Performance Equations

WHITE PAPER

The Failure of M&A's to Deliver Added Value

And what can be done about it

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Despite the apparent gloom & doom in the economy, M&A activity still seems to be alive and kicking, perhaps more so. But the history of mergers and acquisitions is pretty abysmal.

As a general rule, a majority of mergers and acquisitions do not achieve the objectives that the parties hoped to achieve through the transaction. In other words, a majority of mergers and acquisitions fail. Studies have documented that anywhere from 50 - 80 percent of all mergers and acquisitions fail. A recent KPMG analysis of UK mergers and acquisitions during the 1990s found that, of the mergers, some 75%+ had demerged within 10 years and a similar number of acquired organisations had been resold within a similar timescale, often for less than the original purchase price .

Mergers and acquisitions have left behind a trail of ultimate under-achievment, of unhappy staff and dissatisfied customers. With apparently little thought given to the wider ramifications of bolting together different organisational cultures, the industry barely pauses for breath before moving in on the next target.

There is a consensus of opinion that often “savings” have been a priority during and after the post-acquisition integration phase of the corporate marriage. But mergers and acquisitions rarely fail because one or both parties did a poor job of due diligence. The technical or "hard" issues are almost always addressed with a good deal of intensity. Financial performance, debt, market share, brand positioning and reputation, product and service fit, and physical operations are some of the hard issues that usually receive much scrutiny before a merger or acquisition is consummated.

Unfortunately, it is the less technical or "soft" issues that rarely receive the same level of attention before the merger or acquisition decision is made. Yet, these are the very issues that cause the majority of mergers and acquisitions to fail. Poor understanding of how to integrate two corporate cultures has led to low morale at many levels, confusion among customers – and potential customers – and, inevitably, business underperformance.

Globalisation, competitive pressures and the desire to accelerate growth are often the drivers that bring organisations together, but one of the most common arguments for mergers and acquisitions is the belief that "synergies" exist, allowing the two companies to work more efficiently together than either would separately. Such synergies may result from the firms' combined ability to exploit economies of scale, eliminate duplicated functions, share managerial expertise, and raise larger amounts of capital. Apparent synergies in markets, product and service offering, and operations – even in espoused values, however, are not the same as having congruence, similarity and resemblance in organisational style and culture.

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When things go wrong

A recent article in the Harvard Business Review (Sept 2008) cites the experience of disability insurers Unum and Provident who merged in 1999.

Unum and **Provident** operated in the group and individual markets respectively, indicating potential for synergy and value-creation. Executives thought that each company's sales people would be able to sell the other's products, but the two businesses served entirely different customers through different models.

Unum's sales-reps called on corporations to sell group policies; Provident's crafted sales pitches for individuals. They had different skills and no particular desire to collaborate in cross-selling. Combining the two entities together proved costly and complicated.

The merger ended up producing higher prices for everyone, and an aggressive posture toward claim handling, which provoked a series of lawsuits that jeopardised UnumProvident's reputation and finances.

Unum eventually demerged, dropping the Provident name and exiting the individual market in 2007. Its stock price plummeted and remains less than half what it was in 1999 and the company continues to cope with class action suits from claimants.

Even when synergies do exist, over excitement and lack of cultural scrutiny can lead a company astray. In 1993 **Quaker Oats** paid $1.7 billion, outbidding Coca-Cola, for **Snapple**, a soft drinks company, which it acquired to freshen up a dowdy brand and gain access to Snapple's direct-store-delivery system and network of independent distributors.

Undoubtedly Quaker made some financial, marketing, and strategic miscalculations. A number of analysts indicated at the time of purchase that Quaker was paying about $1 billion too much for the company. Another reason was strategic in nature. At the time of purchase, Quaker probably thought that it would use its highly regarded skills in distribution to supermarkets and mass markets to boost Snapple's sales. However, it eventually realised that more than half of Snapple's sales were at convenience shops, petrol stations, and similar outlets, which it had no special skills in managing. Moreover, Snapple distributors fought efforts to push Quaker products. In 1997 Quaker sold Snapple's to Triac Companies Inc for $300 million.

