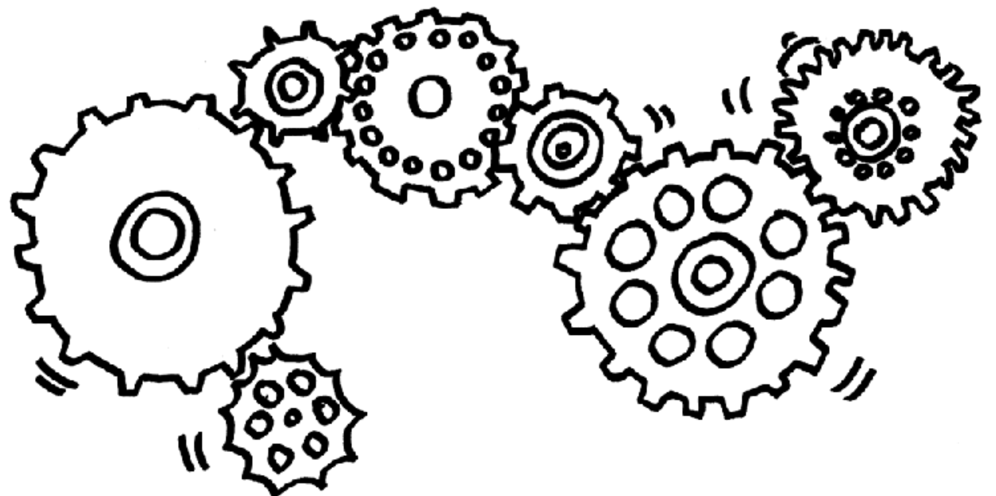
Merger and acquisition

Seven golden rules



Failure is expensive

Over the last twenty years studies by respected observers like McKinsey and KPMG have shown that most mergers fail to create any shareholder value and that some can be quite destructive. KPMG put the failure rate as high as between 70% and 90%. Given that in 2014 we will see in the region of $1tn of M&A deals this is an enormous destruction of shareholder value.

We need to find equilibrium when joining cultures

"I'm not sure that culture is as important as it's made out to be. I've never seen a deal really fall apart on a culture issue – or any soft issue."

Dennis Kozlowski, CEO, Tyco International, 1992 – 2002, Prisoner 05A4820, Mid-State Correctional Facility, Marcy, New York, 2005 – 2014 [1]

No one doubts that for most deals that fail, the numbers made sense on paper. To paraphrase the great Liverpool manager Bill Shankly, these deals are not played out on paper, but in the hearts and minds of the people whose lives will change forever. Study after study shows that the number one reason so many deals fail is that the people and cultures of the two organisations can't find a new equilibrium after they combine.

But some mergers succeed. Sometimes spectacularly. The lesson from all the failed mergers is not that companies should never acquire or merge with others. The most important lesson they provide is that organisations need to go in to these deals with their eyes open to the greatest challenge: persuading employees and others that the value of the deal and having a well thought out plan for how two organisations will become one are not "nice to haves" that can be considered at the end of the process. These are the critical success factors that will dictate whether the proposed deal will create or destroy value for shareholders.

In this white paper we review a number of mergers – some which ended in glory, others in disaster – to identify what organisations need to do if they are going to increase the probability of their mergers going well.

[1] Lessons from Master Acquirers: A CEO Roundtable on making mergers succeed, Harvard Business Review, May 2000.

Case study 1:
Daimler and Chrysler

Chrysler is one of the "big three" US car manufacturers. The car industry is extremely capital intensive with large investments required in manufacturing facilities, stock and development of new models. During the 1970s, Chrysler struggled to compete with changes in consumer demand and increased competition from Japanese and other competitors.

By the late-1990s the losses had stabilised largely as a result of the booming US economy but Chrysler's board decided they needed to do a transformation deal that would secure the future of Chrysler. In 1998, Chrysler merged with Daimler-Benz, one of Germany's leading car manufacturing businesses.

The deal was positioned as a "merger of equals", but in practice Daimler-Benz were in control. At the time the deal was valued at $38bn, making it the largest cross-border merger in history. Few of the expected synergies, in particular the creation of a common car platform, were achieved. In 2007 Daimler-Benz sold Chrysler for $6bn.

