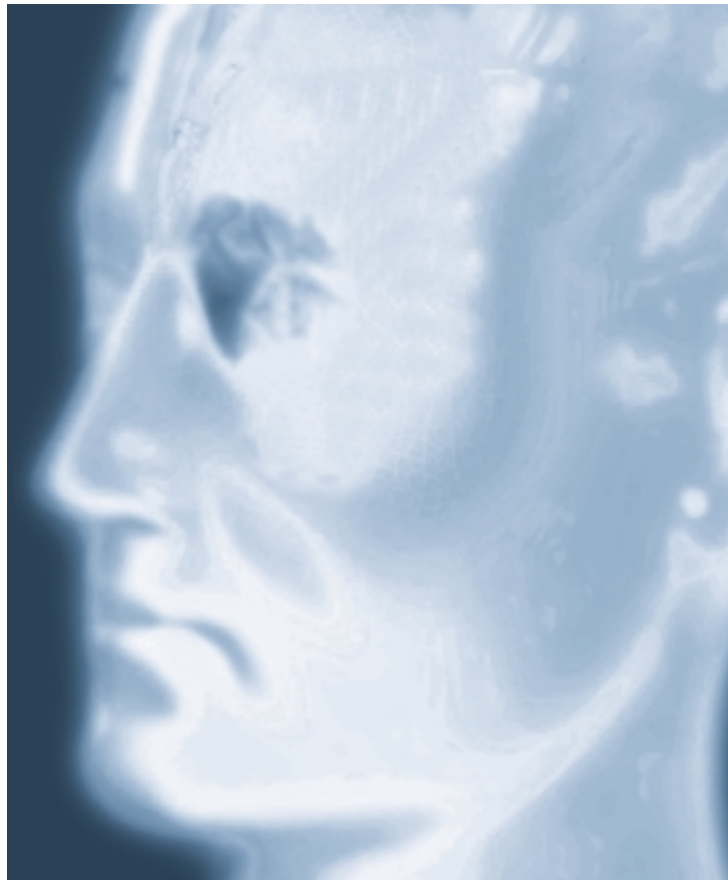




World Class Transactions

*Insights into creating shareholder
value through mergers and acquisitions*



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Foreword

This report presents the findings of KPMG Transaction Services' latest survey into the issues surrounding M&A activity. Our last survey, published in 1999, showed that there was a considerable gap between the respondents' view of how successful their transactions had been, and the assessment delivered by objective criteria. One of the encouraging features of the findings in our new survey is that, while the perception gap is still wide, this time almost twice as many companies were found to have created shareholder value.

The scope of the new survey, however, extends far beyond analysis of the success or otherwise of the deals themselves. Drawing on the judgements and experience of the respondents, we have set out to identify and isolate the practices which lead to the creation of value.

Given the diverse circumstances in which deals are consummated (and the equally diverse cultures of the organisations which get involved in them), a single, prescriptive approach to transactions is clearly inappropriate. However, the survey highlights certain themes which point the way to success. These include a robust approach to process management, the assumption of direct responsibility for transactions at senior board level and the implementation of key activities at an early stage.

The survey focuses on the larger global deals completed between 1997 and 1999, capturing the experience of some of the world's largest companies. This, combined with our own experience – KPMG Transaction Services has acted on many of the larger M&A deals in recent years – has enabled us to develop a deeper understanding of the factors which make for World Class Transactions. We are grateful to all those who took part.



Colin Cook, Partner
KPMG Transaction Services
London



Don Spitzer, Partner
KPMG Transaction Services
New York

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1 Executive summary

Survey objectives and methodology

This report sets out to identify how companies approach M&A deals, correlating this with how successful the transactions were in creating shareholder value.

The research was conducted in two parts: main board directors who had been closely involved in their company's deal were asked about the process adopted and their view of the success of the transaction. Then, for each deal, a relative measure of change in equity price was taken pre-deal and then a year later. This was compared with the overall trend in the relevant industry segment to arrive at an assessment of whether or not shareholder value had been created.