Quaker's failure to understand the Snapple's brand and culture has been pointed to by Harvard marketing professors such as John

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Deighton. According to Deighton, there is a vital interplay between the challenge a brand faces and the culture of the corporation that owns it. When brand and culture fall out of alignment, both brand and corporate owner are likely to suffer. Quaker's failure can be put down to a fatal mismatch between brand challenge and managerial temperament (or culture). The debacle cost both the chairman and president of Quaker their jobs and hastened the end of Quaker's independent existence (it's now a unit of PepsiCo). In October 2000, Triarc sold Snapple to Cadbury Schweppes for about $1 billion.

Synergies can prove problematic in more subtle ways too. When executives focus so much management time and energy on capitalising on the apparent economies and advantages, they lose out on other, more fruitful, opportunities. And clashes of culture, skills, or systems can make it extremely difficult to achieve even those synergies that seem easy and obvious.

So Why Do Mergers and Acquisitions Fail?

The incompatibilities of the organisational cultures of the companies involved has been pointed to for more than ten years as the main reason why mergers and acquisitions fail (i.e. don't achieve the expected gains). And yet, report after report, study after study, still points to the lack of real understanding of the detrimental effects this can have.

Part of the reason is because 'organisational culture' has remained difficult to define, measure and manage.

Organisational Culture is simply "the way things are done around here".

In all cases, due diligence will have been conducted in infinite detail, but the vast majority of organisations fail to conduct a "cultural" due diligence to look at the compatibility of other aspects of the organisation.

There have been cases in the US where boards of merged companies have been sued by disgruntled shareholders who have not seen the returns promised by a merger, and where inefficiencies were created through culture incompatibilities. While this trend has not been seen in the UK and Europe, the issue remains a live one.

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Why is organisation culture so important?

Even in the rapidly changing corporate world of today, employees get used to doing things in certain ways. Organisations devise structures, systems, and procedures for getting things done, and they become part of the way of life in organisations.

If, however, the way things are done in organisation A is significantly different from the way things are done in organisation B, you can immediately see the potential for conflict, disharmony and confusion. We often see, in these situations, the dominant party in the takeover trying to impose its way on the other party.

There may be absolutely no evidence, however, to suggest that their way may be right for the new partner. It may not even have been the best solution for the original organisation in the first place!

Integrating company A and company B does not consequently create an inevitably unified organisation. As shown in the diagram below (Fig.1), two organisations coming together without consideration of the style, approach, climate and environment of either party creates a hybrid in which legacy sub-cultures remain.

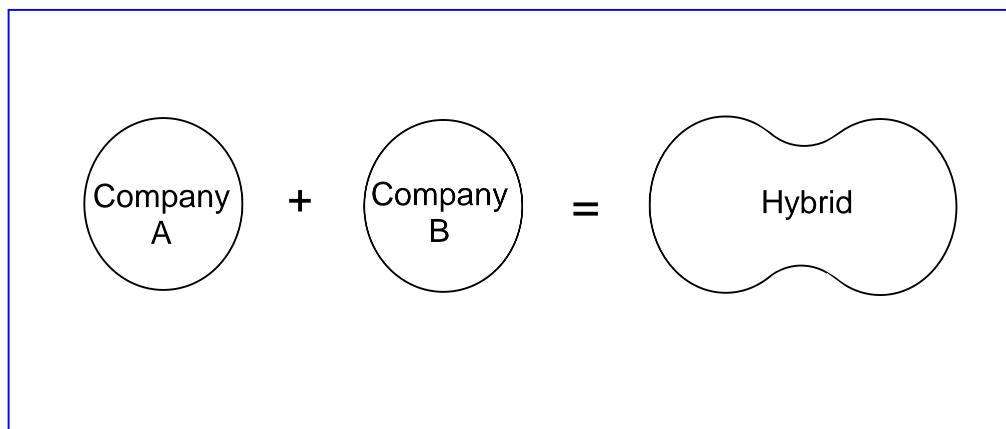

Fig 1. Union of companies with different organisational cultures

The hybrid organisation maintains large parts of its legacy culture, with only elements of similarity and true cultural synergy actual existing.

