# Forest Products:
## Achieving high performance through merger and integration success

By Ravi Chanmugam and Mehul Jain

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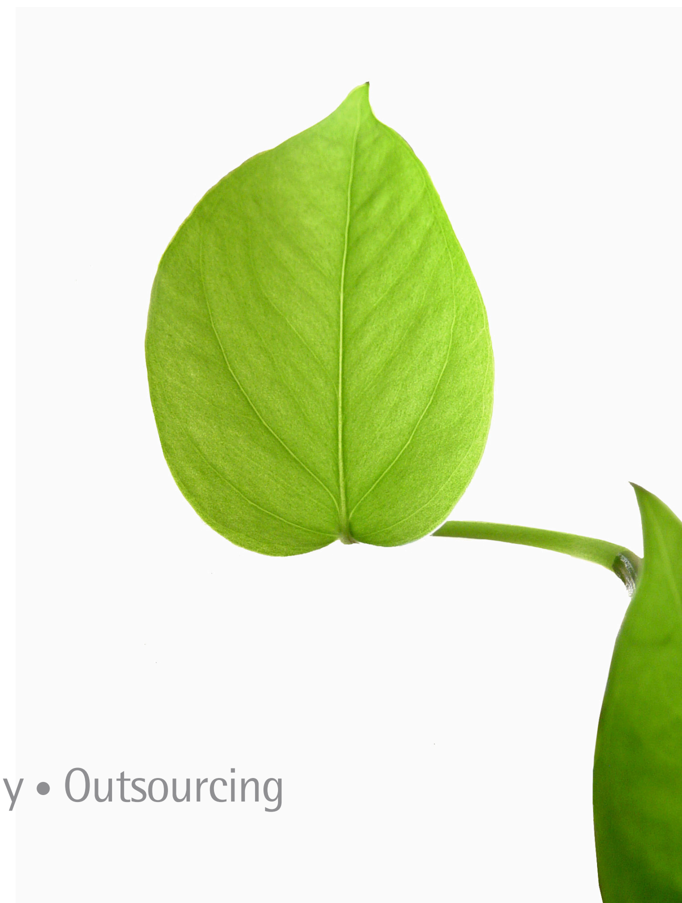

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## Introduction

Like many industries, the forest products industry has witnessed an increase in merger and acquisition (M&A) activity over the past several years. Although deal sizes have not been as large as some of the 2000-era transactions, there is no doubt that the current wave of M&A activity is reshaping the competitive landscape, especially in the paper and packaging segments, as companies seek ways to achieve high performance.

In the past five years the level of M&A activity—as measured by the number of transactions in the industry—has increased as major companies have acquired divested segments of larger players and smaller mills. Earlier waves of industry consolidation saw International Paper acquiring Champion International, Weyerhaeuser acquiring Willamette Industries and Westvaco and Mead merging. In addition to limited strategic consolidations, today's transactions are characterized by smaller carve outs and asset purchases such as Glatfelter's two 2006 acquisitions of single mills from larger entities.

Reasons behind M&A activity vary, but deals generally stem from the essential belief that companies can create more value together than separately. In practice, however, it is not always easy.

Companies undertake mergers for many strategic and financial reasons. A typical driver is increased profitability, such as higher return on invested capital through synergies and economies of scale. Companies often hope to achieve increased profitability through cost savings by combining labor forces and administrative programs, as well as efficiencies in purchasing areas such as fuel and raw material. Increased market share and capacity are also important objectives, as merging companies often seek the creation of broader sales and distribution channels while getting closer to key customers. Finally, some companies simply utilize M&A activity to gain access to best-in-class assets and resources.

## Factors behind M&A success and failure

In the past, the best sectors for M&A in the forest products industry were the ones with the least capacity such as tissue and bleached board. Now, there are instances where after acquisitions are made, mills are being shut down due to excess capacity. We believe successful merger and acquisition activities in the forest products industry have the following distinguishing features:

- Clear vision of M&A goals
- An established M&A function for finding and selecting targets
- Targets valued based on the implementation of a company's own best practices, processes and systems
- Acquirer best practices and processes implemented quickly and effectively
- Deals targeted in the same industry sectors, enabling the acquirer to sell more to existing customers
- Focus on integration and established an integration track record

Accenture's experience and research on mastering M&A indicates that many mergers fail to deliver expected results due to two fundamental issues: insufficient integration planning and failure to address people and process issues in the supply chain.

