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Turnaround Topics

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The Roll-Up That Never Rolled

Lessons Learned and Reasons Why

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In the restructuring world, we see how today's great investment thesis turns into tomorrow's restructuring or bankruptcy. One perennial candidate for tomorrow's bankruptcy is the roll-up strategy. In today's world, there are heaps of "dry powder," so the roll-up strategy is an attractive idea. Consolidate several, or many, similar businesses and benefit from the consolidation of overhead, input/raw material pricing and other synergies. With few opportunities to achieve outsized returns, this strategy always seems to find followers. As an investment *thesis*, the roll-up strategy almost always works. In *reality*, the integration of multiple independent entities is fraught with risk.

Inevitably, a significant portion of these rollups will fail, some leading to restructurings and others to bankruptcies. Knowing the cause of failure (that is, was it failed from the beginning or were there exogenous factors that caused the failure?) can help identify the best outcome in a bankruptcy proceeding.

The typical reasons why integrations fail and succeed will be explored, while providing some lessons learned. When deciding whether to reorganize a company in total, sell it as a whole business, break it into parts or liquidate it, understanding the drivers of the failure, and whether they can be addressed or not, provides a potential roadmap for value maximization.

The challenge to integration and synergy creation is that there are a lot of things that need to go right with very little room for error, especially given today's leverage levels. By understanding the key reasons why integrations fail, one can avoid the risks of a "chapter 22." The authors have created the "Pillars for a Successful Integration" as a guide to assist investors with attaining clarity on integration, with an end result of unlocking synergy and maximizing return.

Pillars for a Successful Integration (The "Ps and Cs")

While most of the pillars are in no particular order, the beginning is to always understand and keep the end in mind: the purpose. After that, the authors recommend that each one of these areas be fully considered and understood when planning the integration and calculating the attractive synergies during the ROI analysis, as some might not apply. Here are the Ps and Cs: people, process, platform, product, place and culture, communication and purpose.

People

If there is one "P" that has a significant impact on integration and synergy creation, it is this one. People might be the apparent reason for failure or the clear driver for success. Many post-transaction integration and synergy creation efforts fail to define things as simple as overall leadership, roles and responsibilities, and who will lead the integration. Other times, the decision is made, but without thoughtful consideration for bias, impacts on culture, implications of compensation, or organizational designs. While there might be a clear choice for a leader, that does not mean that it requires less thought and energy. Even with a clear leader, anticipation of future-state organizational designs must be performed along with thorough consideration for a balanced team. *People drive integration and synergy creation performance*.

Process

Process might take on many different forms: back-office process, front-office process, sponsor process, manufacturing process or some other deal-specific process. If there is an area that is difficult to package in a bow under a nicely compartmentalized list of alliteration, this is it. The challenge for dealmakers and leaders is the granularity that comes with this subject. Unfortunately, some elements of process failures often lead to unsuccessful integration and missed synergies, or fractional value-realization. Therefore, the authors believe that someone on the team should be focused on the detailed processes being undertaken, as this is where the rubber meets the road. *Process is key to integration traction and value realization.*

Platform

Not to be confused with an investment platform, this "P" refers to the elusive subject area of information technology (IT). An integration cannot be successful until disparate systems are effectively integrated. Imagine the good news when you discover a middle-market company with an above-average ERP system. Now for the bad news: There are still two of them. Sound familiar? From experience, the authors have seen the worst of this issue, and it is a serious constraint. As granular as process, all areas of IT should be considered: ERP, time-entry systems, telecom, networking and firewalls, security, payroll, employee portals, production-control systems, operational reporting and BI, HR systems, sales management/CRM, etc.