More deals created shareholder value

Of the companies in the survey, **30%** created value as a result of the transaction. This marks a significant improvement on the position reported in our last survey *Unlocking shareholder value: the keys to success*, where only **17%** of deals added value. Similarly the percentage of deals which destroy value has fallen from **53%** to **31%**.

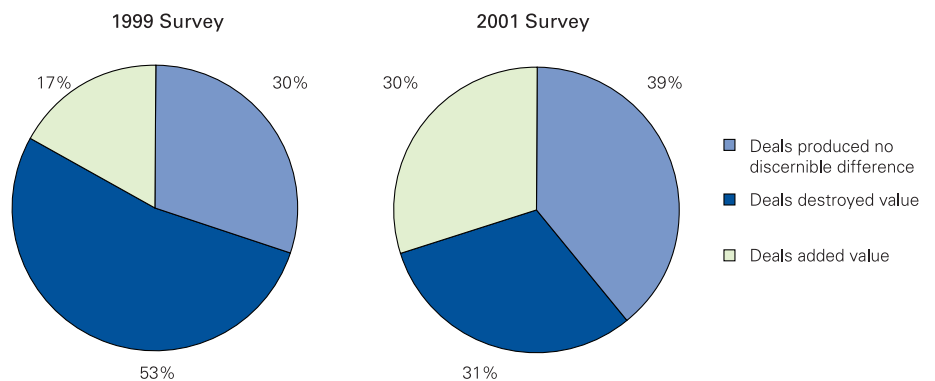


Figure 1: Objective measure of success

24% of companies in Europe and **35%** of companies in the US created shareholder value from M&A transactions.

We found no correlation between experience and success, as those companies that are involved in a high number of transactions do not necessarily have a better track record in creating shareholder value.

The perception gap

However, a gap persists between these results and the respondents' subjective assessment: **75%** believed that their deal had been successful in achieving its objective.

The most likely explanation for this discrepancy is the way respondents defined their objectives. While it can be assumed that the ultimate objective of all corporate activity is to enhance shareholder value, it was clear from the survey that respondents often had other, more immediate goals in mind when embarking on a transaction.

In this context, **29%** of respondents referred to increasing market share and **28%** to expanding into new geographic markets, as opposed to only **23%** who cited maximising shareholder value. Furthermore, when measuring the success of the transaction, only **25%** of respondents evaluated its effect on shareholder value, and most failed to measure implementation against their original objectives.

The drivers of success

Respondents strongly agreed that transactions are more successful in creating shareholder value where:

- There is a robust and well managed process;
- Priorities are allocated to the activities to be carried out;
- Clear decisions are taken about how and by whom the activities should be handled.

From this, we have developed a model of best practice within the transaction process:

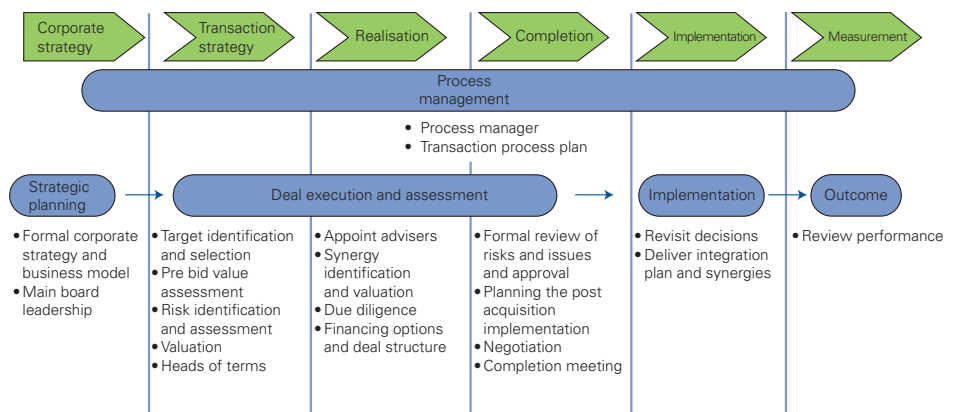


Figure 2: The World Class Transactions process

Within this framework, the survey indicates that certain key practices are likely to have a significant bearing on the outcome of a transaction.

