Board Perspectives: Risk Oversight

The Board's Role in Overseeing Acquisitions

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As companies spend more than $2 trillion every year on acquisitions, many studies peg the rate of failure of these transactions in fulfilling expectations somewhere between 70 and 90 percent.[1] Such performance is unacceptable in just about any endeavor. However, over time old lessons in M&A failures continue to be relearned by many companies. The question arises as to the board's risk oversight role[2] in overseeing the process of screening, selecting and pursuing M&A candidates, closing M&A transactions, and integrating merged and acquired entities, with emphasis on reducing risk in M&A activity.

Key Considerations

The board has always had a broad role in championing good governance, overseeing strategy-setting, monitoring enterprise performance, overseeing risk management and advising management. These roles are relevant to overseeing M&A transactions. The discussion below is from an acquiring company's perspective.

As directors are responsible for approving a company's strategic plan, they should evaluate proposed acquisitions in the context of that plan. Therefore, the board should understand the strategic underpinnings of a proposed M&A transaction to evaluate the deal's benefits (e.g., cost savings, additional revenues through expected synergies that create new ways of doing business, cost-effective entrance into new markets, performance improvements through cost reductions, or resource acquisition to command higher price points). If the strategy envisions growth through acquisitions, the board needs to satisfy itself that the management team includes individuals with the requisite skills to execute M&A transactions and integrate the acquired businesses.

When M&A candidates are proposed, directors should ask probing questions to assess the reasonableness of revenue and cost assumptions, benefits from expected synergies and the plan to achieve those synergies. Directors need to understand the risks inherent in the deal and the cultural and people issues involved. Most importantly, directors need to understand, and agree, why the deal is being done in the context of strategic fit and incremental value-add. Directors must be careful with situations where management is emotionally invested in growing the company and potentially could lose objectivity in pursuing acquisition candidates.

The due diligence process is vital to reducing M&A risks. Through due diligence, management's assumptions are tested, deal pricing and the financing approach are evaluated, legal liabilities are investigated, internal controls are assessed, accounting policies and estimates are reviewed, cultural differences and staffing issues are better understood, and related-party transactions are assessed. However, despite management's and the board's best efforts, due diligence has inherent limitations when it is not possible to gain access to the required information.

[1] "The Big Idea: The New M&A Playbook," *Harvard Business Review*, March 2011.

[2] Our focus is not intended to examine the legal fiduciary responsibilities of the board.

Before approving the deal, the board should carefully review management's integration plan to ensure there is clarity around why integration is necessary, how it is to be achieved, who is leading the integration efforts, and obstacles that could frustrate execution of the plan.

Because M&A transactions are relatively infrequent for many companies, the board and management may not have thoroughly vetted the process by which they should interact during the M&A process. For complex and risky transactions, the board should expect periodic updates at various stages of the due diligence process, as well as on the progress of the integration strategy after the deal is approved and consummated. To address the risks of poor due diligence and/or lack of attention to integration, many boards address M&A transactions with the full board or various board committees taking the lead, or by forming a special committee to take the lead with members who have the relevant expertise to get more deeply involved in reviewing the deal economics and integration plan to identify opportunities and risks. In some cases, it may be necessary to stress test management's assumptions and rigorously evaluate deal pricing to avoid overpaying. In other cases, the board may see value in engaging subject-matter experts to provide objective due diligence in specific balance sheet areas involving significant risk, as well as compliance and regulatory areas such as tax, anti-trust and corruption exposures.

Effective integration requires attention to managing cultural differences and retaining key personnel. Careful attention must be given to how the integration process is handled, and compensation plans may require adjustment if retention of key staff is a priority. Also, directors should inquire as to whether the integration of internal controls and the accounting for the transaction has been reviewed.

A postmortem review of past transactions should be considered to determine what worked well, what were the lessons learned and which lessons should be addressed in future proposed transactions. The key is to assess whether the acquisition has achieved the desired outcomes from a strategic standpoint.

Questions for Directors

Following are some suggested questions that boards of directors may consider, in the context of the nature of the entity's risks inherent in its operations:

- When M&A targets are brought before the board, do directors evaluate the transaction using a strategic context?
- Are directors satisfied that they are sufficiently involved in advising management in a timely manner on complex and risky M&A transactions warranting close board oversight?

How Protiviti Can Help

With emphasis on speed, expertise, results, flexibility and a risk focus, Protiviti assists companies in addressing their M&A needs, including due diligence, integration planning and integration execution. We help companies identify and then manage the key risk areas in their transactions, with experienced industry, process and technology experts aided by proven program/project management tools and techniques.

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