Even with lower-middle-market companies, one should not dismiss solutions as simple as spreadsheets. If it is holding data and a process together, you need to plan for it. Extending this further, middle-market and lower-middle-market companies typically underutilize data. IT integrations work not only to facilitate a common platform and process, but also to set the stage for better analytics to drive action — hence, a segue to even more enterprise value. *Platforms facilitate process and enable analytic value.*

Product

Products are typically a complex area depending upon the investment scenario and the drivers to the integration and synergy success. The complexity will depend greatly on the investment strategy at the outset: overlapping products, complimentary products, distribution, common customers, supply chain, etc. Regardless of the scenario, a detailed integrated product strategy is a must. This will range from relatively simple to extremely difficult. Regardless, it is an essential component for successful post-transaction integration and helps drive clear messages to the marketplace in defining the newly combined company(s) (the "newco"). And yes, while "marketing" doesn't start with a "P," this is where a marketing plan should be developed to help communicate the newco message. *Product-marketing plans align your company and inform your marketplace.*

Place

This is an optional topic depending on the situation, but if there are multiple locations for headquarters, service facilities, manufacturing/assembly plants or sales offices, then a consolidation strategy and clear timeline for execution is a requirement. This is often the single biggest failure to achieving those ROI-driving synergies, as execution often falls short. Consolidation might be not be needed in every case, as there might be good reason(s) not to consolidate. In all likelihood, there is some synergistic element of value that relies on consolidation. A note of caution when determining the people to make these decisions: In most cases, it is helpful to have an unbiased person or partner in the driver's seat for this one. *Consolidating places facilitates integration.*

Culture

Culture is typically the hardest concept for investors and management to truly quantify, as it is the most abstract concept. Although a company without good culture can be somewhat effective, it usually will not sustain or optimize its effectiveness. Organizations with good culture have a way of enduring obstacles, which reflects the notion of good leadership.

Good leadership, with a positive culture, elevates the organization overall; it is a multiplier. For a strong and cohesive culture to exist, there are several dynamics that impact it. These dynamics might include things such as communication, HR policies, compensation and benefits, and organizational design. The point is that anything and everything that can affect the people of an organization needs to be addressed during the integration while also offering a great opportunity to refresh or reaffirm a company's culture. The fact is this: Employees do not like changes, but you might be about to make significant changes, whether they like it or not. If you do it with positive cultural change as the foundation, employees just might decide to like it. *Culture drives organizational effectiveness.*

Communication

Communication and culture feed each other. You must communicate extremely well if you want a new culture of trust. The authors' experiences show that nearly all integrations suffer from a lack effort in some area of communication and that an organization can never over-communicate. Absent clear communication, post-transaction planning is likely to fall short, regardless of the plans. (Hint: "communication" was used in every sentence above.) *Communication is the core of positive culture and integration success.*

Purpose

The best is saved for last: purpose. Defining the collective purpose drives the integration strategy and execution. Whether it is to achieve a cost savings, revenue lift, complimentary product/territory or some other element of "synergy," the successful integration must start with a purpose that clearly identifies the objectives. You might ask the following questions: What did we envision, and why did we select this investment? What elements drove the value formula? What results do we expect?

In fact, these topics should be addressed and determined at some point during due diligence. *Purpose-driven planning is paramount*. It is also likely to be the first element considered when situations have failed and parties are attempting to understand the options: restructure, bankruptcy sale, out-of-court, or a blend of possible strategies.

Given the "pillars of integration" discussion, the appropriate point to begin the integration plan and to best improve the chances for success is as early as possible, as a part of due diligence. To be clear, it is not during diligence, or in parallel to due diligence, that the authors believe the pillars should be an integral part of the pre-transaction diligence. What better place to start planning for success than while the transaction is being evaluated?

Conclusion

When evaluating the best course of action for a restructuring, either in court or out, identifying where the investment thesis went wrong will help identify the best path forward. Has the consolidation of the people and organizations occurred? Is leadership clearly identified and consolidating its power? Have the company's significant processes been integrated? Are there IT platforms and systems still segregated? Does newco have credible information? Have product offerings been streamlined and integrated? Are there clashes of cultures within the organization? Are mission-critical employees leaving?

If these elements have failed, it is highly likely that there will be significant costs in cash and time resulting in significantly higher risk to the newco being successful as an integrated entity. This would create difficult challenges against a reorganization plan that intends to keep the company intact, unless significant funding and cooperation is achieved to address these issues.

It is more likely that there would a sale of the unintegrated elements or a sale of the entire enterprise to a strategic competitor who is best suited to address the critical failures and see the potential of newco. These considerations will likely lead to a maximization of the enterprise and reduce the likelihood of a "chapter 22." abi

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