Why this deal failed:

- The differences in German and US business cultures were completely disregarded. Chrysler's culture was "daring, diverse and creative" while Daimler's was "conservative, efficient and safe".
- Daimler was a very hierarchical organisation with chains of command and respect for authority. Chrysler was the opposite.
- Daimler values reliability and quality, Chrysler design and competitive pricing.
- Daimler executives were given most of the senior leadership positions in the merged business, leading to a large number of Chrysler's best people leaving the organisation.
- There was very little interchange between the parts of the business, making it almost impossible to deliver any of the promised synergy and new products. The lack of personal relationships between Chrysler and Daimler people led to little respect for what each had to offer or little trust between them.
- The deal was sold as a "merger of equals" but the plan that people, particularly Chrysler people, saw executed made it clear that Daimler was taking over Chrysler and placed little value on the products, processes and people that existed in the Chrysler part of the combined business.

Lessons learned:

- Audit the cultures of the business you are planning to acquire to understand how they differ from your own. Plan to mitigate the risks this audit highlights.
- Make sure that what is communicated matches the reality of the integration process.
- Allow people to meet and build personal relationships which will form the basis for the integrated organisation's culture.

Case study 2:

AOL and Time Warner

For many, the high watermark in the dotcom boom of the late 1990s came when AOL announced the acquisition of Time Warner in January 2000. The deal was sold to the market and other stakeholders as a way to use the fast-moving pace of Silicon Valley culture to accelerate the moribund pace of growth in Time Warner. AOL's network would allow Time Warner's content to reach millions of homes.

In practice the two businesses never achieved any of the synergies they hoped for. By 2006 the market capitalisation of the business had fallen from $226bn to $20bn and in 2009 Time Warner (as the company had gone back to calling itself) spun-off what remained of AOL in to an independent company. Market conditions after the dotcom bust and the September 11 terrorist attacks had an impact on performance, but deeper cultural issues lay at the heart of why this deal failed.

Why this deal failed:

- AOL had an entrepreneurial, Silicon Valley culture. Time Warner had a much more conservative culture. How this would be reconciled did not seem to play an important part in the decision to proceed with this deal
- AOL's leaders were used to managing 100s of people but now found themselves leading over 100,000 people. They were not prepared for the scale of this challenge or equipped with the skills or tools that would allow them to engage with such a large number of people.
- Time Warner's employees resented the way they were being acquired by a company that was only a few years old and lacked the heritage and track-record that Time Warner had.
- Even before the proposed acquisition, the various divisions of Time Warner were extremely independent and had difficulty working together. The logic of the deal was based on these divisions overcoming their historic differences and delivering their content using AOL's network. This was never likely to happen.
- Even after the companies had merged, leaders found it impossible to create a core story to explain the rationale of the deal that people could unite behind.
- Poor business performance created a vicious circle which reinforced people's perceptions that this deal was not going to work.

Lessons learned:

- Audit culture and plan to mitigate the issues this highlights. If the differences are too great (as was the case with AOL and Time Warner) do not proceed.
- Make sure that people feel that the history of their organisation is respected.
- Create a compelling core story which people feel they can engage with.

Case study 3:

British Steel and Dutch Royal Hoogovens

The Western European steel industry has been plagued for many years by overcapacity, support for national champions, high labour costs, currency fluctuations and distance from the growth markets in East Asia. The predictable response has been to consolidate this industry and try and create economies of scale that would allow producers to compete more effectively.

In June 1999, British Steel and Dutch Royal Hoogevens (DRH) announced they were to merge, forming a new business called Corus. The prospects for Corus were good. Corus would be the world's fifth largest steel maker. And there was a long tradition of Anglo-Dutch business collaborations including Shell, Unilever and Reed Elsevier. At the time of the deal Corus was valued at $6bn but within four years its valuation had fallen to $230m. Tata eventually bought Corus in 2007.

Why this deal failed:

- The two organisations had very different styles of management. DRH was very consensual, balancing the needs of many different stakeholders. In contrast British Steel was more focused on serving the needs of shareholders.
- Few lessons about how to make this Anglo-Dutch relationship work were drawn from successful comparisons with businesses such as Shell or Unilever.
- Corus failed to establish a clear leadership and organisational structure as a result of trying to please too many internal stakeholders.
  This had two results:

  First, Corus struggled to establish a core story that could unify the organisation. Even several years after the organisation has merged, the Dutch and British parts of Corus had distinct narratives that were hard to reconcile

  Second, frustrated with the lack of leadership and direction, employees took industrial action that had an immediate impact on business performance and employee morale.
- Communication across the organisation was poor with most communications being delegated to site level mangers with limited support from more senior leaders.