Seven key practices

Early action	<i>Process management and other key activities tackled at an early stage in the transaction</i>
Main board leadership	<i>A main board member responsible for M&A policy and activity, resulting in leadership and buy-in to achieve transaction goals</i>
Pre bid value assessment	<i>Rigorous assessment of the target company and the deal, including understanding the drivers of value and the price range which will enable the purchaser to create value.</i>
Formal transaction process plan	<i>A formal transaction process plan setting out clear roles and responsibilities, prepared before the detailed investigation into the target. To be formally reviewed and approved, addressing any variations to the original assumptions arising during the process</i>
Process manager involved throughout	<i>Appointment of a dedicated process manager with appropriate skills, involved from an early stage</i>
Process manager empowered with wide ranging role	<i>Process manager with responsibility for key activities, including risk and issue management, deal assessment, negotiations and implementation</i>
Independent assessment of post deal implementation	<i>The use of external advisers to provide independent evaluation of the implementation process and measurement post completion</i>

It is not, however, the individual practices themselves but rather their combination which leads to successful transactions. The more that are adopted, the more likely it is that the deal will increase shareholder value:

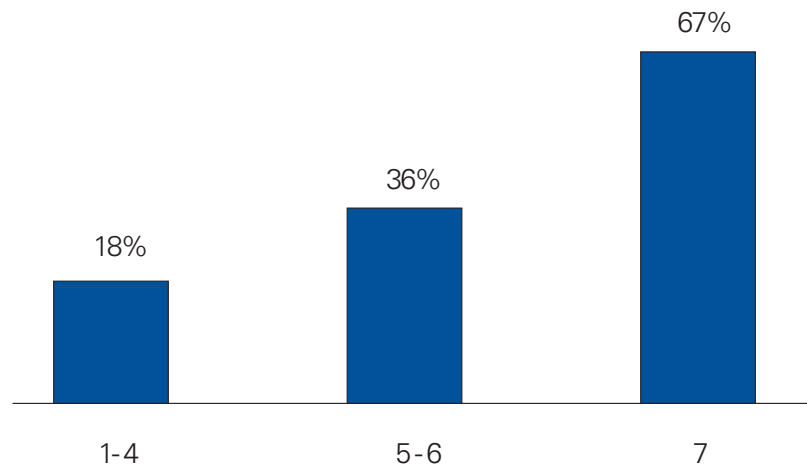


Figure 3: Performance of key practices and percentage of companies creating shareholder value

We also found that successful companies undertook nearly all the practices earlier than those that failed to create value.

There were significant differences in the adoption of key practices by respondents in Europe and the US. European companies were more likely than those in the US to have a main board director responsible for the transaction and a formal plan in place at the earliest stages. However, process managers in US companies were more heavily involved than those in Europe, and more emphasis was given to pre bid value assessment and issue management.

2 Survey methodology

Objectives

The aim of this survey was to establish how companies approached M&A deals and to correlate this with how successful the transactions were in terms of creating shareholder value.

Specifically the objectives were to:

- Establish whether applying a robust and well managed process to an M&A deal increased the chances of a successful transaction;
- Identify how companies and institutions prioritise their activities and those of their advisers before, during and after transactions;
- Define the roles undertaken by companies, institutions, advisers and stakeholders throughout the transaction process.

In our previous survey, *Unlocking shareholder value: the keys to success*, we identified six factors that were critical in creating shareholder value. For this survey, we have looked more closely at how these factors are addressed through the conduct of transactions and what therefore constitutes best practice.

