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Board Perspectives:
Risk Oversight

10 Keys to Effective Board Oversight of M&A

An effective board of directors is a champion of strong governance for the organisation it serves. All aspects of its oversight role are germane to mergers and acquisitions (M&A) — with some oversight activities specific to M&A.

The board's oversight with respect to M&A mirrors its overall focus on advising the CEO — including offering a contrarian voice when necessary — regarding strategic matters, policy approval, enterprise performance monitoring, reporting transparency and enterprise risk management. Our discussion below is from the acquirer's perspective.

In 2016 and 2015, M&A activity remained strong with a 14 and 16 percent year-over-year decline globally and in the United States, respectively.[1] Underpinning the level of deal-making is the near de facto risk that most consummated deals will fall short of expected strategic outcomes. One article asserted that multiple studies set the rate of failure of M&A transactions in fulfilling expectations somewhere between 70 and 90 percent.[2] Other sources assert a lower failure rate. Regardless of the rate of failure, M&A warrants a board's close attention.

Key Considerations

In 2016, the National Association of Corporate Directors (NACD) and Protiviti co-hosted a series of roundtables that brought together more than 60 directors to discuss current challenges and effective practices in board-level M&A oversight.[3] Based on insights from the roundtables and our experience serving clients in the M&A space, we offer the following 10 keys to the board's M&A oversight:

1. **View M&A through the lens of the growth strategy:** With global competition intensifying, investors and boards are demanding more top-line and bottom-line growth to increase long-term shareholder value. Working closely with the board, companies pursuing growth through M&A should articulate the strategic underpinnings of the growth strategy and its linkage to the overall corporate strategy to provide a context

[1] Dealogic Investment Banking Scorecard, *WSJ Moneybeat*, *The Wall Street Journal*, available at http://graphics.wsj.com/investment-banking-scorecard/.

[2] "The Big Idea: The New M&A Playbook," *Harvard Business Review*, Clayton M. Christensen, Richard Alton, Curtis Rising and Andrew Waldeck, March 2011, available at https://hbr.org/2011/03/the-big-idea-the-new-ma-playbook.

[3] "Navigating M&A Deals in an Uncertain Environment: Five Questions for Directors," NACD Director Dialogue Series, Feb. 1, 2017, available at www.nacdonline.org/Resources/Article.cfm?ItemNumber=40002.

for evaluating prospective targets and their strategic fit (e.g., additive to the core business, diversification into a new line of business, entrance into new markets, and/or transformation of the organisation). A strategic context provides a strong foundation for directors and executive management to agree, long before a deal is placed on the table, on the appetite for risk and the metrics for measuring deal success.

2. **Oversee M&A as an end-to-end cycle, rather than a transaction:** The board should focus on the M&A life cycle — from the acquisition targets pipeline to the learnings from deal post-mortems and all phases in between. The cycle begins with identifying the right markets and targets consistent with the growth strategy and acquisition criteria, and continues with:

   - Defining and executing a thorough but efficient due diligence process;
   - Preparing a robust, phased integration plan to capture targeted deal values;
   - Pricing and financing the deal;
   - Following up a consummated deal with a well-resourced and effectively communicated execution of the integration plan according to the established timetable; and
   - Conducting a post-mortem to identify opportunities to improve the process.

   Directors should be engaged throughout the process and ensure it is improved continuously.

3. **Determine the extent of board involvement in each phase of the process:** 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 approval and consummation of the deal.

   To address the risks of poor due diligence and/or lack of attention to integration, the board needs to decide where the point of oversight should reside — with the full board or one or more standing committees. To the extent necessary, the board should avail itself of the advice of subject-matter experts on due diligence, tax, valuation, corruption, antitrust, cybersecurity and other significant issues.

4. **Make sure the critical competencies are in place to execute the full M&A process:** It takes talent and expertise to manage the M&A life cycle. Viewing M&A as an end-to-end process provides a powerful context for evaluating the management team's capabilities to execute. The board needs to satisfy itself that the management team includes individuals with the requisite skills to understand and break down the deal economics, execute approved transactions, integrate acquired businesses, and avoid costly strategic errors that destroy enterprise value.

5. **Challenge deal assumptions and expected synergies:** When M&A targets are proposed, either the full board or a designated standing or special committee should assess deal assumptions and synergies. Are management's revenue and cost assumptions reasonable? Are the expected synergies reflected in the deal pro formas realistic? Is the integration plan to execute on the assumptions likely to deliver the synergies after consummation of the deal? For complex deals, the board may want management to stress-test deal assumptions against well-defined scenarios and alternative futures before deal approval.

6. **Manage senior management's emotional investment:** Directors must be careful with situations where management is emotionally invested to the point of potentially losing objectivity in pursuing acquisition candidates. A clear business case should outline why the transaction is essential and how it enables the growth strategy. Deal presentations that hype optimistic projections and accentuate only positive possible outcomes are a red flag. The board should insist that management also provide a balanced contrarian view that articulates the deal risks and what can go wrong — perhaps through a "red team" that challenges deal assumptions to discover fatal flaws and temper the complacency that often follows past successes. Executive sessions are another means of ensuring the board has access to the candid and dissenting views it needs to weigh in on such matters as target suitability, deal pricing and go/no-go decisions.

