code	Low alignment
CAPABILITY	Little indication of a customer focus for ensuring needed talent base	Dominant practice: complex systems key skills and capabilities extremely	Medium alignment
MOTIVATION	Strong indication that employees are motivated by company values and leaders	Indication that employees are motivated by a balance of factors, including company values	Medium alignment
EXTERNAL ORIENTATION	Company engages internally with a strong customer focus, but some government focus	Strong indication of a clear customer focus, but also signs of focus on competitors and government	High alignment
INNOVATION	Clear indication that management generates new ideas and innovation top-down	Management team ideas for change dominate innovation practice	Medium alignment

Legal, Regulatory and ASX Coordination



Detailed Plans





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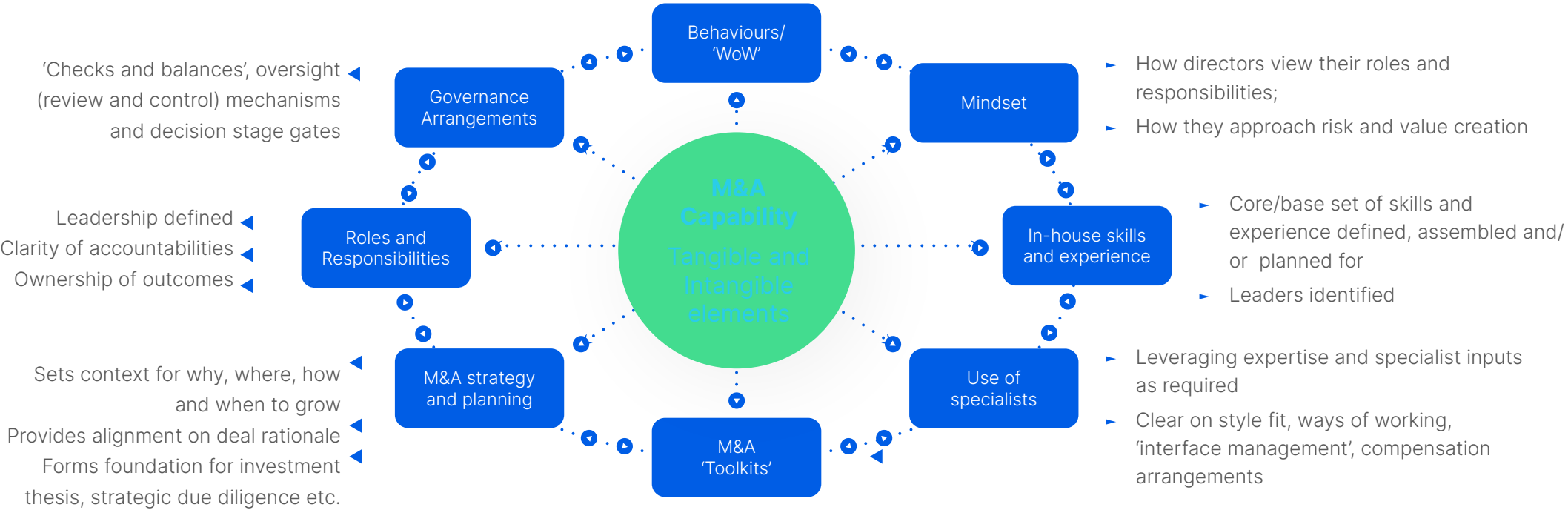




04

In the very early stages of preparation, boards and management should determine which elements of 'M&A capability' are required

Ways of working: How directors and management interact with each other, advisers, the target, investors



Compendium of tasks and activities, tools, templates, checklists, stage gates



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Here is a small sample of important 'opening' questions that Boards ought to ask, across the M&A lifecycle



TARGETING STAGE:

Start with the Strategy - upfront

01

- ▶ What level of shareholder value creation do we want to derive from M&A?
- ▶ What kind investment would we be prepared to make to support that? How would we fund it?
- ▶ If acquisition is the preferred way to go, what is the primary purpose: asset- or cost-efficiencies? Scope? Skills? Scale?
- ▶ What are our agreed target evaluation criteria?



"I know transactions are opportunistic and they do come up quickly, but the planning process should be starting two to three years' prior..."

TRANSACT (OR TERMINATE) STAGE:

Transact (or Terminate) stage:

02

- ▶ Have we adequately tested how Management's view corresponds with or differs to that of other industry experts?
- ▶ Have we adequately anticipated changes in the status quo with regards key customers, key suppliers, prices, key people, key competitors?
- ▶ Have we really thought through what could go wrong, modelled sensitivities, and built adequate contingency? Does the investment thesis/business case stand up to material 'shocks and knocks'?
- ▶ Are we all clear (Board & Management) on our critical assumptions and unknowns?



"To me that sort of stress testing,...getting into the detail, it's a given. And you have to really look at close testing those assumptions..."



03

Here is a sample of important 'opening' questions that Boards ought to ask, across the M&A lifecycle (cont'd)

03 (PRE-) TRANSITION STAGE: Should We Trust The Plan?

- ▶ What does success look like? How will we know we are on /off track?
- ▶ What is the targeted run rate with benefits' delivery and costs? What sort of financial commitments will integration and synergy delivery require?
- ▶ What adverse financial and non-financial impacts and dis-synergies should we expect?
- ▶ What are the key beliefs, assumptions and unknowns that underpin this deal proceeding?
- ▶ Who is or will be accountable? Is the plan properly and realistically resourced?
- ▶ Can you / we confidently commit to these plans and to our shareholders?
- ▶ Would our plans convince a sceptical market?



"...you've got to...work throughwhat you're aiming to return to your shareholders...and then prove backwards what this does for you."

04 TRANSFORM STAGE: Culture is a board item

- ▶ What skills and behaviours will be needed for Merge Co. to be successful?
- ▶ What makes you confident that you have an accurate and objective fix on their culture and its alignment with ours?
- ▶ Where are the areas of cultural uniqueness to preserve?
- ▶ How significant are the cultural disconnects/gaps? How can these be remedied? Will it be feasible and worthwhile to attempt to do so and what are the key risks?



"...things like culture and values which are often taken for granted; they are in fact also things that will destroy you if there's incompatibility."



Activity – Poll Question

Choose Your Top Three



What do you think would be most helpful to improving external visibility of, and confidence in, boards' governance over M&A ?

- 01** M&A readiness audit statement lodged with regulatory body

- 02** Formal notification to your shareholders about the deal intent / rationale

- 03** Publishing synergy targets and run rate being achieved

- 04** Quarterly update to analysts on progress / performance

- 05** Independent strategic/commercial DD – internal only

- 06** Don't think it is appropriate / relevant for the acquirer's board to advise its investors

- 07** M&A readiness audit statement but should be internal only e.g. via internal audit



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53.	ASK me anything Governance	On Demand
54.	How to avoid death by Hubris at the board table	On Demand
55.	Benchmarking board performance: 500 board reviews later	On Demand
56.	M & A - How to improve the likelihood of success!	On Demand
57.	Why a good board needs a solid connection with their CEO	Aug 10
58.	Setting the strategic board meeting agenda	Aug 24
59.	How to create effective minutes for your meetings	Sept 7
60.	How to continually refresh your annual board strategy	Sept 21



Thank you

