Generative Leadership Group

Enabling Extraordinary Results

Mergers and Acquisitions

How to Get the Best from Combining Two Companies

STATISTICS ABOUT MERGERS AND ACQUISITIONS ARE FRIGHTENING:

- *Fortune Magazine*: Of 10 acquisitions studied, *none* measured up to the median ROI of 13.8% for the same period. Only *two* of ten made it through the ten-year period without significant difficulty. Five of ten realized *negative* return.
- *KPMG*: While 82% of mergers were subjectively viewed as successful, only 17% added value to the merged company.
- *New York University*: In 2/3 of 168 cases investigated, shareholder value *fell* after M&A activity.
- *Deloitte Touche*: One in two mergers *fail* because of inadequate planning and poor management of human resources.

The prevailing view is that 70 to 80% of mergers and acquisitions do not produce the business results that they were intended to produce. Yet the basic approach to integrating mergers and acquisitions has not changed in ways that alter the statistics.

WHAT ARE THE REASONS FOR THIS FAILURE RATE?
AND, HOW DOES YOUR COMPANY BECOME PART OF THE 20% THAT SUCCEEDS?

We have identified four fundamental errors that most companies make in the integration process:

1. They fail to appreciate and align three aspects of leadership;
2. They re-organize the business systems and assume people will fall in line;
3. They dictate practices and processes;
4. They begin the integration process after the transaction is announced or closed.

While there are many circumstances that can derail an integration, failures are almost never attributable to errors in judgment related to the original reasons for merging. The errors seem to arise in the application of what may be called “conventional wisdom” or commonly accepted practices for M&As. Our experience shows that recognizing “conventional wisdom” significantly increases the chances of meeting the original expectations.

Based on our M&A work with both large and small companies, the balance of this paper will discuss these common errors, how to avoid them, identify “what is missing” and present a short case study with testimonials to demonstrate the effect of our approach to integration. We hope that our hard-earned learning will help you and your organization succeed with integrations.

Common Error #1: Misaligned Leadership

Simply stated, senior executives are the source of leadership during an integration. This does not mean they are the only providers of leadership, but they have to model the leadership needed to have the process be a success. We have found what we call three "preferences" in leadership. A failure to recognize, appreciate, and align these leadership preferences leads to missteps in execution, unnecessary work, and distracting confusion.

- One preference of leadership is to focus on the future and the possibility it holds. This dimension of leadership looks into a future that is further out than most others can see or are willing to spend time on. These are the visionaries or, in extreme cases, dreamers.
- Another preference of leadership, which often seems at odds with the first, is to focus on ensuring stability through increased reliability, predictability, and certainty. This dimension of leadership can seem conservative, concerned with what might go wrong, and in extreme cases, to have a high aversion to major change which is perceived as being risky.

  NOTE: Both of the above dimensions of leadership are obviously important. However, because of the wide diversity of their points of view, they often appear in conflict with each other, rather than as contributions to a common goal.

- The last, and least apparent, preference of leadership is focused on translating future possibilities into grounded present day realities. When done well, this contributes to continuity and stability on one hand, and new horizons and change on the other. This dimension of leadership tends to work in the background, is willing to experiment and make mistakes (for which they are most remembered), to start before figuring it out in advance, to discard what does not work, and to build on what shows promise.

All three of these dimensions of leadership are critical to effective integration. It is important to recognize when each is needed and to provide the appropriate dimension when required.

Common Error #2: Starting with the Business Systems

After the basic business justifications are established, most integrations begin by looking at the *business systems* – the operations, practices, products, and business processes by functional area (finance, manufacturing, packaging, distribution, etc.). It is assumed that by rationalizing these systems, the integrating businesses will profitably increase market share, retain key talent, reduce headcount and achieve economies of scale by operating as one larger, integrated organization. While this may be true, there is an unexamined assumption related to this approach, which is that people will understand and naturally follow the re-organized business systems, operating procedures, and best practices.

That is not necessarily the case.

