Bringing it all together

Getting a great deal
Why mergers and acquisitions matter

A BT White Paper

David Furniss

Vice President M&A Integration
Practice, BT Global Services

Choosing the right supplier is never easy – especially if you're thinking about outsourcing things as complex as the networks and software applications that connect and enable your business. Get your decision wrong and you'll live with the consequences for years.

No wonder, then, that intending customers have so many questions to ask. Can suppliers provide what's needed in all the right countries, for example? What service guarantees do they offer? And how much do their solutions cost?

Few, though, question potential suppliers about their rationale for completing mergers and acquisitions and their track record of delivering the target benefits.

Using industry examples and our own experience, we demonstrate why this can be a mistake. Correctly conceived and executed, mergers and acquisitions make a vital difference to a supplier's ability to deliver the networked IT services its customers need, both at the outset of any contract and in the longer term.

Corporate marriages, it seems, are just like any other.

Every year, tens of thousands of companies decide to tie the knot, spending vast sums between them. According to McKinsey, the combined value of mergers and acquisitions agreed in the first seven months of 2007 exceeded the previous year's record total – US$4 trillion. Later in the year, the sub-prime lending crisis struck, cutting the numbers of new deals significantly. In the last four months of the year, 50 per cent fewer deals were announced than in the same period of 2006[1].

However, despite all this investment, mergers and acquisitions don't always go smoothly. Estimates suggest that 50 per cent or more of corporate marriages fall short not just of the participants' expectations, but those of their customers and shareholders[2,3].

Some 'couples' never even make it to the church. As the engagement settles down, they discover things about each other they didn't know before – things they don't like. The relationship ends, but not without cost. The end of merger negotiations between Renault and Volvo in 1993 temporarily destroyed a fifth of the latter's value, for example[4].

On other occasions, the marriage goes ahead, but ends in stalemate or acrimonious divorce. After a while, the romance fades. The parties continue to share a home, but live separate lives. As in Danny DeVito's film, "The War of the Roses," they start to bicker, destroying far more than their relationship. As executives struggle with the situation, service to customers falters, business suffers and share prices tumble. AOL's US$147 billion acquisition of Time Warner, completed in 2001, reduced the combined business's valuation by more than US$210 billion over three years[5].

The urge to merge

Despite such problems, mergers and acquisitions are commonplace in the new networked IT services business that's been created as networking and information technologies have advanced and come together.

A quick look at some of the industry's leaders emphasises the point. The networking technologies company, Cisco, announced the acquisition of 33 businesses between January 2005 and December 2007[6]. HP announced 31 deals over the same period[7] and BT 24, most of which now form part of BT Global Services.

Understandably, though, Microsoft tops this quick poll. It announced 22 deals in the year to May 2006 alone[8], and had announced 27 more by February 2008[9]. The outcome of its bid for Yahoo! – the largest acquisition Microsoft has ever attempted – was still being awaited as this paper was written.

So why are such companies such keen acquirers?

As Don Dodge from Microsoft's Emerging Business Team noted[10], it is often for one or more of the following four reasons:

- **to acquire new skills** more rapidly that can be achieved 'organically' through training and so on
- **to gain access to new technologies** that enhance existing offers or are enablers for future developments targeted at existing markets
- **to reduce time to market** by bypassing the need for in-house development
- **to enter new markets** whether they are defined by geography, customer grouping or the functionality of the products or services on offer.

As we set out in the following sections, acquisitions made for these reasons can have a big impact on a supplier's ability to meet its customers' future needs, enriching what's available to them as time goes by.

Mergers completed for other reasons are – from the customer's viewpoint, at least – much less interesting. For example, firms in established industries often face reduced margins. There, mergers and acquisitions can increase scale, allowing costs to be cut and margins restored. By making companies bigger, and therefore harder for competitors to swallow, takeovers also provide a way to defend against attack. But while such deals may impress analysts and the stock market, they generally hold little other than disruption and change in store for the customers involved.

Benefits acquired

Let's take a more detailed look at why customers stand to benefit when technology and market leaders undertake mergers and acquisitions. We'll do this in the context of a customer that's choosing a supplier to work with strategically over the long term – perhaps over five or 10 years.

