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Upfront*analysis*

Making M&A work

Andreas Hinterhuber, an Aventis manager who has steered the integration process in the Asia-Pacific region, offers a practical guide to successful mergers and acquisitions.

A comparison of the stock market performance of the largest mergers and acquisitions in 1999 with the development of the S&P 500 index provides salutary reading for executives contemplating mergers and acquisitions (M&As). Merged companies – including Vodafone/ Airtouch and Mannesmann – not only significantly underperformed the S&P 500 index but have to date failed to create any significant value at all.

Broader research (summarised in Table 1) also suggests that the average merger is doomed to fail.

Our research into M&As produced two main findings:

First, most mergers fail because managers apply a set of apparently commonsense rules.

Second, outstanding "integrators" are able to create extraordinary growth in shareholder value, and employee and customer satisfaction by applying a set of apparently counterintuitive measures in M&A integration.

Accepted wisdom in M&A

Most executives implicitly follow a set of commonly held assumptions when merging or integrating two companies. The most widely spread assumptions are:

- In-depth planning is a key requirement for success
- Synergy realisation is a primary goal once the deal is closed
- Early wins in integration – pick low-hanging fruit first
- Integration managers are appointed for monitoring and implementation of synergies
- Financial yardsticks are the best instrument to monitor the progress of integration activities

These practices appear commonsensical. Yet our research indicates that they lead many companies dangerously astray. Though apparently focused on the integration process, they ultimately distract companies from the grounds where the real battle for integration success is fought – the *marketplace*. This is the main reason why most mergers fail.

Outstanding M&A integrators

When we started to study the integration practices of some companies with immense acquisition experience such as GE, Cisco, Citigroup and others, a set of counterintuitive patterns began to emerge. Similar patterns surfaced when we studied the rare cases of successful mergers, such as Aventis. The implicit assumptions of managers responsible for integration within these companies were radically different in critical ways.

First, the focus of all integration activities was the creation of an immensely competitive organisation – rather than beating analysts' estimates of expected synergy levels. Second, managers in these companies realised that the creation of a common mindset was the most important prerequisite for achieving this objective.

The key lessons from the integrators were:

The window of opportunity is small – if after three to six months integration is not complete, it will never occur

The best integrators recognise the need for urgency, rather than planning, in integration. Less focused on producing detailed business plans with the next three-year sales and earning developments, they know that the window of opportunity in integration is open for only a very limited period of time.

Success is determined largely by how quickly a common mindset is created

The creation of a common mindset calls for the perpetuation of strong values and a performance-oriented corporate culture attentive to signalling effects.

Strong values and a strong corporate culture are necessary to give the employees joining the new organisation a powerful sense of what the organisation will stand for. These values are a combination of external market requirements, the unique strengths of both organisations and the envisioned future of the new organisation. They should also carry the organisation towards a point in the future that is never quite reached yet is powerful enough to guide day-to-day decisions.

While most organisations pay at least some attention to values and corporate culture, only outstanding organisations realise the strong signalling effects that all actions implicitly have on the enforcement of corporate culture. In a merger, these effects are particularly important in two instances: commitment to start at the top with synergies; and commitment to let top performers go if needed.

The outstanding integrators in our sample realise that synergies implemented at the executive floor send a strong signal to the rest of the organisation about top management commitment to synergies. By contrast, weak integrators, in their reluctance to let senior executives go, frequently move these persons to staff positions deliberately created, thereby implicitly communicating to the organisation that complacency is more important than performance, that history matters more than the future. With this, middle managers are tacitly encouraged to be softer than the requirements of the external marketplace, making it impossible for the company to realise any significant cost savings beyond what each organisation would have been able to do individually.

The vision of creating an immensely competitive organisation drives all integration activities

Outstanding integrators realise that the only vision worth pursuing in the disruptive phase following a merger is the vision of creating an organisation focused on being extremely competitive in the marketplace. Several steps are involved.

First, an audit of the competitive profile of the two companies is conducted by an independent party to assess strengths and weaknesses of the two companies *in the eyes of key customers*. This view is then confronted with the perception of executives about strengths and weaknesses of their own and of the merged or acquired company.

Second, an *ideal competitive profile* is drafted, taking into account the requirements of an extremely competitive marketplace, company aspirations, and existing strengths and weaknesses.

Third, in light of usually considerable gaps between current customer perceptions of the company's strengths, management perception of actual strengths and the competitive profile required in the future, action plans – frequently requiring drastic changes in operating logic, staffing and strategy – are laid out, discussed, and implemented.