Research

The research was conducted in two parts:

Phase 1: Research amongst directors of companies participating in major M&A deals

The fieldwork was conducted by Simpson Carpenter between January and March 2001 via confidential telephone interviews. The sample frame was taken from M&A activity databases across the globe between 1997 and 1999, focusing on larger transactions. The respondents were main board directors who had been closely involved in the deal in question. In total, 118 companies participated from around the world.

During the course of the interviews, respondents were asked which activities they had undertaken, who had been involved, the priorities they had attached to certain activities and processes, and whether or not they believed the transaction had been successful. Results are unweighted.

Phase 2: Analysis against an objective measure of M&A success

Further research was conducted using external share price data supplied by Datastream, Bloomberg and the Financial Times.

Each deal was categorised against an objective benchmark of success. This assigned each deal to one of three categories: "*deal destroyed value*", "*deal neither created nor destroyed value*" or "*deal successfully created value*".

In order to assess shareholder value performance objectively, for each deal a relative measure of change in equity price was taken pre-deal and again approximately one year afterwards. This result was then compared with the overall trend in the relevant industry segment, in order to assess which benchmark rating was most appropriate.

To preserve the confidentiality and anonymity of survey respondents (and in accordance with standard market research guidelines) analysis of the survey findings was carried out by Simpson Carpenter and not KPMG Transaction Services.

3 The drivers of success

Deal assessment

The popularity of M&A activity is illustrated by the fact that the value of transactions has grown in the year 2000 for the tenth year in succession.

Confidence in the success of M&A remains high, with **75%** of the respondents in general believing that their deal had been very successful.

This reflects the findings of previous surveys. However, a gap remains between the respondents' subjective assessment of the deal and the verdict provided by objective measures:

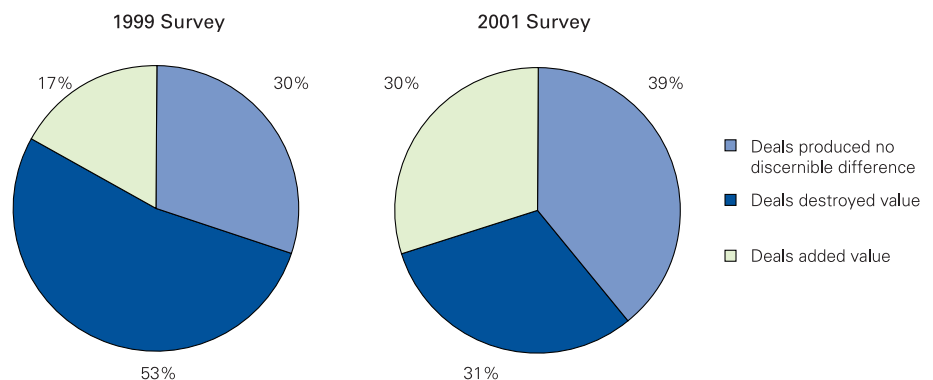


Figure 4: Objective measures of success

Encouragingly, the gulf between subjective and objective assessments has narrowed significantly since the last survey in 1999. The findings from that research showed that only **17%** of the deals in the sample had generated value one year after the transaction whilst this survey indicates an improvement to **30%**.

We found there was no correlation between experience and success, as those companies that are involved in a high number of transactions do not necessarily have a better track record in creating shareholder value.

In the US **35%** of companies created shareholder value from their deal compared with **24%** in Europe.

European companies were more likely than those in the US to have a main board director responsible for the transaction and a formal plan in place at the earliest stages. However, process managers in US companies were more likely to be involved for longer and were more empowered in their role than those in Europe, and place more emphasis on pre bid value assessment.

Process management

Respondents strongly agreed that transactions are more successful in creating shareholder value where:

- There is a robust and well managed process;
- Priorities are allocated to the activities to be carried out;
- Clear decisions are taken about how and by whom the activities should be handled.