Two situations are typical. One is outsourcing, where the long-term nature of agreements will often be prominently stated in press releases and other announcements. Those involved understand that up-front investments will be needed as responsibilities and, perhaps, employees are transferred, infrastructure is updated and so on. They know it will take time before the rewards can be reaped, so contract terms will have been agreed accordingly.

In the other situation, the long-term nature of the deal is apparent. Companies choosing to buy computers, software or other infrastructure clearly expect them to be in service for some time, and will depend on their suppliers for maintenance and, more particularly, enhancements over that period. While these are important considerations, they are rarely subject to any formal commitment.

Either way, corporate customers need to make their decisions based on a view of the future as well as the realities of the present. But exactly what does lie ahead? Given the rapid pace of technological advance, 'straight line' projections based on past performance will only ever provide a small part of the answer. What matters most is the speed and efficiency with which a supplier can grasp new ideas and technologies and deploy them to its customers' advantage – something that is increasingly going to be determined by the supplier's rationale for undertaking mergers and acquisitions and its success in delivering results.

In our view, customers gain four main advantages when they choose to do businesses with an active and effective acquirer. To illustrate them, we'll use examples from BT's continuing mergers and acquisitions programme – examples with which we are familiar. Others will have similar stories to tell.

New services and capabilities

Done properly, mergers and acquisitions are excellent ways for firms to acquire the new skills and capabilities their customers are demanding.

Targets have to be chosen with care. BT acquired voice and data network provider, Infonet, to strengthen its global service platform. And it acquired Radianz, a financial services business process network, from Reuters to extend its portfolio of finance-related networked IT services and deepen the expertise it could offer to the financial services sector.

A broader range of customers has benefited from BT's acquisition of Counterpane Internet Security, Inc. BT bought the company, which now trades as BT Counterpane, to expand and develop its managed security services portfolio. Its customers' needs for intrusion detection, network monitoring and other managed security services were growing fast, and the acquisition of Counterpane has helped it respond.

Soon after the deal was struck, customers were realising benefits. Services from BT Counterpane are a significant part a five-year US$20 million contract with CLSA, a leading provider of brokerage and investment banking services in the Asia-Pacific market. Its security solutions monitor both the device and network layers of CLSA's infrastructure around the clock, providing real-time correlation of alarms and analysis of security events and alerts.

Customers have also gained access to new people with new skills. Many of BT's acquisitions – those of Frontline, Counterpane, and International Network Services (INS), for example – had professional service capabilities that have are now available to all of BT's customers worldwide.

Better service

Several of BT's recent acquisitions – Infonet and Radianz, for example – had established excellent reputations for customer service and BT Global Services wanted to act quickly to capitalise on their expertise and insights and further improve the overall performance of its core business.

It began by looking closely at what had enabled Infonet to win 15 consecutive 'Best in Class' ratings from Telemark Consulting for customer satisfaction in the managed data network services market, and at how excellence in customer service had contributed to Radianz's third successive number 1 ranking as best network provider by Waters, an influential publication serving the financial services industry.

Based on this, a common service model was implemented across all of BT Global Services' direct and indirect service channels. It ensures the customer's experience is the same across the 170 countries in which BT provides services and has had a significant impact both on standards of service and customer satisfaction.

The result is a highly-responsive 'call local' approach that improves BT Global Services' ability to manage local suppliers, allows in-country teams to respond more quickly and consistently, and clarifies ownership and accountability. Performance is now measured and reported against common key performance indicators (KPIs), regardless of whether services are delivered directly or through a local partner.

Greater reach

Acquisitions have also helped BT Global Services extend its reach into new territories that matter to its customer base – for example, because they have operations there – and to amplify its capability in high-growth economies, notably the BRIC countries: Brazil, Russia, India and China.

In the past few years, many corporations have been outsourcing activity to such locations to take advantage of lower costs and/or the skills of their workforces. At the same time, these emerging markets are growing in their own right and many of their home-grown corporates have increasingly global ambitions. BT's significant investments in India, where it has become the largest foreign global carrier, mean it now serves some 200 multinational companies across the country, including around 95 per cent of the business process outsourcing firms that operate there. BT has particularly strong relationships with some of the biggest players in India's fast-growing IT and IT-enabled services industry – companies like Tech Mahindra, HCL, Infosys, TCS and Wipro. Even before its recent acquisition of i2i Enterprises, BT expected the revenues it earns in India to exceed US$250 million per annum by 2009.