When company A and company B come together as a result of a merger or acquisition, what is required is the articulation of what the new organisational entity needs to be like – its way of working and style – in order to fully satisfy its new strategic goals. What will be created is a new organisational entity (see Fig. 2. below).

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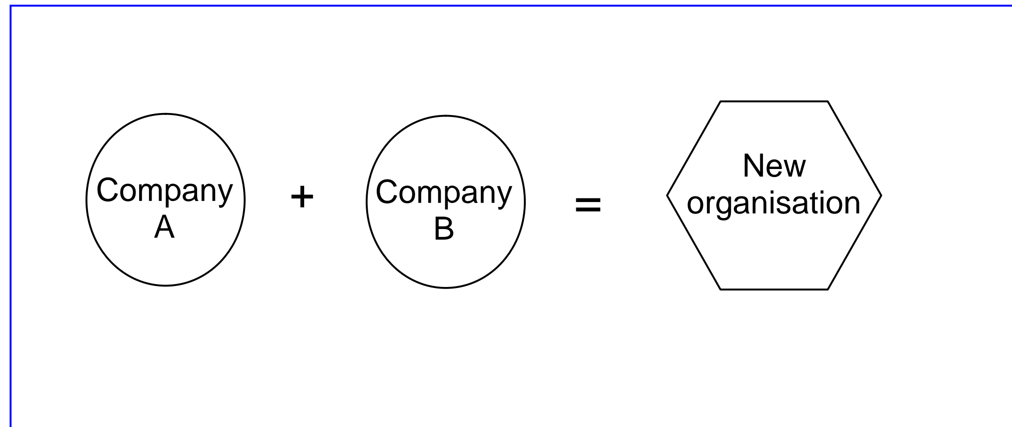

Fig 2. Union of different companies creates a new organisational entity

Through strategy mapping, for example, and defining the culture and organisational effectiveness demanded by the new strategy, two questions that affect future success can be answered: What do we need to be really good at to achieve our strategic goals? What does this place need to be like in order to increase the likelihood of success? This second question addresses issues of organisational culture.

How to determine compatabilities and define needs

An organisational diagnostic analysis will show the exact level of compatabilities between the organisational culture, leadership styles and practices, strategies and values, systems and processes of the merging companies. By using this analysis in potential merger partners, it is easy to see how things are done in the two organisations, and their component parts.

This kind of analysis will also diagnose the resultant impact on various organisational results such as customer service, sales growth, staff satisfaction, etc, providing quantifiable data on the key levers to pull in order to lead and manage organisational change effectively.

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Begin any merger with the end goal defined first

The start point would involve senior executives in defining what the new organisation needs to look like – what is its vision, mission and strategy and what values would or should underpin how things are done?

Any merger or acquisition by definition creates a "Newco". Once the Board has defined the mission, strategy, values etc. of the new merged organisation they would then define a Desired state using a diagnostic assessment tool such as our Organisational Transitions Inventory (OTI). This quantifies and makes graphic how things need to be done in order for the new organisation to achieve its new strategic objectives.

With these defined, they can then articulate what the Desired State would look like in terms of structures, leadership, systems, processes and procedures that need to be put in place in order to efficiently and effectively achieve their strategic goals.

Using the same tool, an Actual state of the whole new organisation produces a quantitative and descriptive gap analysis showing clearly what has to be done and where, in order for the whole new organisation to achieve the new set of strategic objectives and to reap the most benefits and synergy form the merger.