This underlines the importance of process management in achieving a successful outcome. A framework for best practice within the transaction process can be illustrated as follows:

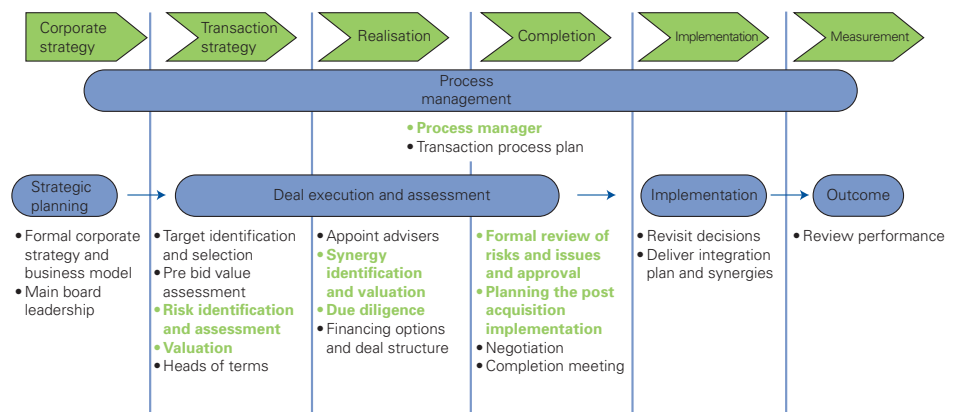


Figure 5: The World Class Transactions process

Timing of activities

We examined the timing of key activities undertaken by respondents between target identification and deal implementation. These are illustrated in green in the diagram. Companies which were successful undertook **all** of the activities earlier than those that failed to create value, with the exception of a formal review of issues. The activity undertaken **first** by successful companies was process management. Companies which destroyed value initiated process management at a later stage.

Among the companies which failed to create shareholder value, respondents said that they would have undertaken **all** activities earlier if given the opportunity to re-perform the transaction.

Board member responsibility

Companies that had a senior board member specifically responsible for M&A were **48%** more likely to be successful than those that did not. **70%** of respondents had a dedicated M&A team, although this had no bearing on the success of the transaction.

Whilst many companies may not have the resources or volume of transactions to justify assigning a dedicated team, there would appear to be value in appointing a senior board director to take overall responsibility for M&A. It is important that this individual has best practice experience of the transaction process and is able to bring leadership qualities to the role.

Responsibility for process management

The results highlight the importance of the process manager's role in achieving a successful transaction.

Companies which had a process manager from target identification until post-implementation evaluation were **71%** more likely to be successful than those that did not.

The process manager must have the requisite skill set to perform the role effectively. These skills are:

- Communication;
- Prioritisation;
- Process knowledge;
- Adaptability;
- Commitment.

We found that the background of the process manager, or whether or not the individual is an internal employee, had no bearing on the success of the transaction. The development of process management skills is most likely to result from exposure to a broad range of disciplines and best practice experience.

It is not just the skill set of the process manager and the timing of his or her involvement which is important, however. The degree to which the individual is empowered is also crucial:

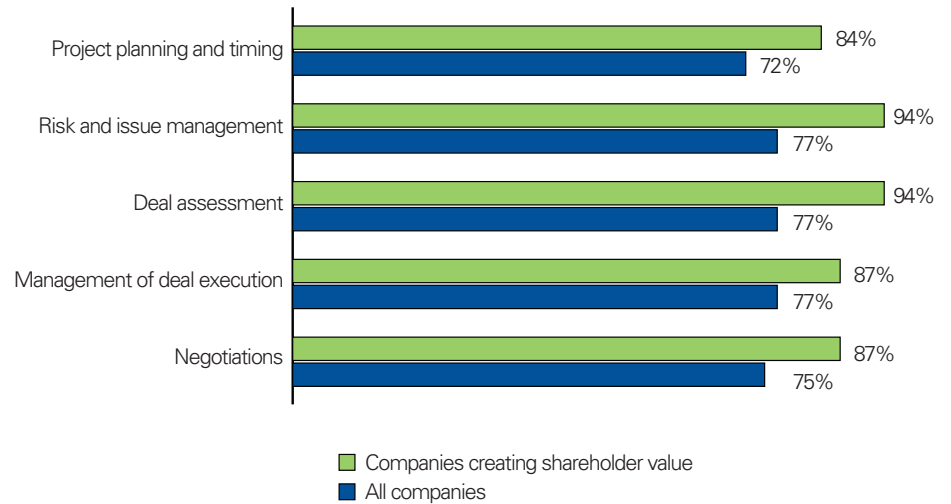


Figure 6: Responsibility for process management activities

Process managers on successful transactions took more responsibility for activities throughout the deal, particularly with regard to deal assessment and risk and issue management.

Formal process plan

The objective of a formal process plan is to ensure that process management can be carried out effectively. The planning of work streams and responsibilities, and monitoring and recording of actions, responsibilities and decisions throughout the process should ensure that all risks have been assessed and reflected in the business model and valuation, and that the target price or sale and purchase agreement is appropriate.

Companies which had a formal process plan in place by the time of the investigation into the target were **29%** more likely to be successful than those that did not.

The content of the plan and the rigour with which it is carried out is important in determining the success of the transaction beyond the mere existence of the plan itself.

4 Strategy

Formal corporate strategy

Whether or not a company is proposing to carry out a merger or acquisition, it is widely recognised that the directors should have formally agreed how the business is to achieve its overall objectives: **97%** of all companies in the survey had a formal long-term business strategy.

The principal features of a successful formal strategy are that it documents the proposed business model and is formally reviewed and approved by the board. (The strategy identifies the critical success factors and the means by which the company is able to achieve competitive advantage and create shareholder value.)

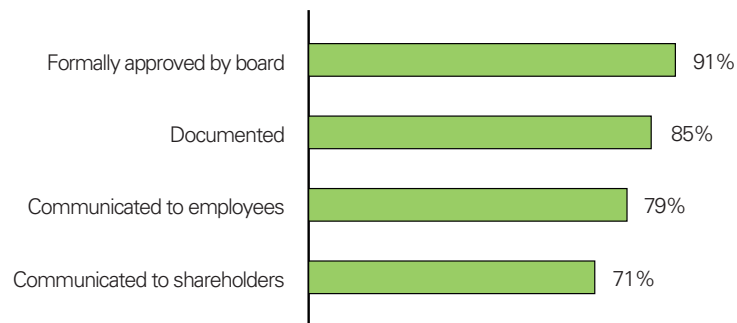


Figure 7: Formal corporate strategy (companies creating shareholder value)

Communicating strategy to employees and shareholders may be important for other reasons, but it is clear from our survey that this activity alone does not determine whether or not transactions generate value. Indeed, of the companies that destroyed value, **94%** said that they had communicated their corporate strategy to shareholders.

Transaction objective

The survey shows that companies pursue M&A opportunities for a number of reasons:

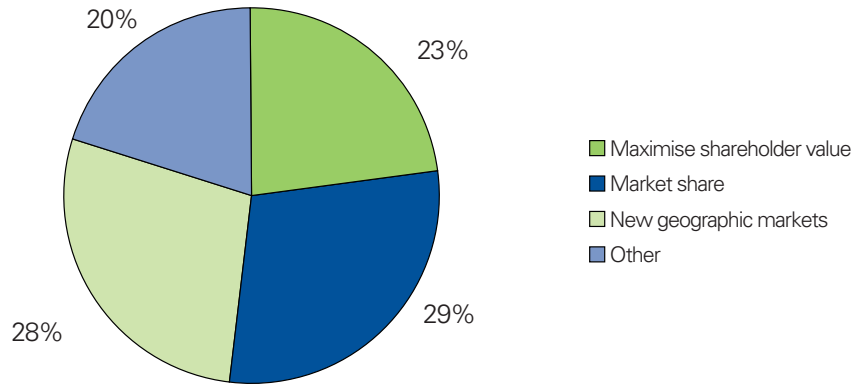


Figure 8: Objectives of M&A transactions

There was no correlation between the stated objective of the transaction and the success of the deal in terms of creating shareholder value.

