HIGHPOINT ASSOCIATES: INSIGHTS

WHY INTENTIONS MATTER IN MAKING MERGERS WORK

ALEX NESBITT

HighPoint InSights taps into the expertise of senior professionals to provide perspective on the latest issues facing businesses today. To follow up directly with any HighPoint Associates experts, please contact us at Contact@HighPoint-Associates.com.

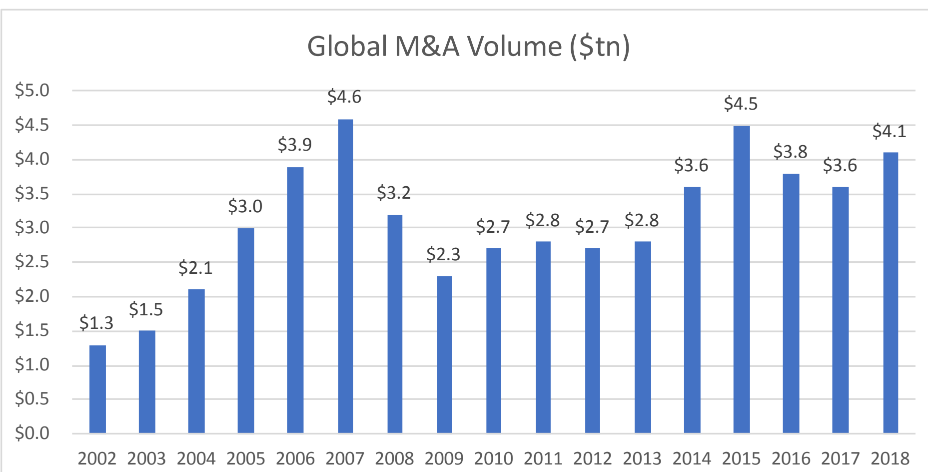
HPA | HighPoint Associates

Why Intentions Matter in Making Mergers Work

INTRODUCTION

Mergers and acquisitions (M&A) represent substantial opportunities for companies wanting to consolidate, grow, and/or diversify their strategic positions. M&A also represents a significant level of economic activity across the global economy. According to JP Morgan, global M&A activity in 2018 reached $4.1 trillion–the third-highest ever. The first half of the year was dominated by "megadeals" (exceeding $10 billion in size), followed by a deceleration of large transactions resulting from geopolitical volatility and challenges from the regulatory environment. U.S. activity made up 43% ($1.7 trillion) of global volume, surpassing numbers from the previous decade. JP Morgan anticipates 2019 M&A activity to remain strong despite ongoing global uncertainty.

While there is tremendous opportunity, a great deal of expected value from M&A never materializes. Various studies estimate between 40% and 80% of all M&A ventures fall short of achieving their stated objectives. No industry sectors appear immune to M&A disappointments, whether such events materialize as quiet failures or public debacles. Verizon Media-Yahoo/AOL, Monsanto-Bayer, Daimler Benz-Chrysler, and HP-Compaq are just a few examples of combinations that failed to realize expected value.



Source: JP Morgan 2019 Global M&A Outlook

On the flip side, what makes post-merger integration efforts work? In my three decades as an organizational change agent and post-merger integration specialist, experience has led me to believe that merger outcomes should be judged by the answers to three questions:

- Did the merger achieve the intended strategic outcome?
- How well was the merger integration process executed?
- Is the new company both more competitive and a better place to work?

It's vital that merger managers keep all three questions in mind as they resolve post-merger integration issues.

WHAT SEPARATES MERGERS THAT WORK AS INTENDED FROM THOSE THAT DO NOT?

Mergers and acquisitions represent unique events in the history of a company. More than an acquisition of assets, they are a big change and need to be recognized as such. They often represent once-in-a-lifetime events for everyone managing the merger and each person impacted by it.

In this article, I address three key questions to help managers lay the foundations for post-merger success: What is the intention of the company instigating the merger? How does the acquirer's intention inform a merger's outcome? And, what should managers do to achieve merger intentions?

My view of mergers as a significant event has evolved through my career helping executives navigate their mergers toward the best possible outcome. Companies that complete mergers, and do so while achieving sustained success, recognize they have one opportunity to get it right–and understand the risks of getting it wrong. Triumphant companies also recognize the importance of speed and consistency in stabilizing the business and getting the new enterprise on the path to success. Having a clear intention for the final stage of the merger helps managers avoid missteps and backtracking.