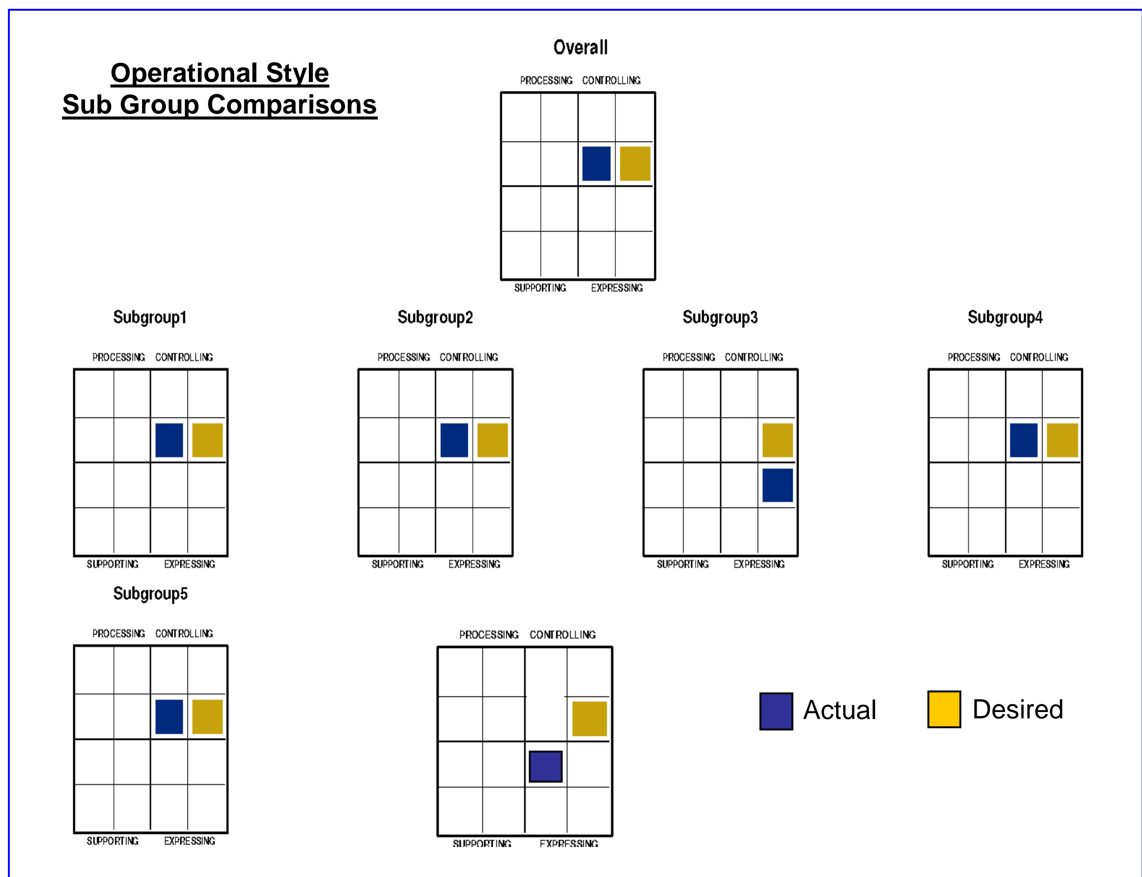
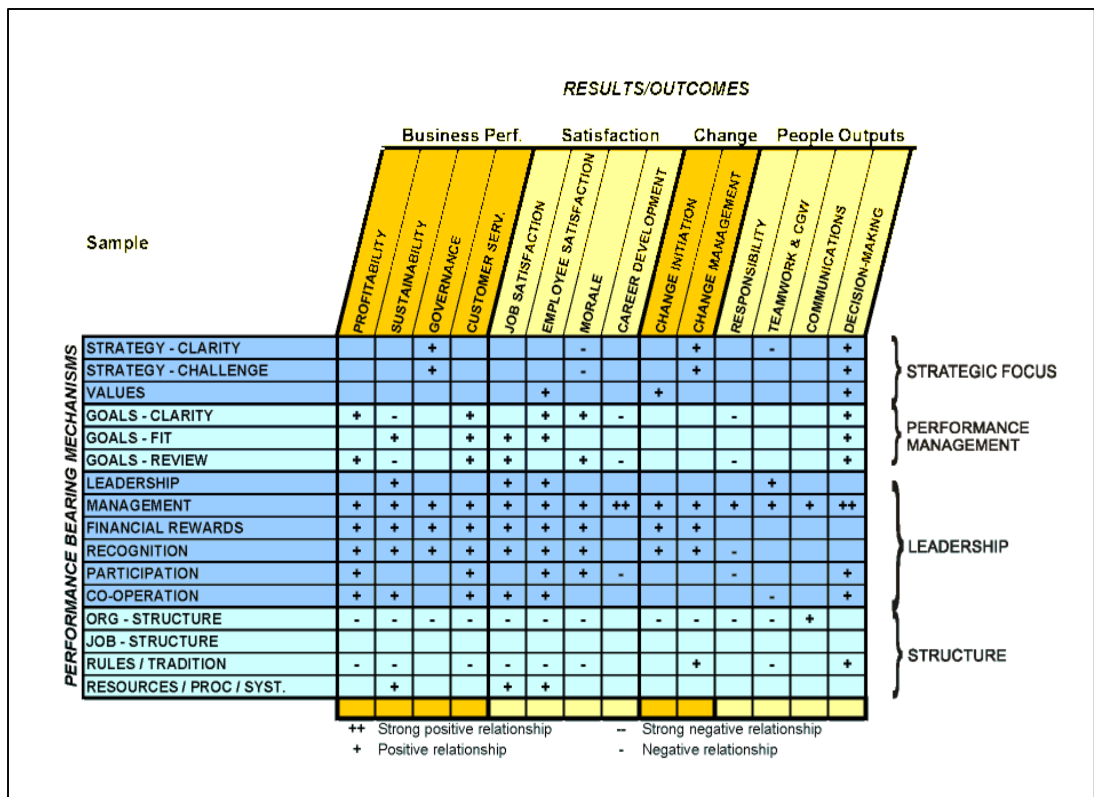