## Insufficient Integration Planning

A common barrier to achieving expected merger synergies is the inability to integrate operations quickly and effectively. To accelerate integration, companies should create a detailed integration plan in advance of closing the deal. By creating this plan, participants have time to identify and resolve integration issues before "Day One." Integration plans should encompass sales and marketing, operational, IT and cultural integration.

In particular, integration plans should identify operational issues that require attention within 100 days of deal close. Following the integration plan helps ensure efficiency and stability gains will be realized across internal operations. Integration plans should also detail how strategic issues will be addressed in the first few months after the deal.

A common trap companies fall into is becoming overly focused on the merger activities and neglecting key customers or "taking their eye off the ball" in day-to-day operations. Resolving this issue requires setting up a dedicated team for the key planning period. Another pitfall is building plans within silos without a heavy degree of interdependency management.

In addition to integration plans, the management structure for the combined entity should be clear and unambiguous. Plans and near-term objectives for the management team should prioritize integration efforts to stay focused on achieving significant synergies as soon as possible. Tying incentives to synergies, tracking synergies and reporting to the board of directors the first year after a deal are becoming common strategies.

## Ignoring People and Process Issues in the Supply Chain

Mergers and acquisitions often run into problems in the form of procurement and supply chain disruptions. Nearly half of the executives in a recent Accenture M&A survey cited issues such as increased product-launch disruptions, a loss of talent, diminished product or service quality, problems with order-fill rates, stock outs, inventory buildups and increased supply disruptions.

In addition, forest products companies cited poor results from slow integration (plant shutdowns, staff reductions, organizational changes, etc.) and the lack of implementation of common platforms. Examples of M&A issues that have occurred in the forest products industry:

- Procurement, supply chain and product-launch disruptions
- Problems with product or service quality, order-fill rates, stock outs and inventory buildups
- Management team selection and retention
- Delayed staff cuts due to an unionized workforce
- Poor cost/price analysis on grade and capacity rationalization due to requalifying of product and other difficulties in moving product to a new mill (in order to achieve the optimal capacity allocation)
- Institution of burdensome reporting and decision-making systems
- Unrealistic forecasting of anti-trust rulings in preclose periods, incurring high costs
- High IT infrastructure costs due to lack of common platform and processes

Accenture's experience indicates that many of these issues stem from the failure to address people and process issues in the supply chain. Without a plan to integrate supply chain operations—and the close management oversight to turn plans into reality—very little will change on a day-to-day operational basis. In terms of the supply chain, the result is that two distinct entities remain after the merger. To help ensure that people can successfully operate the merged processes, companies should have a comprehensive communications plan in place long before the deal is closed. With this plan in hand, management should engage early with employees to help them understand the changes taking place, reinvigorate morale, and support the execution of supply chain integration plans.

## Pulling Things Together

When companies take a comprehensive approach to planning and executing a merger integration effort, they put themselves in a much better position to quickly achieve synergies and create value with the new organization. In order to achieve this value, there must be clear acquisition selection criteria, which could include capital structure, return on capital and ensuring fit within the strategic framework.

For example, as part of a new acquisition strategy, a major paper manufacturer purchased a pulp and paper mill operation. Accenture worked with the manufacturer to take a comprehensive approach to integration, creating a plan for integrating the supplier base and maintaining the seller's distribution network while a new network was put in place. The effort also included development of an enterprise resource planning migration strategy and the design of a new market-focused organization.

With a clear integration plan in place, the company soon saw solid business results. Using pre-close trial runs to establish operational skill and test its supply chain, the company quickly began producing and shipping product from the acquired mills, creating scale and cost advantage. A smaller, less competitive location that had been manufacturing these products was closed without disruption. The company has been able to optimize pricing of its products in a strong market after years of weakness. And it now has a repeatable integration process—a "mini-playbook"—that can be used to support future asset acquisitions.

The potential synergies of merging organizations in the forest products industry are significant, and some mergers do live up to expectations. But most do not. Often, the difference lies in thinking ahead. To succeed with mergers, companies need to take a comprehensive, careful approach to planning how the two companies will be integrated—and how the new, merged organization will take advantage of its scale and its capabilities to achieve high performance.

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## About the Authors

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