BEGIN WITH THE END IN MIND

Having a clear end-state objective in mind is primary. Whatever your intention–from a strategic, cost reduction, capacity expansion standpoint–if you do not have a clear view of what your intention is and what specifically you want to accomplish, it is highly unlikely you will realize that goal. In other words, "if you don't know where you are going, any road will get you there."

Too often, people confuse motion and activity with progress. Just because you're moving does not mean you are making progress towards achieving your intended goals. One client called this undirected approach the "ready, fire, what did we hit?" syndrome.

WHAT IS THE INTENTION OF THE MERGER?

Mergers must deliver positive change. At the end of a merger process, a successful business combination results in a single operating entity with a unified culture. A merger between two desperate companies may only result in one big, desperate company. That's not progress; it's setting the stage for a bigger fiasco.

During the first meeting with an executive planning a merger, I typically ask, "What's your goal? What do you need to accomplish here?" I encourage the merger executive to clearly articulate their goals as a precursor to discussing how the work of post-merger integration should be approached.

While managers are typically eager to focus on the process of post-merger integration, they need to consider the desired outcomes of the merger first. Identifying the desired merger outcomes informs the post-merger integration process. Knowing what the combined entity must achieve serves as the foundation for establishing the intention of a company instigating a merger.

HOW DOES INTENTION INFORM MERGER OUTCOMES?

There are many reasons one company may wish to acquire another, leading to a variety of merger types. In this article, I cover three broad and common categories of end-stage goals associated with intentions: **efficiency**, **extension**, and **transformation**. These end-stage categories serve as a starting point for considering the desired outcome of a merger.

The goal of ***efficiency combinations*** is to achieve cost reductions through consolidation. Cost reductions come in the form of reduced operating costs or in the form of reduced capital intensity, or both. The intention behind an efficiency combination is to reduce something, with measures of success being improved cash flow and profitability.

The highly anticipated $26.5 billion T-Mobile-Sprint merger, announced in 2018, provides an example of an efficiency combination. In an attempt to go up against competitors, AT&T and Verizon, both T-Mobile and Sprint assert that combining their assets will enable them to more efficiently provide next-gen 5G networking and lower prices to customers across the United States. Given the extensive overlap between the two businesses, they should be targeting very high levels of improved capital and cost efficiency.

Most mergers represent the potential to realize greater internal efficiencies through rationalizing one or more functions of the business. The key question managers need to address is whether the intended merger is primarily designed to reduce costs or whether the achievement of some other intention is of greater importance. If cost reduction is the motivation, then the merger intention is *efficiency*.

Extension combinations, including industry roll-ups, are typically pursued to expand the acquiring firm's product offering or market presence. Boosting revenues is a key metric for success. The acquiring firm may seek to expand product lines, add product categories, or obtain access to markets they do not currently serve. Extension mergers represent combinations of complementary product/market portfolios. They are not necessarily marriages of equals. Nor do they necessarily take costs out of the businesses.

Technology giant, CISCO is known to be acquisition-happy: Over the past decade alone, it has bought up a couple of hundred companies, making them a clear leader in M&A strategy. According to its company website, "Cisco's growth strategy is based on identifying and driving market transitions. Corporate Development focuses on acquisitions that help Cisco capture these market transitions." Focusing their M&A activities in three areas–market acceleration, market expansion, and new market entry–Cisco seeks to acquire companies with strong business and technology synergies, and, of course, real bottom-line potential.

Intention	Efficiency	Extension	Transformation
Example	T-Mobile Sprint	CISCO	CVSHealth aetna
Primary Purpose	• Cost Reduction • Capital Efficiency	• Revenue Enhancement	• New Capabilities • Differentiation
Desired Results	• Improved Cash Flow	• Profitable Growth	• Change the Nature of the Business

Quest Diagnostics is another notable example of a company that has successfully leveraged extension roll-ups to increase its market share and value. You can read more about Quest and other companies that use roll-ups as part of their growth strategy in my two-part piece on Extension Mergers.

