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Viewpoint

Insights and opinions from Baringa Partners

Navigating Mergers and Acquisitions

advice for the Telecoms and Media industry

Navigating Mergers and Acquisitions:
advice for the Telecoms and Media industry

The UK Telecoms and Media sector is undergoing a seismic shift as the Mergers and Acquisition (M&A) agenda gathers pace and the industry is having to cope with an unprecedented level of change. Over the last couple of years we have seen Liberty Global buy Virgin Media, Vodafone acquire Cable and Wireless, and BskyB buy Sky Italia and a majority interest in Sky Deutschland.

These integrations are still ongoing. In addition, we have the recent news of BT agreeing to buy EE, 3 planning to buy O2 and we see daily speculation in the press of further consolidation.

The drivers for these M&A deals have had a lot of coverage in the press but broadly fall into three categories, which often are interconnected:

1. Scale –
growing in scale allows Telecoms and Media companies to access more customers, to spread large investments across a larger customer base, to gain synergy savings and at the same time increase their buying power when negotiating content deals with the US giants.

2. Quad play or convergence –
many of the recent acquisitions in the UK will allow these joint entities to offer more products to their customer base. The long-awaited monetisation of quad play deals is seen as both a revenue generator but also a defensive churn reduction mechanism.

3. Efficiency –
the UK Telecoms and Media sector is one of the most highly competitive markets in the world and M&A enables companies to drive down their cost base and offer lower prices to their customers whilst maintaining or improving margins.

> The UK Telecoms and Media sector is one of the most highly competitive markets in the world.

Opportunities from M&A

In addition to the three main drivers (shown opposite), there are also a number of other benefits that M&A can drive:

1. A refresh of management and better engaged workforce – M&A gives both the opportunity to retain top talent by promoting them into larger roles in a larger business, as well as the ability to replace less able management via the integration process. If selected people in management positions leave as part of an integration it gives opportunity for progression to more junior staff – something they might not have achieved during the status quo. Therefore, a well-managed integration can leave the business with a refreshed leadership team and a more engaged work force.

2. Being a catalyst for change – due to the historical pace of change in the industry many Telecoms and Media companies recognise that they might have an outdated operating model for today's business environment. It is, however, often very difficult to make the case for changing the Operating Model when the management team is focused on day-to-day trading in an aggressively commercial world. This can be short termist and reduce shareholder value over the long term. M&A forces a business to re-think its operating model and gives it an opportunity to re-base its operation to be more relevant to the current trading environment and for the trading environment of the next five years.

3. The challenge of sacred cows – all organisations have a list of sacred cows that it is very difficult to overcome – for example, the move away from engineer installs to self-install, breaking down product siloes and product P&Ls to move to a more customer-centric P&L, how far to drive the self-service and online agenda, views on the brand or customer service impact in the move to offshoring. M&A allows both businesses to directly compare their operations and, if managed well, can be used to break down the sacred cows and address them head on – usually to the benefit of the P&L.

4. Delivery of synergy savings – near-term benefits from legal entity rationalisation, head office synergies and procurement savings through to more strategic savings such as network consolidation and IT rationalisation. Also, improved Revenue Generating Units (RGUs) and Average Revenue per User (ARPU), resulting from new and more integrated products and services. If managed well, the efficiencies can make the combined organisation more competitive and the revenue benefits can drive improvements in market share and ARPU.

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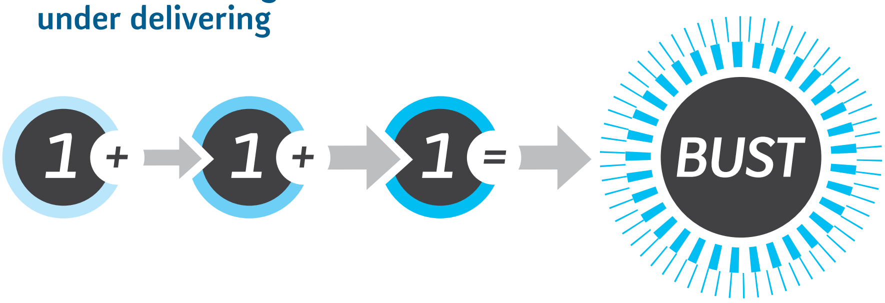
Key risks to consider:

As these deals move from due diligence, through regulatory approval into integration planning and execution there are a number of key points to be aware of specific to M&A and integrations. We have selected a few of the challenges facing integration programmes:

▶ Over committing and under delivering



Because of the competitive nature of the UK market each company will have aggressive Business as Usual (BAU) plans already in place to release new products, attract new customers, and invest in strategic programmes. These plans will have been through the annual planning process and the long range planning process and will be hard fought for. They are usually incredibly aggressive, stretch plans and are just about achievable in their own right.