Fig 3. Sub-group reporting

In addition, sub-group comparison report (see Fig. 3 above) will identify areas of potential conflict about how things are done, where priorities differ, where different values or philosophies exist, or where structural and systems (in) compatibilities exist in different departments or functions in the organisations. By so doing, management both prevent and manage any potential problems that may lie ahead.

This will almost certainly infer that all parts of the organisation will have to change as opposed to just those that have been acquired. But it will also likely result in a more functional organisation that does not waste a lot of energy on debilitating in-fighting. It means that the merger actually unites rather than divides.



	PROFITABILITY	SUSTAINABILITY	GOVERNANCE	CUSTOMER SERV.	JOB SATISFACTION	EMPLOYEE SATISFACTION	MORALE	CAREER DEVELOPMENT	CHANGE INITIATION	CHANGE MANAGEMENT	RESPONSIBILITY	TEAMWORK & CGW	COMMUNICATIONS	DECISION-MAKING
STRATEGY - CLARITY			+				-			+		-		+
STRATEGY - CHALLENGE			+				-			+				+
VALUES						+			+					+
GOALS - CLARITY	+	-		+		+	+	-			-			+
GOALS - FIT		+		+	+	+								+
GOALS - REVIEW	+	-		+	+		+	-			-			+
LEADERSHIP		+			+	+						+		
MANAGEMENT	+	+	+	+	+	+	+	++	+	+	+	+	+	++
FINANCIAL REWARDS	+	+	+	+	+	+	+		+	+				
RECOGNITION	+	+	+	+	+	+	+		+	+	-			
PARTICIPATION	+			+		+	+	-			-			+
CO-OPERATION	+	+		+	+	+						-		+
ORG - STRUCTURE	-	-	-	-	-	-	-		-	-	-	-	+	
JOB - STRUCTURE														
RULES / TRADITION	-	-		-	-	-	-			+		-		+
RESOURCES / PROC / SYST.		+			+	+								

Fig 4. Relationship matrix

The chart above illustrates the strengths and weaknesses that run through the organisation. Based on the “Newco” Desired State, it is then a fairly straightforward exercise to identify the performance levers that must be pulled to enable a change in organisational culture and an improvement in organisational effectiveness.