It's been a similar story in Italy. By combining Albacom, Atlanet and, more recently, I.Net with its other operations there to form BT Italia, BT has rapidly increased its market share in the country, which is Europe's fourth largest economy. Prior to the acquisitions, BT employed only 30 people in Italy and earned less than €50 million a year. Just two and a half years after the acquisitions were completed, the situation has been transformed. BT Italia has become the company's largest operation outside the UK, with in excess of 1,500 people and revenues approaching €1 billion a year.

The greatly extended reach made possible by connecting the acquired networks to BT's global backbone has been an essential ingredient of the success. For example, it won BT Italia a five-year, €450 million contract with Italian automotive giant, Fiat, to supply network services to connect its operations in Italy and 39 other countries across the globe. Before they joined forces, neither Albacom nor BT would have been able to meet Fiat's needs.

Accelerated innovation

The fourth key benefit customers gain by dealing with suppliers that have continuing programmes of mergers and acquisitions is the confidence that their needs will be met not just today, but into the future.

Traditionally, firms like BT would depend on their in-house research and development departments for new ideas and to drive those selected for deployment through to market. One result of this approach was that the pace of innovation was limited. With fixed team sizes and budgets, only a certain number of ideas could be worked on at any one time.

Mergers and acquisitions are an answer to this problem, which is one reason why technology leaders like Cisco, HP, Microsoft and BT are particularly active in the area.

Returning to the example of Counterpane, BT had recognised how important threat monitoring was becoming to its customers and knew it has to make the choice between developing its own capability and buying it in. The deal with Counterpane – the leader in the field – allowed it to meet its customers' needs much more quickly and effectively.

The deal delivered similar benefits to Counterpane's customers. In 2007, it was able to launch more new services than it had over the previous four years.

Spotting winners

Over the lifetime of an outsourcing contract or a hardware or software solution, such benefits can prove significant. No company knows exactly where its future lies, but all would prefer to deal with suppliers that will be ready to support them when they get there.

So how can firms identify suppliers that have long term potential?

The answer, we think, is to conduct something akin to a job interview. Questions asked must probe a candidate's past experience and achievements, looking in particular at what's been learnt along the way. Things may not always have worked out right. This in itself isn't a problem. What matters is that applicants have learnt from their mistakes and won't repeat them.

There are several areas a customer may want to probe – the record of the supplier's in-house R&D team, for example. But when it comes to mergers and acquisitions, questions should focus on the following:

The rationale

As we set out at the beginning, technology-based businesses usually consider acquisition as one of the ways in which they can adapt to change, enrich their skill base, enter new markets and generally prepare themselves to address their customers' future needs.

In contrast, companies in mature industries often look to mergers and acquisitions as a way of increasing scale, reducing costs and restoring margins.

These are generalisations, of course, but they highlight an essential point: while deals almost always hold something in store for shareholders, customers don't always benefit.

As a result, there is good reason for firms to include in their invitations to tender questions about the supplier's takeover history, its future appetite for mergers and acquisitions and the rationale that would lie behind them.

The strategy

There are several different types of acquirer out there in the market.

The media tends to focus on corporate raiders, so-called 'vulture capitalists' and private equity firms. They tend to buy companies purely to make profits, acting opportunistically. Small or injured fish that are swimming in the corporate pond are gobbled up and processed. Assets may be sold to generate quick profits, and anything that's left will be restructured or streamlined to boost profits and allow the remaining business to be sold at a profit.

Of greater interest to customers are firms that acquire other businesses because they are interested in what they do and feel they'll be able to help them grow and prosper.

Typically, companies are acquired when they have reached a major decision point in their evolution, and will be looking for a way to move forward. They will have been successful, but know they will need help if their ambitions are to be fulfilled. This might just be cash – its current shareholders might not want to dig deeper into their pockets – but it could be something complete different. The business might be looking for a way to reach a larger, more global, market, for example.

