Integration Management

Positioning Mergers and Acquisitions For Success

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More Than Two-Thirds of All Mergers & Acquisitions Fail to Meet Shareholder Expectations

You'd think CEOs and boards would learn. After all, the oracles at McKinsey & Co. suggested in 2001 that "the belief that mergers drive revenue growth could be a myth." The celebrated takeover law firm Wachtell, Lipton, Rosen & Katz, which makes its fees regardless of whether the acquisitions it facilitates succeed, recently issued a report to clients and banks outlining the seven primary reasons mergers fail. From other consultants and advisors come articles warning that "83% of Mergers Fail to Produce Any Benefits for Shareholders" or explaining "Why 70% of Mergers and Acquisitions Fail." From J.P. Morgan's 1901 formation of U.S. Steel to the fairly recent AOL Time Warner and Daimler/Chrysler mergers, these transactions, which made so much sense in their formative periods, have disappointed executives, employees and investors with their inability to produce any long term value for stakeholders.

Yet *Business Week*, in its January 10 issue, announced "Here Comes the Year of the Deal," citing Kmart's $11 Billion purchase of Sears and the $39 Billion Sprint/Nextel merger as harbingers of unprecedented M & A activity in 2005. Bolstered with $2 Trillion in cash and short term cash and encouraged by a strong economic recovery, executives and boards are "scouting for potential merger partners or acquisition targets, lest they be left behind." With this rampant enthusiasm for what is historically, at best, risky activity, one is left to wonder: what are they thinking?

Size Matters

In a recent article, analysts at the Conference Board noted that "two market forces— globalization and a bull market— arose simultaneously and [have] become intertwined, creating a snowball effect that has caused CEOs to become swept up in bigness." What the Conference Board calls "the bigness pathology" often fuels an obsession with top-line growth; pressure from Wall Street to meet unrealistic revenue targets inspires corporate leaders to grow through acquisition when internal, organic growth is not enough. Although Wall Street analysts claim to be focused on long term results, what's consistently newsworthy are the quarterly earnings to which analysts and investors alike pay the most attention. "Time and again," the Conference Board reports, "CEOs turn to the quick fix: a sexy merger to boost revenue, earnings and, they pray, the stock price."

Given the pressure the investment community puts on executives and their boards, many mergers or acquisitions take root in rocky soil: deals are often made simply for the sake of making deals, rather than to lay the foundation for creating long-term value. In that sense, then, many of these transactions are already in danger of failing to satisfy those same investors before the companies even have a chance to integrate. And, with all due respect to those who craft the deal, integration is when the real work begins, and where even the most strategically sound mergers or acquisitions can fail quickly and spectacularly.

As noted earlier, there are reams of white papers on why the majority of mergers or acquisitions are long-term disappointments. Given the 2-1 ratio of failure to success, one would expect a proportionate number of articles offering various strategies for success. That those articles are few and far between hints that the consultants and analysts are adept at diagnosis but not prescription.

To be fair, each merger or acquisition is a unique transaction with complex dynamics. Each acquiring company employs its own integration process, influenced by the company's culture and management style. Relative size, time, the acquisition's culture and, in particular, strategic intent are all variables in the equation. In 1964, Supreme Court Justice Potter Stewart said of obscenity: "I may not know how to define it, but I know it when I see it." The path to M & A success, the literature suggests, appears just as thorny and indistinct, even when that successful third is confident enough to stick a flag in the ground and declare victory.

Organizational Transformation

England "acquired" France, however briefly, at Agincourt in 1415. In 1999, Daimler "merged" with Chrysler. Neither transaction worked particularly well, with the blame conventionally laid at the doorstep of differing management styles and the clash of cultures. The root cause of these and other similar failures, however, is poor pre-consolidation due diligence, integration planning and execution. Both Henry V and Daimler CEO Jurgen Schrempp were driven by the prospect of "the deal," the path to bigness that can consume the attention of even the most able leaders to the point at which integration and execution are merely a postscript to the contract.

This essential understanding begs the question: who does this well and how do they do it? The obvious candidates, who approach these transactions from different perspectives, are General Electric and Johnson & Johnson. GE's strategy for integration seems to be simply digestion; the companies they acquire understand from the beginning that they will be assimilated into GE and the parts that don't fit will be jettisoned before they have a chance to become an anchor that holds the bottom line down. Johnson & Johnson, on the other hand, acquires companies, sets expectations for performance, and allows them to operate more or less autonomously as long as they hit their numbers. GE and Johnson & Johnson conduct almost completely opposed approaches to acquisitions on the surface, but both achieve remarkably strong records of transactional success.

What the two giants share, however, is a remarkably similar and effective approach to managing the risk inherent in any merger or acquisition: they presume that success is dependent on the transformation of both companies. Necessarily, GE experiences change whenever it acquires, regardless of whether it imposes the "GE Way" on its acquisition. Likewise, Johnson & Johnson becomes a different company as it adds the capabilities of a new business unit. Both companies - as well as many others who have achieved M&A success - recognize that dynamic and understand that "the deal" is the only static part of these significant business transactions.

Managing Transformation

"The deal" itself is popular for two reasons. First, it's sexy. There are egos at work, investment bankers with "hockey-stick" charts, and each sides' lawyers working to find the slightest advantage. Maybe another suitor rides in on a white horse. Time is of the essence. Second, the investment bankers are whispering in the CEO's ear, talking about bigness and opportunity and legacy. (They're not talking about their fees.)

What makes a deal a successful one, however, is not sexy. Success is based on three key practices:

- **Pre-deal operational due diligence.** Most corporate development offices and investment bankers are adept at financial due diligence, but the best focus as strictly on assessing a target's current management, employees, markets and infrastructure. This work serves two purposes: to assess the strategic soundness of the proposed deal and to lay the groundwork for integration planning.

- **Integration planning.** Derived from the both the due diligence and strategic intent of the deal, the detailed plan for integration enables both companies to begin to transform quickly, which is essential to success. The essential base of the integration plan is a thorough, company-wide understanding of the vision behind the deal.

- **Post-deal execution.** Successful acquirers execute quickly and confidently, because they have done the proper planning. As with most business ventures, the less time it takes to complete an initiative, the lower the cost and the greater chance for success.

Furthermore, it is essential that these practices are managed by an *integration champion*, appointed at the beginning of the operational due diligence phase. Integration is most effective when each company appoints a champion from similar ranks — from either senior management or fast-track young executives. The buck stops with the integration champions; their full-time responsibility is the success of the integration.

In order to ensure the success of each transaction, the champions must coordinate and supervise:

1. Assessing the integration readiness of its own organization.
2. Assessing the integration readiness of its target/acquirer
3. Mapping the differences and similarities between target and acquirer
4. Distilling the list into a prioritized short list of key drivers (critical success factors)
5. Focusing on the key drivers that lead to integration success.

At the same time, the champion must cultivate trust by developing a "transparent" culture around the integration, so that employees understand the new organization, and can assess both its health and their own prospects within it. Making compensation and incentive policies clear, for example, can minimize fear and distrust.

Altreya's Work as Integration Advisors

Altreya's experience with clients and their individual integration champions suggests that there are ways for any company to successfully address *what happens before and after the deal is done*. Our approach rests upon five key factors:

1. **Thoroughly understand the vision of the combined entity**
2. **Be highly selective where you integrate**
3. **Retool the culture in a way consistent with the strategy behind the merger**
4. **Move quickly and early**
5. **Protect the base business**

We have supported numerous integrations in many different industries in the past decade. Our approach draws on our accumulated experience, but is highly tailored to the specifics of a deal. Each of our principal consultants has hands-on, practical integration experience.

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