5 Realisation

Target identification

M&A transactions may not always result from a company's pre-identified strategic requirements. Where a suitable opportunity arises, the board determines whether pursuing it will fulfil the company's objectives.

Transactions are equally likely to result from either a process of identifying a target followed by a direct approach, or a candidate becoming available without having been targeted in advance. The provenance of the transaction has no bearing on whether or not it ultimately creates value. Success is more likely to be determined by the quality of the assessment and valuation process.

Pre bid value assessment

The rationale for purchase should be supported by a rigorous and robust process for evaluating the value and price of the target. The price should be within the range of values to the purchaser which will enable shareholder value to be created.

The business model will assist in quantification of:

- Value to the vendor;
- The value to other prospective bidders in the market place;
- The potential value to the purchaser, based on a range of assumptions;
- The opening bid price and the maximum price the purchaser should be willing to pay which will enable the creation of value for the purchaser.

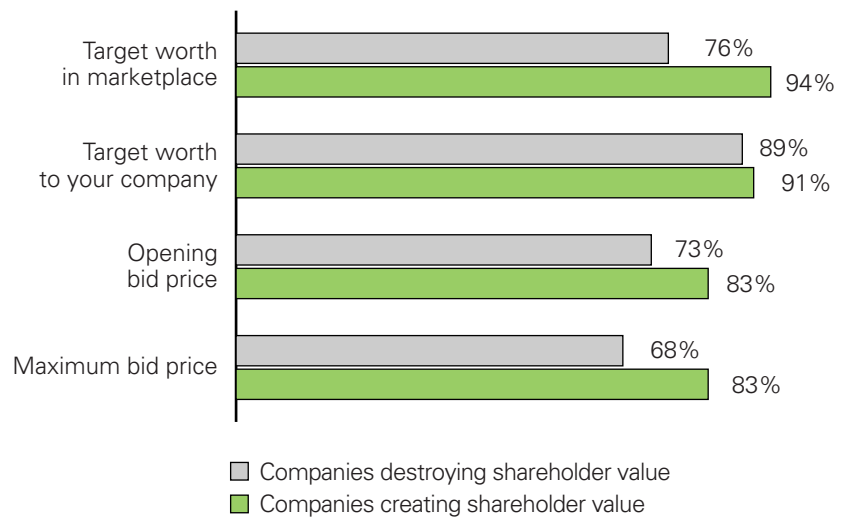


Figure 9: Pre bid value assessment

The companies which created value were more likely to undertake a thorough pre bid value assessment, in particular establishing the value of the target in the marketplace.

Investigation priorities

The respondents were asked to assess the importance they attached to the various areas of investigation required during the transaction process. On average, companies gave a marginally higher priority to the areas which helped to ensure there were no skeletons or surprises, such as financial and commercial due diligence and legal issues. A slightly lower priority was accorded to areas such as technology and environmental issues.

Responsibility for investigations

The majority of companies used either internal teams or a combination of internal personnel and external advisers to tackle the various areas of investigation. The areas most likely to be addressed solely by external advisers were regulatory, legal, financial, operational and environmental issues.

In general, companies which created value were more likely than those which destroyed value to seek external advice, particularly on financial and operational due diligence, communications and regulatory issues.

6 Completion, implementation and measurement

A robust and well managed transaction process will include reviews and checks to ensure all risks and issues are addressed and to confirm positively that the deal should proceed through to completion.