Knowing that a tie up with a bigger firm is one way to get the help it needs, the business may well have been actively courting a takeover. Generally, it will be a going concern – not one that is loss making or otherwise in poor shape – so it might well have several suitors it can choose from. All will see it as a good way to accelerate their growth or fill gaps in their geographical reach, product portfolio or skills. In other words, they'll be looking for deals that benefit their customers as much as themselves.

> "The connection between successful acquirers and their adherence to an overarching strategy is shown by the fact that none of them acquired companies for defensive purposes – that is, to block a competitor."
>
> McKinsey, 2006[11]

The process

Once the decision to acquire has been made, the way the process is handled matters a great deal. While some companies pull together teams to manage acquisitions case by case, others maintain a standing force of specialists who carry their experience from one merger or acquisition to the next, learning as they go.

BT, for example, is an example of the latter. It uses a proprietary project management methodology called in2great to ensure the goals for each deal are clear and that detailed plans exist for the integration of each acquired business.

in2great covers all the activities required to implement a merger or acquisition and sets out a template structure for the project team to follow. Like other project management methods, it has evolved over time. Lessons learnt in the process of cementing previous mergers and acquisitions have been fed back to increase the chances of future success.

One of the many lessons BT has learned over the years is to give integration projects the attention they deserve. They are, after all, substantial projects of great importance to the company's future and, like other such projects, they can't be planned on the back of an envelope. BT's 2005 acquisition of Albacom, for example, involved nine separate work streams, each of which involved completion of several sub-projects. The full plan for the merger project detailed thousands of steps.

This may sound like overkill, but there's strong evidence to show that thorough planning makes a big difference when it comes to achieving the targets companies set for their mergers and acquisitions.

This is particularly the case where the value of the firm being acquired lies in its people rather than in other assets. In such situations, it is absolutely essential for acquirers to understand and address any issues those joining may have and set out integration strategies for their teams at the earliest possible stage. Starved of reasons to stay, talented staff members are likely to vote with their feet, taking the ideas and expertise that made the business attractive with them as they go.

Needless to say, this doesn't bode well for customers.

> "If what you buy is a business with 1,000 knowledge workers each charged out at US$1,000 per head per day and they start to leave, your acquisition could soon be worth much less than you paid for it."
>
> Maggy McClelland, President Business Operations & Professional Services, BT Global Services

The results

Of course, the ultimate proof of any acquirer's strategy or process is the result. Did customers benefit? And if so, how?

We've made it clear what we think mergers and acquisitions can deliver to customers, but finding evidence of a supplier's track record can be difficult. Deals that go wrong grab media headlines, not those that succeed all-round.

Most likely, then, customers will either want to seek an industry analyst's opinion or go straight to the supplier itself. They'll find those with good track records more than happy to talk about their success and show how their acquisitions have extended their products and services, improved their reach and performance and enabled them to deliver the innovations their customers need.

The bottom line

A great deal has been written about mergers and acquisitions over the years. Much has focused on the creation or destruction of shareholder value. Clearly this is important, but we think it is one step removed from what matters most about any deal – that it has a positive impact on the customer.

If mergers and acquisitions are conceived with customers in mind and executed well, in a way that ensures that products and existing services are enhanced, new ones made available and any service improvements are delivered, customers stand to gain a great deal.

If, on the other hand, deals are entered into based solely on the potential impact on a company's stature, share price or margins, dangers await. With as few as 50 per cent of deals delivering the results forecast when they were announced, the chances are that managers will be distracted by the problems their company has brought upon itself. Such distractions can put customers at a disadvantage and end up costing them a great deal.

Under the circumstances, we think it appropriate for customers to ask their suppliers searching questions about the strategy for entering into

When you're looking for a supplier for the long term, such things make a tremendous difference.

About the BT M&A Integration Practice

Although BT's hugely successful strategy in becoming a world-class services organisation has been widely reported in the press, its parallel concentration upon creating a world-class M&A capability has not been so well publicised. In a conscious decision to eschew the use of external consultants, BT created an M&A Integration Practice. The unit would not only assure the integrity of BT's M&A activity but would also give BT a powerful new consultancy arm.