Henry Ford revolutionized manufacturing in 1908 by making mass-produced cars that had interchangeable parts, allowing one part to work in different models. In 1911, Frederick Taylor extended this view to people, writing in his *Principles of Scientific Management*, “In the past the man has been first; in the future the system must be first.” Almost 100 years later, this “common wisdom” continues to be applied, and companies operate as if people are interchangeable parts. We know that executives who lead integrations do not think that people are interchangeable - they know better than that. However, when you take a critical look at how integrations are conducted, it certainly seems that this view prevails. It is present in the assumption that people will fall into line once the business systems are set up.

In a Harvard Business Review article from 1990 about managing complex organizational systems, Christopher Bartlett and Sumantra Ghoshal talk about the *anatomy* of a company (the formal structures), its *physiology* (the systems and relationships that allow the lifeblood of information to flow through the organization), and the organizational *psychology* (the shared norms, values and beliefs that shape the way individual managers think and act.) They write: “Companies that fall into the organizational trap assume that changing the formal structure (anatomy) will force changes in interpersonal relationships and decision processes (physiology), which in turn will reshape the individual attitudes and actions of managers (psychology). But as many companies have discovered, reconfiguring the formal structure is a blunt and sometimes brutal instrument of change.”

Paying attention to the people side of mergers and acquisitions is what we call integrating the *human systems*. Many companies do not even consider what it takes to integrate people. It would be an “up-stat” if they considered it and rejected the notion as unimportant or not critical. But in our experience, human systems do not show up on the radar screen for most companies, and for the few that do see it, the challenge is handled through some form of “making nice with the new folks.” While this is important, it is not sufficient, and by itself can lead to numerous unmet expectations and result in the loss of off-balance-sheet assets - the human capital that came with the acquisition. In retrospect, each individual loss is justified and rationalized by statements like “they weren’t a fit, they had another agenda, they were not willing to change, they don’t understand our culture,” etc. Yet in our experience it is possible to work with the human systems with the same precision as the business systems. Paying proper attention to the human systems during an integration provides an even greater advantage than paying proper attention to the business systems. In other words, focusing on the human side is the catalyst to making the business and organizational systems deliver on expectations. In fact, some of the most successful integrations are those in which companies take to heart one of our principles, which is to use the merger as an opportunity to grow not only the company but also the people, and to develop them in their roles.

Of course, most mergers and acquisitions will create duplications of staff and other kinds of redundancies. We are not suggesting that companies should keep everyone or tolerate duplication of effort. However, even as the “hire or fire” decisions are being made, there are still ways to integrate the human and business systems simultaneously. By having people participate in the process, helping them to meet, understand, and work with one another, giving them a chance to contribute what they know and empowering them to make critical decisions and recommendations, integrations proceed much more smoothly and the chances for success increase significantly.

Common Error #3: Using Authority Where Alignment is Needed

Executives have a tendency, especially in a large-scale integration, to want to control the process. After all, this business strategy represents a significant investment, and often has the participating companies under scrutiny from investors, shareholders and stakeholders. There are several problems that can arise in this approach.

First, no matter how intelligent and well-informed the executive staff and their direct reports are, they cannot possibly know enough about how their companies operate to have an integration succeed. The people with "on-the-ground" wisdom about the practices and processes have vital information that allows them to see the benefits and pitfalls of various decisions. By inverting the traditional decision making process and pushing decisions down in the organization, well-rounded views are obtained and, in our experience, better decisions are made.

Second, the human system in an organization is societal in nature. In fact, the definition of "society" is "a group of human beings broadly distinguished from other groups by mutual interests, participation in characteristic relationships, shared institutions, and a common culture." That sounds fundamentally like an organization, where mutual interests are pervasive.

Societies change in two ways. One is through brutality, which is brought about by control and domination, administered top-down. This kind of change destroys valuable assets, weakens loyalty, and reduces participation.

The other change is from the bottom up, in a kind of "grass roots" movement that starts lower down at the local levels, tapping into the intelligence that exists where most of the work is done. This kind of change is more organic, longer lasting, and garners the respect and participation of the societal members.

Turning integrations into grass-roots movements includes empowering those who do most of the work to participate in and/or make important decisions. It also means providing forums through which people can provide meaningful input and feedback around decisions that are not appropriate for them to make. This gives people a chance to participate, to contribute, and through the process to take ownership of the changes.