7. **Constructively engage management in due diligence:** The due diligence process is vital to reducing M&A deal risks to an acceptable level. Through due diligence, management's assumptions are validated, deal pricing and the financing approach are evaluated, legal issues and potential

liabilities are investigated, key internal controls are assessed, accounting policies and estimates are evaluated, cultural differences and staffing issues are better understood, related-party relationships are assessed, and the feasibility of the integration plan is considered. To that end, the inclusion of objective third parties on the due diligence team may be warranted, particularly for financial, tax, compliance, human resources, cybersecurity and industry-specific issues.

However, despite management's and the board's best efforts, due diligence often has inherent limitations when it is not possible to gain access to the required information. Furthermore, boards may not be giving sufficient attention to the need for due diligence directed to nonfinancial areas — cyber risk and corruption risk, for example. Despite these limitations, an acquirer should be cautious about making a deal without sufficient due diligence, even when time may be of the essence. No one should be in a rush to make a serious error.

8. **Understand the integration plan and its viability before approving the deal:** Before approving the deal, the board should carefully review management's integration plan. The review should seek clarity of the plan's intended purpose, how it is to be achieved, who is leading the effort, and the change management and other obstacles that could frustrate the plan's execution.

   Deals often go wrong when there is too much ambiguity in target operating models and critical path milestones. Expected deal value is derived from many sources — from 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 prices.

   The board should satisfy itself that the integration plan is compelling and robust. The plan should engender confidence that management understands how the integration effort and team will deliver the expected deal value, whether through changing the current operating structure, blending talent from the two companies, addressing the technology infrastructure or overcoming cultural challenges. The board should sign off on the duration of time in which the expected value will be delivered and consider holding leaders accountable even when they have moved into other areas of the company.

9. **Stay on top of the integration process:** When the deal is consummated, often there is a sigh of relief and even a celebration. However, the hard work toward delivering the expected deal value has just begun. Effective integration requires continued vigilance, including periodic tracking of progress, attention to managing cultural differences, making decisions quickly, retaining key personnel, staying on schedule and maintaining accountability for results. One company has taken a Scrum approach from Agile[4] to make critical decisions within 24 to 48 hours, resulting in a more effective integration process.

   During the NACD roundtables, several directors reported that their boards used information from the pro formas generated during the due diligence phase to hold management accountable through periodic (say, quarterly) reports after a deal closes. The idea is twofold: (a) gauge management's success comparing pro formas with actual results; and (b) drive more realistic pro formas during the deal evaluation phase. When sponsoring executives know that pro formas will be the board's baseline for evaluating deal performance, they are incentivised to set realistic integration goals.[5]

10. **Continuously improve the process through look-backs:** Once significant deals have run their course, the board should consider requesting senior management to conduct a post-mortem review of completed transactions to determine what worked well, the lessons learned and specific improvements to address in the future. Reviews conducted with a focus on learning should not resort to finger-pointing. Bottom line, history has a way of repeating itself in M&A. Failures need not be relearned.

In summary, effective board oversight of M&A can create competitive advantage and enterprise value through consummation of successful deals. Likewise, the board's M&A oversight can help avert the loss of enterprise value through preventable deal failures.

[4] For more about Scrum and Agile methodologies, see: http://scrummethodology.com/.

[5] "Navigating M&A Deals in an Uncertain Environment: Five Questions for Directors," NACD Director Dialogue Series, Feb. 1, 2017, available at www.nacdonline.org/Resources/Article.cfm?ItemNumber=40002.

Questions for Boards

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:

- Does the board understand how M&A supports the company's growth strategy, and does it undertake an end-to-end view of its M&A oversight? Does it have access to the complete M&A pipeline, including targets and active deals?
- Are directors satisfied that they are involved sufficiently, and promptly, in advising management on complex and risky M&A transactions? Is the board involved throughout the process?
- When M&A targets are brought before the board, do directors evaluate the transaction using a strategic context? Is the board satisfied that it is receiving a balanced view of the opportunities and risks inherent in each deal? Do the board and management celebrate deal shutdowns?

How Protiviti Can Help

With an emphasis on speed, expertise, results, flexibility and a risk focus, Protiviti assists companies and private equity firms in addressing their M&A needs, including due diligence, integration planning and execution. For example, we help organisations identify and manage the key risk areas in their transactions with experienced industry, process and technology experts aided by proven program and project management tools and techniques that instill confidence in senior executives and board members across the transaction life cycle.

Is It Time for Your Board to Evaluate Its Risk Oversight Process?

The TBI Protiviti Board Risk Oversight Meter™ provides boards with an opportunity to refresh their risk oversight process to ensure it's focused sharply on the opportunities and risks that truly matter. Protiviti's commitment to facilitating continuous process improvement to enable companies to confidently face the future is why we collaborated with The Board Institute, Inc. (TBI) to offer the director community a flexible, cost-effective tool that assists boards in their periodic self-evaluation of the board's risk oversight and mirrors the way many directors prefer to conduct self-evaluations. Boards interested in using this evaluation tool should visit the TBI website at http://theboardinstitute.com/board-risk-meter/.

Learn more at
www.protiviti.com/boardriskoversightmeter

Protiviti is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Protiviti and our independently owned Member Firms provide consulting solutions in finance, technology, operations, data, analytics, governance, risk and internal audit to our clients through our network of more than 70 offices in over 20 countries.

We have served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on https://blog.nacdonline.org/author/jdeloach/. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.

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