In approaching a merger, the Practice is targeted with a single overriding objective: to deliver the financial and non-financial goals set out in the BT business case. Along the way the unit also has to:

- Deliver the integration synergies and upsides for each acquisition
- Ensure key target capabilities are retained and not diluted (or even destroyed)
- Demonstrate continuous improvement by capturing learning
- Maintain effective communications with all stakeholders

An integration director leads each engagement, taking over from the business development director when the deal is announced. At the core of BT's way of working is an integration methodology that has become known as in2great. It ensures that all M&A exercises in BT follow standardised, consistent, and repeatable processes. Furthermore, the existence of in2great provides a framework that can be continuously populated with newly acquired internal and external best practice.

The in2great integration methodology is a carefully graduated process that passes through four distinct phases: pre-transaction, integration, transition, and business as usual. The integration director is appointed and involved pre-transaction and a formal handover to the Practice takes place when the deal is announced. The critical integration phase – usually in the region of 12 months in duration – is characterised by monthly reporting to a programme steering group against achievement of weekly checkpoints. Moving into transition and through to business as usual, reporting is relaxed to quarterly intervals.

Although there is sharp and specific focus upon key areas – for example, financial systems integration, organisational alignment, and employment package relativities – the in2great approach is in the main functionally agnostic. Interdependencies are fully taken account of and process mapping assures end-to-end integrity and drives cross-divisional synergies.

The M&A Integration Practice has now been involved in more than 30 transactions in the past four years ranging from the acquisition of the 90-person Counterpane Internet Security Inc. to substantial deals such as Albacom and Infonet. In every case, synergies are increasing the value of the businesses to both BT and its customers and allowing costs to be reduced – for example, by introducing common back office systems and processes and gaining other economies of scale.

BT Global Services' mergers and acquisitions

BT Global Services announced 24 mergers and acquisitions were completed or announced between January 2005 and December 2007. Businesses were also acquired by other BT businesses, notably BT Retail.

2005	2006	2007
Infonet Services Corp.	Altanet SpA	International Network Services Inc.
Albacom SpA	Infonet Deutschland	i2i Enterprise Pvt Ltd
Radianz Limited	Telexis Polska	Comsat International
CWC Espana	Telexis Brasil	CS Communication & Systèmes, Infrastructure Division
SkyNet Systems Limited	Counterpane Internet Security Inc.	Infonet Turkey
Total Network Solutions Limited	Infonet Luxembourg	INS Group SA
Dinsa Soluciones		Net2S SA
i3:it		Infonet Switzerland Ltd
CARA Group		Frontline Technology Corp Ltd

BT and Counterpane

Founded in 1999 by the renowned security technologist and author, Bruce Schneier, Counterpane developed solutions to address the risk left by relying solely on firewalls and other security products for network protection. Based in the heart of California's Silicon Valley, its business had grown rapidly. Offices had been opened in Washington and Tokyo, and turnover had risen to more than US$10 million per annum.

BT's customers were hungry for the sorts of solution Counterpane could deliver, but one thing was clear: the company's principal asset was the expertise of its people. If the acquisition was to be a success, they would have to be persuaded to stay once the deal had been completed.

Targets were set. Despite the difficulties other companies had reported in keeping people from small entrepreneurial businesses once takeovers were complete, BT hoped 90 per cent of Counterpane's staff would stay for at least a year and put a range of programmes in place to make sure this would happen.

In the end, all of Counterpane's staff stayed. As Paul Stitch, President and CEO of BT Counterpane, has said, the statistic speaks volumes. "There's no doubt we must have done something seriously right."

BT and Infonet

Prior to its acquisition by BT, Infonet had established an enviable reputation for customer service. It was something neither business wanted to lose as the organisations were brought together. The goal was exactly the opposite, in fact: BT wanted to capture the goodness inherent in Infonet's customer service systems, processes, and methodologies and replicate it for the benefit of its customers.

Because of their design, it wasn't possible simply to scale up Infonet's existing systems to meet the needs of BT's larger business. New systems had to be built from the ground up based on the Infonet model – systems that could only be introduced to support customers previously served by Infonet once their performance was equal to or better than their predecessors.

The work has now been completed, and with great success. Customers were soon noticing the difference.

"The fact is that every time BT acquires a well-run company it learns how to be a better service provider."

José Collazo, Vice President, Global Capabilities, BT Global Services

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