Third, organizations themselves, and integrations in particular, are complex and dynamic. Imposing a rigid, top-down management process on something that is inherently complex and chaotic diminishes results and increases risks. The trick is to allow the system to establish its own natural patterns. In chaos theory, "strange attractors" naturally arise to suggest patterns in the chaos, and the same happens with organizations.

Of course, senior executives do have a critical role in integrations: to provide the context for change. What is needed from them, rather than rigid processes and control, is leadership. While management remains a critical component, integration calls for an increase in leadership, including a strong and clear vision, organization-wide communication, and a flexible, dynamic strategy that can adapt to the learning curve during the integration. These elements provide the attractor that allows for patterns to emerge in the chaos. Once the vision and strategy are clear, the task for senior leaders is to step back and let small groups organize their own thinking about how to bring about change and fulfill on the company's objectives.

Meg Wheatley, in her simple and elegant book "Leadership and the New Science," says, "Anytime we see systems in apparent chaos, our training urges us to interfere, to stabilize and shore things up. But if we can trust the workings of chaos, we will see that the dominant shape of our organizations can be maintained if we retain clarity about the purpose and direction of the organization. If we succeed in maintaining focus, rather than hands-on control, we also create the flexibility and responsiveness that every organization craves. What leaders are called upon to do in a chaotic world is to shape their organizations through concepts, not through elaborate rules or structures."

Common Error #4: Starting after Announcement or Closing

There are rules during a proposed merger or acquisition about who can talk to whom and when …including the "quiet period." Restrictions are in place for good reasons. However, they are not an excuse for waiting until after the announcement to start the integration process. Our experience shows that approaching an integration holistically rather than sequentially produces far greater results. By beginning the integration work before the announcement (Phase-I), and continuing the work post-announcement/pre-close (Phase-II), companies can achieve significant velocity and certainty in the process of post-close (Phase-III) integration work.

The goal here is to be as close as possible to operating as one company on the day after closing, with people clear about their new roles and using the agreed-upon processes across the organization. Obviously, this may be an impossible dream in some cases – for example, it may make more sense to change financial systems at the beginning of the fiscal year rather than mid-stream – but at the very least, plans should be in place to implement new processes at the first practical opportunity.

Our integration process includes three phases:

- *Phase I, Pre-announcement:* In addition to completing due diligence, now is the time to establish the vision for the new company and the integration, the mission statement, the integration strategy (distinct from the business strategy), set integration objectives, and create the frameworks to achieve the objectives. This includes interviewing key influencers who have privileged knowledge about what is planned, to understand their concerns and ideas. At this point, there is no need to drill down into the details, but it is important to create and communicate a clear, compelling future for the combined organization. Not only will this help guide people's actions as the integration progresses, it will also help to retain and attract the right people for the new company.
- *Phase II, Post-announcement, pre-close:* Start the people and process integration by establishing cross-functional Task Force teams that include employees from both companies, to discover where breakthroughs can be produced, to map out all the pre-close requisites, to examine and recommend Best Practices for the combined entity.

- *Phase III, Post-close*: Continue the work of implementing Best Practices. Establish new levels of organizational communication. Execute on breakthrough projects. Provide development opportunities to leaders who have emerged during the first two phases. Continue to ramp up communication (there's never enough!) Don't be afraid to change what has to be changed – you will be learning as you go.

Best Practices

We mentioned "Best Practices" above, as a part of Phase II of an integration. This is an important element of our integration process, and one of the ways that we make sure the human and business systems are integrating in parallel. Let's talk about the Best Practice process briefly.

What is it?

We see integrations as a time to examine everything about the organization. It's almost like packing for a move – now is the time to examine all your dusty corners, everything you do and how you have done it, all the relics you have kept without knowing quite why, to see what you really want to have in your new home. We suspect that you will discover that many of the practices you have been following are no longer appropriate for your current company, much less your new organization! Once you shine a light onto your work-arounds, "put up withs" and even those processes and practices that are working well, it's time to decide how you really want to do things.

Creating and implementing Best Practices takes an act of courage on the part of senior management and also on the part of people who have been working in the company for a while. They must be able to maintain an open mind about what they are currently doing, and be willing to admit that it may not be the best way.