Lessons learned:

- Audit the culture and develop a mitigation plan.
- If there are any differences, use relevant parallels to help plan the integration process.
- Clarify structure and leadership quickly so people know where they fit and who the boss is.
- Create a single core story for the integrated business and communicate this to all stakeholders, including above all employees.

Case study 4:
VW and Skoda

As noted in the Daimler Chrysler case study the car industry is plagued with over capacity and supply chain challenges that have eroded the profitability of this industry for much of its existence. The Daimler Chrysler merger failed, but another example, VW and Skoda, shows that this does not always have to be the case.

In the post-war period, Skoda cars became synonymous for poor design, quality and reliability. The reputation of the brand, and by extension anyone that purchased the brand, was very low. After the end of the Cold War, Skoda was again exposed to the demands of the market and the well-known weaknesses of the business put its continued existence at risk. To address this, Skoda entered into a strategic partnership with Volkswagen that lead, in 2000, to Skoda becoming a wholly-owned subsidiary of the Volkswagen Group. Through this partnership, perceptions of the quality of Skoda cars transformed, with sales of Skoda cars increasing from 210,000 in 1995 to nearly 1m in 2013.

Why this deal worked:

- Skoda was under no illusions about the scale of the challenge they faced and the consequences of failure. But they also recognised their competitive advantages in terms of unit labour costs, access to labour and markets and the availability facilities (which needed modernisation).
- VW had a clear plan for Skoda and explained this to employees. This offered a way forward that built on the advantages Skoda had, while addressing the weaknesses everyone was aware of.
- VW leaders took a very active role in engaging Skoda employees, visiting factories to explain the turnaround plan and what this would mean for the people that worked in those facilities.
- VW retained almost all of Skoda's existing managers. Over a period of time they trained them in VW practices and processes.
- To build leadership capability in Skoda, VW established a dual-leader model for most key positions, with one VW and one Skoda person for each role. In time this model was replaced with a single leader model when there was sufficient leadership capability in Skoda and mobility across the VW Group.

Lessons learned:

- Help people understand the logic of the deal and why it makes sense.
- Be able to explain what the deal means for people at the frontline of the business.
- Make senior leaders visible during the integration process and be one of the primary communication channels. Their responsibility is not just to their investors.
- On day one, have a clear sense of what you plan to do with the business you are acquiring or merging with and have a well thought-through integration process.

Case study 5:

BP and Amoco

By the mid-1990s the major, global oil companies faced a bleak environment. Driven by the size and costs of projects and increasingly demanding government demands for revenue sharing or production tariffs, these oil companies needed to create scale to be able to compete effectively in the market. A series of mergers around this time, between Exxon and Mobil, Chevron and Texaco, Conoco and Phillips, Total, Elf and Fina and lastly BP and Amoco dramatically reshaped the competitive landscape in this industry.

Why this deal worked:

- Shortly after the deal was announced, new organisation charts were released. This started with the most senior leadership teams with lower tiers added quickly afterwards. This answered people's basic question "who's my boss" and helped show that the new organisation would be led by both BP and Amoco executives.
- People from BP and Amoco were quickly combined into teams to address the most challenging issues facing the new business such as organisational design, IT integration and reconciling assets.
- When BP and Amoco merged, they tried to identify the best practices that existed in both organisations and quickly standardised these across the new business. Neither side in the deal felt like the other's way of working was being imposed.
- Neither side felt like the winner or loser. As it emerged, the new organisation felt like something new that built on the heritage and expertise from both BP and Amoco.
- People were encouraged to mix with new colleagues and build relationships that in the long-term established the new organisation's culture.

Lessons learned:

- Act quickly to answer the questions people will have about the deal. Initially these will focus on hygiene factors – make sure these are answered while establishing the bigger picture.
- Respect the heritage of the entities that are merging. Find the best of both entities as the basis for the way the integrated business will operate.
- Get people from both sides of the deal working together quickly. These personal relationships will help break down barriers and will establish the assumptions and behaviours that will become the foundation for the culture of the integrated business.

Case study 6:

P&G and Gillette

Procter and Gamble (P&G) is the owner of many of world's most recognisable consumer brands including Pampers, Crest, Lenor and Duracell. Managing such a diverse portfolio of brands means constantly looking for emerging consumer trends and either developing products organically or through acquiring new brands or selling underperforming brands. One trend P&G spotted in the 2000's was the growth in sales of men's toiletries and shaving products. In 2005 P&G made an offer to buy Gillette, the leader in this market, as a way to fill this gap in its brand portfolio.