Both organisations in an M&A will be committed to these plans, and then on top, the Board will have agreed an even more aggressive synergy case – the rationale behind the deal.

Typically these synergy cases are done behind closed doors, with external support, to minimise the likelihood of a leak in the lead up to a deal. They have to be aggressive to appease shareholders and analysts and often don't take into account the existing and aggressive BAU plans already in progress.

When you combine the two BAU plans and a synergy plan, as well as a Day One preparation project, a potential brand re-launch, and some staff attrition you end up with a real challenge – there is a risk of creating a beautiful set of undeliverable plans which will have significant financial consequences if they under deliver.

The bottom line – forewarned is forearmed

Take the time to plan properly. Look at the triple constraint of financial outcome, scarce resource and ability of the business to absorb the change. Prioritise ruthlessly, be ambitious but realistic and make sure the Integration leadership team raise all potential conflicts early to drive proper decisions.

Key risks to consider:

▶ Losing your focus when your competitors are targeting your customers

Your competitors will be watching intently as the deal progresses. They will have carefully developed plans to deploy in order to capture as much market share as possible during a period when your business attention is focused elsewhere i.e. on the integration, or delivering remedies imposed by the regulators.

Don't underestimate the amount of disruption M&A has on three primary levels:

- **Leadership** – will be focused on landing the deal, competing amongst themselves for a reduced number of roles, or starting to check out mentally.
- **Management and staff** – may have been kept in the dark, will be focusing on what the deal means to them - will they be rich as a result of the deal, will they have a job, who will be their new line manager and of course many will be interviewing with competitors.
- **Customers** – business and consumer customers will also be wondering what the deal means to them, will there be better products, will customer service fall off, will competitors be bringing great, new, low-priced propositions to market.

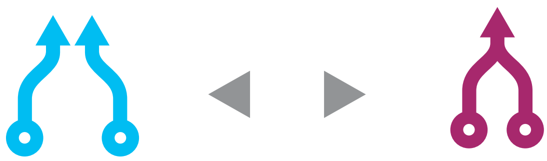
Competitors will naturally be more aggressive in the market trying to make a decisive move to gain customers and increase ARPU. Management will need to be even more aware and focused on short-term trading to address this challenge. All of this will put pressure on the achievement of BAU plans and the ability of Management to focus on synergy savings and Day One readiness.

The bottom line – division of labour

It is imperative that a cadre of senior management is 100 per cent focused on trading, on the market and on competitor activity. It is equally important that another cadre of management is focused on integration and delivery of a successful Day One, as well as setting up the synergy programme for success. Of course, these teams must work together but you will need to make sure your management team is set up for success – don't expect them to focus on all areas otherwise something will drop – and that something could have a larger than normal financial impact.

Key risks to consider:

▶ Being clear on the purpose of 'integration'



Synergy Case Only

Full Integration

As the deal concludes and the business starts to plan for 'integration' an inordinate amount of time is wasted by businesses debating what 'integration' means – even when a set of integration principals have been agreed.

On the one hand there will be a relatively clear synergy case that the Board has signed up to and has committed to shareholders and the City.

On the other hand, Management may consider that integration means fully integrating the back end of the business and addressing many of the burdens on their day-to-day lives – including significant operational and systems-related improvements.

In reality, integration will probably sit somewhere between the two and the synergy plans will make high-level assumptions around underlying process and systems consolidation.

In addition, many people will be looking at integration as one of the 'only games in town' for the next two to three years and, therefore, can see this as a way to get their pet project on the agenda through scope creep and 'interpreting' the integration in a favourable way to their business area.

All this can result in a loss of focus and wasted delivery effort and cost. Scope creep is a real threat and if unmanaged can make an already difficult execution plan even more undeliverable.

The bottom line – clarity of integration

Set a clear and detailed description for the purpose and scope of integration. Communicate it consistently and regularly throughout the business. Closely monitor the programme to minimise scope creep – otherwise an already difficult delivery becomes increasingly hard to achieve.