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Building commitment and employee engagement

This approach provides the opportunity for leaders to lead and to get people excited about the vision of the new organisation for the future. This will enable organisational members to buy-in, and see the connections between their own contribution and the organisation's performance – i.e. their added value.

It means that leaders and managers have to walk the talk, to personify the values of the organisation and be seen to be working to the vision.

It probably also means that the change process becomes owned by many in the organisation other than the top team. Change and integration teams can be set up to look at the gap between the Desired State the new organisation needs for success, and the Actual situation.

Invariably, when organisations merge there will be some expected or anticipated job losses. Hopefully, these are planned and those who are made redundant can be helped to do so with dignity.

It should also be recognised, however, that in addition to those being made redundant, some who are left behind may choose to go. This in turn could put more pressure (even if only in the short term) on those left.

In this case, there could be a danger that the organisation loses some of its knowledge, competence or experience, particularly when those who choose to go are long-term employees in relatively senior or important positions.

One of the issues, therefore, (often neglected in mergers and acquisitions) that faces the new organisation and needs to be dealt with at a very early stage of the merger process, is to ensure that systems are in place that capture knowledge and its management in ways that do not depend upon the memories, experience or skills of individuals.

Other elements that need careful management, and may be related to knowledge issues, are how to create, build, and use effective channels of communication to keep everyone engaged and on track throughout the merger process.

It is essential to communicate and celebrate success – and to share good ideas, tips and learning that could benefit other parts of the organisation.

Not Just 'Business as Usual'

One of the key roles of leaders in this process is to help organisational members understand that it is not just 'business as usual.' Of course,

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business has to be maintained and probably grown, but having got everyone committed to and engaged with the vision of the future, leaders need to help each other (and other members) to understand the change process they will be going through, the implications of it and time scales. This could include plans to address any difficulties identified by the culture audit and analysis.

Attention needs to be paid to staff. Those who remain must not be over-burdened, but helped to manage the change process and learn to behave differently, but appropriately, for the new culture and new organisation.

Diagnostic tools, like OTI, not only help get commitment to change but help spell out in easily understood terms what the goal is; plus what change each group and individual will need to make, in terms they can understand.

Showing graphically the start and end points, as well as charting progress, makes an abstract process more concrete through the visual as well as verbal communication media.

Tracking progress helps success breed success. Finally, it means that change can really be managed – after all, you cannot manage what you cannot measure.

Organisations are people as well as cultures. This may not always be obvious at the time mergers and acquisitions are being arranged and implemented, but it is a fact and one which should not be forgotten.

So now we have a quantifiable way of defining the destination and start points (rather like a map reference). We also have planned a route from one to the other to ensure the success of the integration process.

If we stick to the route, then integration plans – whether they be about new systems, about leadership, organisational restructures or market place competitive strategies – should all give off consistent messages and be properly co-ordinated.

So, at last, post-merger cultural integration no longer has to be haphazard, nor does it need to be an act of faith.

Cultural due diligence is possible, and measuring overall organisational effectiveness can be achieved. Working with many organisations in several sectors, we have found that it is possible to identify the few key levers that enable the organisation to more effectively use its human capital to fully deliver the strategy.

Organisational change, particularly post merger, has often been viewed with trepidation and full of difficulty, but we have found that taking a

robust and diagnostic, rather than purely information, based approach significantly increases the chances of the change achieving its desired results fully. Moments of business change can be very opportune times to carefully scrutinise what is both helping and hindering the organisation from fully delivering its intended strategy and achieving its aspirations in its chosen markets.

In our experience, this forensic approach can identify the absolutely kernel features of organisational performance that can mean all the difference to critical decision-making and results. Having worked across sectors, cross-organisationally, with teams and at the most senior levels, we know that creating the impetus and high levels of performance to deliver the expected results is a very do-able thing.

To ensure your next Acquisition or Merger actually achieves the synergies you want, or to lead organisational change more effectively, contact Performance Equations Ltd.

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