Finally, the company has to be energised towards achieving the desired goal of competitiveness from the very beginning of the integration process. Training, lectures and so on are usually helpful but, in the end, frequently only drastic changes in the way people perceive themselves, the company and competition are able to produce the required changes. In addition to sometimes demanding implementation skills, outstanding integrators also have the skills to deeply touch and affect people's minds and hearts.

Start with radical changes – manage the easier parts later on in the process

In contrast to cautious changes and multiple rounds of reorganisation typical of inexperienced integrators, we found outstanding integrators reorganise aggressively from the start. The desired competitive profile, discussed above, is the blueprint for reorganisation at this stage. In the experience of outstanding integrators, which we amply support, it is far preferable to reorganise heavily and drastically at the beginning of the integration process – but only then. Afterwards, the organisation is given the time and the psychological reassurance to establish its own identity and internal cohesion.

Compare this to the erratic rounds of reorganisation observed in the

Table 1

Source	Scope of study	Period studied	Main findings
AT Kearney	115 mergers and acquisitions	1993 –1996	58 per cent do not create positive shareholder returns
Mercer Management Consulting	All mergers from 1990-1996	1990-1996	48 per cent destroy shareholder value
Pricewaterhouse-Coopers	97 mergers and acquisitions	1994-1997	Over 40 per cent fail to create shareholder value
Booz-Allen & Hamilton	117 mergers and acquisitions	1994-1996	Over 50 per cent underperform relative to industry peers

vast majority of mergers. At the beginning, fearful of provoking conflict with the other party, only minor adjustments are made to company structure; later, in a second round of reorganisation, the resulting inefficiencies are eliminated, until, in a further round of restructuring, changes in the marketplace can be addressed. During this process, employee morale goes from bad to worse while the executive management is unable, even if it were willing, to provide any direction to the company.

Integration managers focus on the competitive profiling of the new organisation

It follows naturally that integration managers will not be held responsible for synergy planning and implementation. Experienced integrators, although aware that synergies are followed by financial analysts on Wall Street, know that synergy realisation can never be the ultimate aim of a merger or acquisition but rather that a strongly competitive organisation will produce earnings and cash flow consistently above expectations.

This, in turn, defines the role of the integration managers. Concurrently with business line, functional or country heads, they ensure that the competitive profile of the merged company is consistent with the overall aspirations. The strategic impact resulting from this task usually far exceeds the rather mundane surveillance of headcount reductions.

Here, external critical success factors, customer requirements and the position of leading competitors are monitored periodically – at least twice per year. The vision of a strongly competitive company is then translated into action-items following current customer perceptions and market demands.

In some organisations, the observed impact of this periodic feedback loop with the market are huge: organisations, happy with delivering products in the past, integrated their supply chains with key customers and redesigned key attributes of some of their products in order to consistently exceed customer specifications.

In another case, a "middle-of-the-road" profile shortly after the merger (no specific weaknesses but also no significant strengths) evolved gradually into a competitive profile extremely focused on lowest costs and superior delivery reliability.

Performance along *external* critical success factors is primary instrument for assessing integration progress

Outstanding integrators recognise that integration success means that a common mindset creates an immensely competitive company. For this to occur, this common mindset – shared values and cultural identity – is established quickly.

Second, the integration progress is measured by comparing the performance along external, customer-defined, critical success factors against the targeted competitive profile outlined in the previous section.

Alongside, indicators for internal efficiency are spread throughout the organisation – some of the outstanding integrators created a "library of best practices" on working capital efficiency and other internal benchmarks that was then cascaded down through the organisation.

The essence of integration

In the end, the unconventional wisdom of the world's best integrators boils down to a few essential rules (see box). Whereas most companies get caught up in internal struggles and start to concentrate far too much upon themselves, outstanding integrators focus on the vision of competitiveness during the whole merger process – the demands of the external market take precedence over self-contemplation.

By the same token, soft issues are treated as the real hard issues. The creation of a common mindset, linking people's values with company culture, is seen as the single most important requirement for a successful merger by successful integrators.

The rules of outstanding integrators:

The window of opportunity is small – if after three to six months integration is not complete, it will never occur

Success is determined largely by how quickly a common mindset is created

The vision of creating an immensely competitive organisation drives all integration activities

Start with radical changes – manage the easier parts later

Integration managers focus on the competitive profiling of the new organisation

Performance along external critical success factors is the primary instrument for assessing integration progress