In integration, there are four possible sources for Best Practices. The first three are: how you do it, how your merger partner/acquired company does it, and how the industry leaders do it. When all three of the preceding sources are insufficient, then make something up! Trust that the people who do the job are fully capable of creating a new practice. It may not initially occur as a *best practice* but if done well, it soon will. Take the time to investigate and thoroughly examine and understand the first three domains before recommending any one approach or before creating a new practice.

How do we do it?

This is where the human integration begins. Because of SEC regulations, this element can't start until Phase II, post-announcement, but we recommend beginning as soon as possible once the merger/acquisition is announced – within days rather than weeks.

We start with a series of interviews at both companies, which we use to help the acquiring company understand the concerns of people in both organizations, and who the leaders and potential “keepers” are at the acquired company. Based on our recommendations and the existing knowledge about the two groups of employees, we work with our client to establish cross-functional Task Force teams that are made up of people from both organizations. Each team represents a functional area (finance, HR, manufacturing, sales, etc.) and is headed up by someone with that functional expertise. The membership of the Task Force, however, should come from both companies, from different levels and different functional areas. Our intention here is to provide the Task Force with different perspectives on the current and proposed practices, what works, doesn’t work and is missing in them, and how they will affect different areas of the company.

The Task Forces are charged with sorting out and managing the tasks that have to be completed for closing, and then with examining and proposing Best Practices – whether from the current operations of one company or an entirely new practice – that will allow the new company to achieve its strategic goals. Of course, this work should be guided by the vision and direction that has been provided by the senior executives.

WHAT ARE THE RESULTS?

We have found that in most cases, people are eager to learn from each other. They know when their practice is not the best – when it needs improvement or to be scrapped all together. They also know what they would like to do, if they could make changes. By facilitating these meetings with some simple protocols for communication and teamwork, the best thinking of the entire group can be represented in the proposed Best Practices. At the same time, people are meeting one another, learning to work together, and coming to appreciate not only their new colleagues, but people from their own company that they may not have worked with before. They are inspired at the level of trust and confidence given to them in the process. While some may find it uncomfortable to be given the kind of power and authority this process provides, most people are motivated to give their best effort, and to work jointly with their new colleagues.

SOME FUNDAMENTAL ASSUMPTIONS

Earlier in this paper, we talked about “unexamined assumptions.” Of course, we also have some fundamental assumptions about the integration process that have been tested over time as we have worked with companies going through mergers and acquisitions. Now is the time to make them explicit!

1. People come to work to make a difference and contribute. We believe that belonging to an organization provides people with an opportunity to contribute, and the reason that people work in organizations is to have an outlet for their contribution. People want to be heard, to know that their work is forwarding the company’s goals, and to provide their ideas and wisdom to help achieve those goals.
2. During an integration, everyone is going to have two jobs – doing the daily work of the company, and managing the integration. This doesn’t end once the close is finalized. It takes about 18 months of diligent work after closing to successfully integrate two organizations, so expect to be “two headed” for a while! (Note: Integration Managers,

however, need to be dedicated to their role and not be expected to have multiple jobs. In cases where an acquisition strategy is being executed, with a number of companies or brands being purchased, it is prudent to have a dedicated team to work through both the acquisition and leadership of the integration.)

3. If done properly, integrations are not just incremental – you are not merely adding new people, new products, new markets, and new revenues. The process can create an entirely new organization. It is especially important for the acquiring company to realize this – you will change, too! Whether it is a "merger of equals" or an acquisition of another company or brand, the end result will be a third new organization, distinct from what you were before.
4. Everyone's job will change. Obviously, some people will be promoted, some hired and some fired. However, even people whose titles remain the same will find that the nature of the challenges in their jobs will most likely be different. It's not just a case of handling more or adding more people. The scale of people's jobs will change, which will require new ways of thinking and acting. This is why training and development opportunities are important post-close, to help people scale up to the new demands in their jobs. Integrations provide a chance for the human systems in companies to grow, as well as for the business systems and results to expand beyond what would have been possible through organic growth.

