THE EVOLVING, EXPANDING ROLE OF THE CFO IN M&A TRANSACTIONS

M&A VOLUME IS INCREASING, BUT VALUE REMAINS ELUSIVE
Over the past several decades, the CFO role has evolved beyond being merely the “keeper of the books and budget” to acting as the steward of the organization’s overall financial health and “creator and protector of value.” This expanded role is more broad, proactive and strategic, especially in the area of mergers, acquisitions and divestitures, which have increasingly become a core tenet of many companies’ strategic growth and profit improvement plans.

While the volume and value of consummated deals have steadily grown, these deals have not consistently yielded the value they were expected to deliver. Post-deal performance of buyers has steadily declined since a 2015 peak, according to data compiled by Willis Towers Watson (WTW) and the University of London’s Cass Business School, as reported in CFO Magazine.

The gap between estimated and actual value delivered is one that the CFO is uniquely positioned to address and — most importantly — close.

Stakeholders are increasingly depending on the CFO to ensure the long-term gains, and there is little patience for failed deals in this dynamic business climate. “At the end of the day, deals have to provide value to the shareholders, or your ability to access funds becomes limited,” said Randy Mabie, Global Managing Partner, M&A Services, TCS.

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CFOs are continuously challenged to deliver transactions on time, on budget, and capture expected synergies, all while transforming the business into new ecosystems. Core transaction challenges include:

- **Strategic Alignment** – Misaligned and unclear transaction and business strategies, lack of disciplined transaction risk-management processes
- **Business Impact** – Unrealistic forecasted deal synergies in the targeted timeframe
- **Execution Flexibility** – Execution plans too rigid to adapt to dynamic external factors and changes to the cost/complexity of the business ecosystem
- **Resource/Skill Availability** – Constrained resources and conflicting priorities, limiting the ability to manage both transaction execution and ongoing legacy business operation
- **Cultural Alignment** – Lack of transparency throughout transaction to maintain morale and ensure realization of growth opportunities

These planning and execution challenges are interdependent and influence the level of business impact created by the transaction. Largely driven by the magnitude of value created and the timeframe during which it is captured, business impact is the yardstick used to measure the success of transactions in a world of non-linear change.
Shortfalls in the value created and delays in the capture timeframe are often caused by inflated transaction pricing based on impracticable synergy estimates and inadequate integration/divestiture delivery that fails to fully convert estimated synergies to measurable shareholder value.

“You need the right team, leveraging both internal and external resources, to determine the value the transaction is expected to generate,” said Praveen Bhasin, M&A Partner, TCS.

While cost reduction is certainly a consideration, it is no longer the primary driver of M&A activity. “In today’s era of efficient business platforms and ecosystems, cost synergies can be achieved, but it is more about acquiring new capabilities to fuel growth,” Bhasin noted.

Closing the value gap requires CFOs to act as analysts, facilitators and communicators. CFOs have historically been, and will need to remain, the strongest analysts in the C-Suite, ensuring that both deal analysis and planning are performed at the level of detail appropriate for the chosen risk level.

CFOs must facilitate discussions with, and thinking like, the COO, CIO and other C-Suite colleagues to accurately identify, codify and value key synergies net of the cost required to achieve them. Strong communication skills are required to facilitate these internal discussions and to articulate the investment thesis and underlying synergies to both internal and external stakeholders.

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Acquiring and selling CFOs play key roles in determining the “right price” for a transaction. Acquiring CFOs determine the transaction price threshold below which a deal would be accretive. Selling CFOs estimate the maximum price that each prospective acquirer should be willing to pay based on extant potential synergies along with market-based factors. “Organizations must be mindful of the transient nature of today’s business climate, and be willing to walk away if price, or any other factor, puts them outside of their comfort zone in terms of risk,” Mabie said.

Synergies can be segmented into two broad groups: revenue and cost. Revenue synergies result when the transaction enables the sale of higher volumes at the same or higher average unit price. Cost synergies result when capital expenditures, operating costs and/or financing costs decrease for the post-transaction entity.

Revenue synergies are typically estimated by the Operations and Sales functions, but the CFO should play an active role in “stress-testing” underlying assumptions before accepting estimated synergies and adding them to the transaction financial model. For technology companies, broad collaboration across the C-Suite is required to identify “productization” opportunities enabled by the transaction and digital technologies. These opportunities are less prevalent for non-technology companies Revenue synergies are far more challenging than cost synergies to accurately estimate, because they are more dependent upon external factors over which companies have limited control, and changing ecosystems create another level of complexity while delivering end user services.