Why this deal worked:

- P&G leaders, in particular the CEO and COO, were very visible during the merger process, taking time to explain who they were (as individuals), what P&G stood for, and to explain what the merger would mean for employees.
- A large number, over 100, integration teams were established to address the most important issues. Where possible these teams combined P&G and Gillette people giving them the chance to build relationships across boundaries that helped to develop trust and respect.
- Opportunities to progress to senior executive positions were immediately opened to Gillette people as a visible sign that their talents were respected by P&G and as a way to increase the overall talent of the organisation.
- There was a very conscious attempt to combine the very best of both organisations. For example, P&G had very good decision-making process based on inquiry and consensus. The new business learned from Gillette's ability to make decisions quickly to create a better, more effective decision-making process that was adopted across the new business.
- Given their history of acquiring brands, P&G were able to use the experience of their people who had been through the acquisition experience Gillette people were about to go through to make this experience as painless as possible.
- Other networks were established to allow Gillette people to participate in P&G consensus based ways of working.

Lessons learned

- Respect the legacy of both entities and create ways of working that build on what each part of the integrated business is good at.
- Use senior leaders to make an acquired business feel welcome and comfortable within the organisation they are joining.
- Get people working together as quickly as possible so that they can start to build personal relationships and remove boundaries.
- Use the organisation and individual people's past experience to make the process of integration as easy as possible.

Seven golden rules for a successful merger

Before the deal is announced:

1 Complete a cultural audit as part of the initial deal research and due diligence. The cultures do not have to be a perfect fit. But you do need to understand where the risks lie and to start planning how these will be mitigated. This is particularly relevant for cross-border deals.

2 Develop a communication and engagement plan. As well as communication with investors, regulators and other institutional stakeholders what is the plan for explaining the deal to employees? Their immediate questions will be very practical: "Will I still have job?", "Where do I fit?", "Who is my boss?"; "Am I going to get paid". Answer these questions directly and honestly.

3 Identify the individuals and groups who are most important to the deal's long-term success. Understand the choices they need to make and the barriers that will stand in the way of them making these choices. Find some quick wins: people are more likely to believe what they see than what they hear.

After the deal is announced:

4 Communicate throughout the process using senior leaders as one of the primary communication channels. Make sure that you don't just focus on what is important to the business, answer your people's questions too. Make sure you are straight and honest with people. If you are not, it will destroy trust later. You won't be able to answer every question on Day One – instead commit when you will be able to get people the answers they need and deliver on this.

5 Get people from both sides of the deal working together quickly. In the process, people will learn more about each other and achieve things together. This process will start to unfreeze assumptions and establish behaviours that will form the basis for the integrated organisation's new culture.

6 Avoid a sense of winners and losers – show that the new organisation will respect the heritage of both legacy businesses and build on the best that both have to offer. This should be reflected in structure, processes, opportunities and leadership.

7 When a person joins a company they will be supported with inductions, mentors and buddies. Without these people will feel unwelcomed, disorientated and inevitably can be less productive. When you merge with, or acquire, an organisation you potentially have 1000s of people joining your organisation at the same time. Think through how you will make them welcome and allow them to become productive quickly.

Let's talk mergers and acquisitions

If you would like to discuss any of these issues or how to apply the Seven Golden Rules in more detail, please drop us a line or come in for a chat.

We're happy to meet up and talk through what to do in advance of an acquisition or how to solve the challenges your merger will have created for your business.

You can email us at
hello@ry.com

Or call on
+44 (0)20 7033 0700

Meanwhile, you'll find some other publications on our website which may interest you.

www.ry.com/what-we-think

About the author

Stephen Duncan is RY's lead employee engagement consultant with over 20 years experience helping organisations create lasting change and better employee experiences. Among his other assignments, Stephen has worked on a number of significant merger and acquisitions projects with clients. These include Thomson's 2008 merger with Reuters and Nomura's 2009 acquisition of the European and Asian assets of Lehman Brothers. Stephen was also part of the RY team which advised PWC during their 2014 integration of Booz & Co to form Strategy&.

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please contact us at:

24 Charlotte Road
London EC2A 3PB
T +44 (0)20 7033 0700
F +44 (0)20 7033 0800
ry.com

Birmingham
T +44 (0)121 200 3890

ry.