Clarifying the purpose and scope of integration and actively managing scope creep is essential to successfully delivering the benefits from M&A.

Key risks to consider:

People don't like to be kept in the dark

M&A is an incredibly stressful time for staff and Management alike. People like to be communicated to and kept aware and it can be difficult to do this during M&A deals – as the deal is coming to fruition it is rightly kept secret. While it gains regulatory approval you want to avoid the business getting distracted by the deal when it may not come to fruition. When the deal is approved there is often a period of uncertainty during consultation and people re-interviewing for their jobs. All the while everyone is working hard to prepare for Day One, deliver the plan and present to the City or Share-holders on synergy savings.

Throughout this cycle, people are often under-communicated to and, as we mention above, people will be thinking about different things when a deal is announced – from calculating their potential pay out to worrying about career prospects.

People in the Telecoms and Media sector are often already working flat out and may be carrying vacancies in their team, so they may not be set up to cope with the additional level of new workload coming from integration. If communication is poor and people don't understand the integration plans, the business priorities, their own future roles, their new ways of working, the degree of extra workload ahead of them (and associated timelines and resource commitments and when there will be a return to BAU), then the M&A will quickly feel arduous and this will create an attrition risk.

If too many people leave, or if people in key roles exit the business, then the management team will be weakened and their ability to deliver the synergy case and compete in an aggressively competitive market will dwindle.

Given that it is people that make a successful company, and that M&A offers companies the ability to refresh their leadership teams, this is an area which needs constant and regular focus throughout the deal cycle. It is all too easy to focus on delivering a successful Day One, preparing for brand launches and synergy savings, and looking at bottom line performance without focusing on the people and communication aspect until it is too late.

The bottom line – people and good communications are critically important

People are your number one asset as a business and you must prioritise them. You want them to be engaged by the proposition of becoming a different company, bought into new ways of working and you want to recognise that you will be asking a lot of them over the next two to three years during an extremely busy and intensive period. Therefore, the people agenda must be front and centre of any integration planning.

Recommendations

The rationale for M&A is usually compelling. The intent is typically sensible and well considered. Execution of an integration and competing business priorities is difficult to get right. The rewards from getting it right can be extraordinary and game-changing.

While there are many potential pitfalls there is also significant opportunity to address these and to deliver a fantastic integration which is great for the company and often career defining for those involved.

The summary of our top recommendations from this paper are:

- Clear, visible leadership from the CEO and their Leadership team
- Clear integration principles, description and scope
- Agreeing an achievable synergy case and BAU plans and driving aggressive prioritisation
- Keeping your eye on the prize, controlling scope and maintaining an unyielding focus on delivery of the integration
- Using M&A as a catalyst for change – addressing those sacred cows and implementing the appropriate operating model and technology changes for now and for the next wave of growth
- Division of labour at the right points during an integration between the integration team and BAU
- Having a strong and dedicated Programme Director and Programme Management function – moving to BAU over time
- Instilling an unwavering focus on people – putting people at the centre and communicating effectively with them at all times.

Execution of an integration and competing business priorities is difficult to get right. The rewards from getting it right can be extraordinary and game changing.

Baringa prides itself on the quality of its Telecoms and Media practice. The Telecoms and Media team has worked with a large number of leading Telecoms and Media companies in the UK, Europe and across the rest of the world, helping them to innovate in a constantly shifting landscape. We work in partnership with our clients to shape and deliver their complex programmes focusing on delivering real, tangible results.

Baringa's broad spectrum of services includes:

- helping to evaluate new revenue streams
- driving cost efficiencies through deep insight into areas such as Field Force operations and customer journey management
- developing and running transformation programmes to improve billing and customer service operations
- implementing new operating models in a quad play environment
- integrating businesses post acquisition.

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About Baringa Partners

Baringa Partners LLP is an award-winning management consultancy specialising in: energy; financial services; telecoms and media, in the UK and continental Europe. It partners with blue chip companies when they are developing and delivering key elements of their business strategy. Baringa works with organisations either to implement new or optimise existing business capabilities relating to their people, processes and technology.

Baringa is recognised both in the UK and internationally for its unique culture, which has been acknowledged by a number of awards and accolades and continues to reaffirm Baringa's status as a leading people-centred organisation.

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