Integration Testimonials

GLG has recently been working as the integration consulting firm at a multi-billion dollar Fortune 500 consumer products company that is managing two acquisitions simultaneously. GLG has provided:

- Facilitation of acquisition negotiations
- Consulting for both of the internal teams managing the integrations;
- On-site consulting, coaching and design work at one of the acquired companies;
- Facilitation for senior staff meetings including the Integration Steering Team;
- Communication planning and content for our client as well as both acquisitions;
- Coaching for various senior executives and integration leaders involved in the acquisitions.

In addition, we are working successfully with a large strategy consulting firm, several investment bankers, internal and external legal counsel, and a marketing research group, all of whom are providing services to our joint client.

Testimonials about our work in this system include:

In a letter to the Chairman of the organization, the President of the Business Unit that is making the acquisitions wrote:

> "This turned out to be a very long, complicated, and arduous acquisition (rated, in fact, by the M&A team at our attorneys' firm as an '11' on a scale of 1-10 in difficulty!), and recognition of some of our internal people and

> external suppliers is appropriate; (including) Generative Leadership Group, who provided critical help in organizing our internal integration efforts and aligning the acquired organization with us in actually closing the deal in the last 1-2 months.
>
> Because this Business Unit is … already stretched with new product activity and category challenges, this acquisition quite simply would not have occurred without these key people and outside resources, and both their exceptional efforts and outstanding work product.
>
> We are fortunate to have them as part of our team."

"I am so impressed with the quality of the consultants you've sent to us. I can't believe how much we're getting done here. We've made more progress on the negotiations in two weeks than we have in the past four months. They're like organizational matchmakers. I wish we'd brought them in months ago."

- CEO of acquired company to President of acquiring company during negotiation stage

"Other consulting firms provide what we could do ourselves if we had the resources. What you provide is something that we could not do ourselves. You are a value-added resource."

- VP, New Products

"I've learned in the last two weeks what it would have taken me a year to figure out on my own."

- Senior VP and General Manager, North American Operations

"The executive that you are coaching is more thoughtful and less reactive since you started working with him."

- Senior executives about one of their peers who is in a coaching relationship with GLG

A partner at the strategy consulting firm told our consultants after a particularly contentious but eventually successful meeting, "I have seen a lot of people try to do what you did, and never seen it done so well." He has scheduled a meeting with one of his senior partners and our consultants to see how we can integrate our work at our joint client more effectively.

The members of the Integration Steering Team acknowledged us for the organization and thoughtfulness that went into their first meeting, the way the integrations themselves are going, and how the integration managers presented themselves at the meeting.

An executive, requesting our presence at a meeting to begin transitioning the product sales from the acquired company to our client's sales organization, said, "We need your leadership, because when you are in a meeting with us, all of the friction is diffused. You hold it all together. We need you to hold it all together."

"You make a seemingly chaotic situation with a lot of different players come together so well and with such elegance. I can't imagine getting this work done as quickly without your facilitation."

- Director of Global Advertising, regarding GLG's design and facilitation of an Advertising Forum, which included members of seven different organizations.

"With your assistance in the formulation and facilitation of our business unit Leadership Team we brought R&D and business management groups together across geographies and aligned their strategies very quickly. The process allowed for accelerating product development and prioritizing the new products portfolio. Within two or three meetings we were ready to present to senior management. The presentation went *very* well and was considered a tremendous accomplishment. Considering where we started—with organizational barriers, different cultures between the U.S. and Europe, among other challenges—the creation of a team that saw the whole experience as being productive was as notable as anything else we achieved."

- Vice President, Global Business Management

"I'd like you to know what I value most from GLG that I don't always find in other firms:

- GLG consultants don't come in with answers predetermined. GLG spends more time understanding our business, investigating without an agenda, without telling us what to do.
- GLG's work in leadership is of great value. GLG takes development planning to a personal, actionable level.
- We're able to use GLG's basic and simple tools. They are extremely helpful. I used them just the other day with a group, very successfully.
- GLG helps to get things done quickly with large groups, and people are able to replicate what has been done after you leave. There's a magic of communication and action that takes place after we've worked with you."

  - Vice President, New Product Development

As a result of our work with these acquisitions, we have been invited to provide services to two additional business units at this highly successful consumer products company.