Cost synergies are governed by the chosen transaction risk level and should be accounted for at an “integrated” level across the entire organization, not just one “silo.” IT consolidation typically creates significant cost synergies, so CFOs who think like CIOs are well-positioned to ascertain which synergies are real and which ones are not. “Technical debt”— the cost premium required to operate the target entity’s current technology platform versus a more cost-optimized one — is a critical area that needs to be thoroughly assessed. Key drivers include age, degree of openness, and level of customization.
Another area that needs to be assessed is the desired Business 4.0™ operating posture. Business 4.0™ is a framework of business behaviors that create customer value by monetizing digital technologies. Business 4.0™ leaders leverage ecosystems to enable new offerings and/or reduce cost of existing ones.(1)

Both revenue and cost synergies are impacted by competitive markets with increasingly compressed product lifecycles and influenced by digital technologies. Successful acquirers typically make conservative assumptions regarding the timeframe during which synergies — especially revenue synergies — create measurable value. In many industries, technology is changing so fast that the platforms upon which synergy calculations are based may be obsolete before the acquisition is fully integrated (or the divestiture is complete). CFOs should employ the “80/20 rule” when codifying cost synergy opportunities and determining which opportunities merit being pursued.

As a general rule, CFOs should prioritize and pursue synergies that can be captured during a 12-18 month period and whose value outweighs the required effort. Only these synergies should be included in the pro-forma financial model used to maximize the price that the acquiring company should be willing to pay.

Recognizing that there is a finite amount of time to capture transaction-related synergies, leading companies design and execute streamlined processes for planning and integration (or divestiture) that reduce time-to-value. As mentioned above, CFOs should create plans designed to capture targeted synergies—typically 80% of total possible synergies—by months 13-18 after transaction close.

The Day 1 target should be roughly 20% of aggregate run-rate synergies and will likely be driven primarily by headcount reduction and, to a far lesser extent, by technology infrastructure consolidation and/or transformation.

During the next 12 months, the plan should target an additional 40% of total estimated run-rate synergies, which will likely be comprised by a mixture of people, technology infrastructure and contract-related cost reductions. “You really do want to focus on the first year to realize the value of the transaction,” Bhasin said. “Beyond that initial period, it becomes more difficult to realize additional value.”

During the months 13-18, the plan should target an additional 20% of total estimated run-rate synergies, which will be largely driven by technology application cost reductions.

**CONVERTING POTENTIAL SYNERGIES TO MEASURABLE VALUE**

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**RECOMMENDED SYNERGY CAPTURE TIMING**

Prioritize synergies that can be captured in 12-18 months
The magnitude of technology-related savings will be driven by the type of integration selected, with greater synergies often made possible by broad-based, select transformational approaches, such as moving to cloud-based business architectures. While broad transformational approaches can yield high synergies, they often require more time, money and staff and create more operational risks. CFOs should play a lead role in codifying the options and quantifying the related financial benefits to provide other key stakeholders with the information required to make an informed decision.

Successful CFOs typically follow an M&A playbook that dictates the “appropriate” level of detail required at each stage in the planning process, with the level of detail varying by magnitude and sensitivity of value and associated risks. In addition, they facilitate/coordinate smooth handoffs between multiple stakeholders and advisors providing assistance at various points during the transaction from strategy development through transaction execution and integration/divestiture.

While executing the plan, successful CFOs track results at both an “integrated” and a “silo” level, which provides them a more accurate, holistic view of actual value captured, which they can then communicate to key internal and external stakeholders.
The CFO role has broadened and become more proactive and strategic as the steward of the organization’s overall financial health. In this role as financial steward, the CFO must act as an analyst, facilitator and communicator to help maximize shareholder value, especially in the area of mergers, acquisitions and divestitures. Failing to “right-price” a transaction — especially a large, strategic one — and/or fully capture identified synergies often results in steep penalties. At the very least, overpaying reduces capital (and Board support) required to contemplate/consume similar, transactions in the future. In extreme cases, the penalty may include massive write-downs, such as the $45 billion write-down announced by AOL–Time Warner two years after their blockbuster $164 billion merger was announced.

Successful CFOs play a key role in pricing transactions as well as creating and monitoring (and evolving as needed) realistic, prioritized plans designed to capture the synergies expected.

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