Review and formal checks

68% of companies undertook a formal review prior to entering final negotiations and **85%** of companies had formal checks prior to completion to ensure that:

- All risks and issues had been resolved or factored into the contractual arrangements;
- All relevant issues were built into the post completion plan.

We found that there was no correlation between undertaking a review or formal checks and success. This result is surprising. Based on our experience, the explanation may be that the review processes are not always sufficiently systematic or comprehensive.

Implementation

A deal may be technically complete or the offer unconditional; however value is only crystallised when the management of the combined business implements its strategy to deliver the objectives of the deal and unlock shareholder value. This phase should also include a review of decisions made earlier in the process, as it is only at this stage that decision makers will have comprehensive information at their disposal. **87%** of respondents believed that their implementation was going according to plan.

Measurement

The majority of companies did not measure the success of the transaction implementation in terms of whether it had achieved its original objective. Only **25%** measured their performance against the ultimate objective of increasing shareholder value.

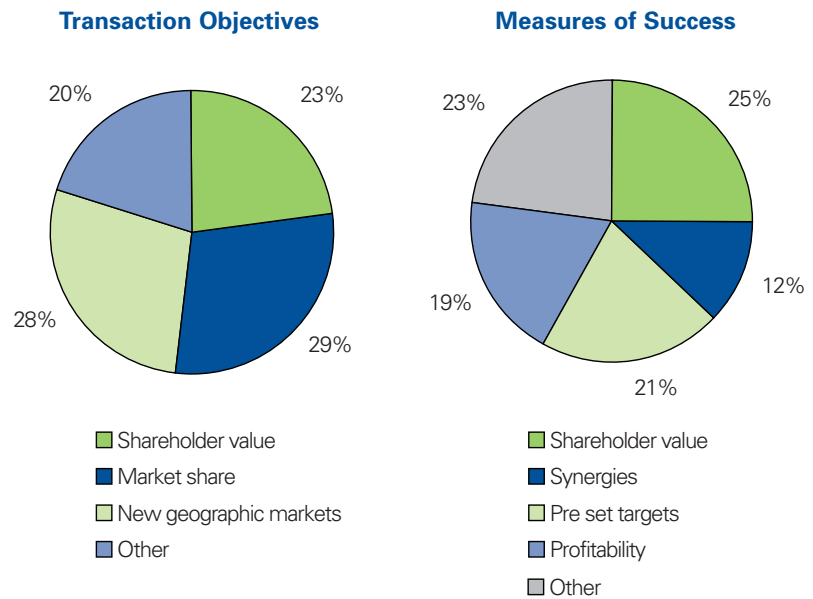


Figure 10: Transaction objectives and the measures of success

It is not surprising therefore that companies fail to deliver shareholder value through transactions, when evaluation and monitoring of implementation is consistently based on criteria unrelated to the original deal objectives. It is also interesting that **75%** of respondents were able to claim success in meeting deal objectives when the majority do not measure the implementation against these.

External assessment

No respondents relied exclusively on external assessment at the implementation stage. However, those who asked external advisers to provide an independent evaluation were **39%** more likely to create shareholder value from the transaction.

A rigorous independent evaluation ensures that the implementation, and ultimately the transaction itself, is measured against the objective and rationale cited in the business model.



For further details, contact:

Colin Cook
colin.cook@kpmg.co.uk

KPMG Transaction Services
8 Salisbury Square
London
EC4Y 8BB
United Kingdom
<http://www.kpmg.co.uk>

Telephone: +44 (0) 20 7311 1000
Facsimile: +44 (0) 20 7311 1640

Donald C Spitzer
dcspitzer@kpmg.com

KPMG Transaction Services
345 Park Avenue
New York
NY
10154-0102
USA

Telephone: 001 (212) 758 9700
Facsimile: 001 (212) 758 9819

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