Transformative combinations arise when the business combination leads to the emergence of new capabilities neither parent firm had previously, and could not fully develop or fully exploit on their own. Transformative mergers typically build on the core competencies of the two firms but result in a combined firm that can do more than either of the original firms could have done solo. Transformative combinations also create new opportunities and establish new kinds of customers. A key metric for transformative mergers is *differentiation*, as these combinations often take the resulting entity far beyond revenue enhancement or cost reduction: They give the merged entities strategic advantage.

One example of a transformative combination is the acquisition of Aetna by CVS Health in Q4 2018 valued at $69 billion. This transformative health-care powerhouse is looking to change the industry by bringing together CVS' nationwide pharmacies and Aetna's established health insurance business. As stated in its news release on the acquisition, the goal is to "transform the consumer health experience and build healthier communities by offering care that is local, easier to use, less expensive and puts consumers at the center of their care."

Global science and technology leader, Danaher has its own flavor of transformative acquisitions. The Danaher formula is to acquire good companies in attractive industries and transform them by implementing the Danaher Business System, a proprietary methodology for running a company much more effectively. According to Danaher, "Mergers and acquisitions have been the driving force behind Danaher's sustained growth for decades–the company has acquired hundreds of businesses since 1984." In fact, a stunning 50% of their revenue comes from innovative companies they have acquired in the science and technology space. These include the anticipated acquisition of General Electric' Biopharma Business for an estimated $21.4 Billion, their 2018 acquisition Integrated DNA Technologies, and any number of their 52 acquisitions over the years.

Another less recent, but still notable example of a similar enabling combination is the acquisition of Pixar by the Walt Disney Company. Pixar was a small but highly successful animation production company when Disney acquired it. Pixar movies such as Wall-E, Cars, and the Toy Story franchise have since reinvigorated Disney's struggling animation division; extended the company's reach in retail products, live shows, and resort rides; and pumped billions of dollars of profit into Disney. By itself, Pixar would not have been able to achieve this level of global success across virtually every entertainment-related distribution channel. Without Pixar, Disney would not have had the kind of creative engine it needed to revive its distribution channels. As a combined entity, both companies have been able to open new frontiers.

WHAT SHOULD MANAGERS DO TO REALIZE THEIR MERGER INTENTIONS?

Managing a post-merger integration varies depending on the motive behind the merger and the kind of combination it is. One size unequivocally does not fit all.

Here are a few tips for achieving success with each kind of intended combination:

EFFICIENCY COMBINATIONS: BE QUICK

While speed is vital in every type of merger, the objective of the acquiring company in an efficiency combination is to gain as much efficiency as fast as possible, while keeping those in the surviving organization motivated to do their jobs effectively, day-to-day. People are primarily considered costs in an efficiency-driven combination. But the explicit treatment of people as costs also affects the acquirer's employees. It makes everybody nervous. Therefore, as important as speed is, so is respect.

Business combinations are disruptive. Whether people are actually at risk of losing their jobs is not as relevant as whether they *fear* losing their jobs. Productivity declines when people feel threatened. Completing the integration process quickly, humanely, and honestly is paramount.

Effective upfront planning and decisiveness are therefore key to achieving efficiencies quickly. Honest communication and fair treatment of people become critical to the achievement of efficiency goals. Managers need to communicate candidly about their plans for staff reduction and their treatment of those who will be let go. Remaining employees need to see consistency between what their leaders *say* and how their leaders *act*. Failing to walk your talk sends the signal "we can't be trusted." Good people–even those who feel secure in their job–get nervous when they don't trust their leaders. Nervous people naturally look for more secure opportunities.

The takeaway: Managers need to prioritize speed to the end result, which requires quick decisions and action, but not at the expense of respecting people. Often one company's processes, systems, and people will dominate the outcome. It can help to be candid with employees about the way the integration is going to work. Integration leaders should communicate clearly and honestly about their intentions to combine operations, reduce staff, and rationalize processes. Keeping bad news secret for fear of upsetting people is a formula for failure. Employees in the surviving organization will judge the merger by their perceptions of how the company treats the people who were let go, so get people through the pain as quickly and as humanely as possible.

EXTENSION COMBINATIONS: BE ATTENTIVE

The goal of an extension combination is to accelerate growth by leveraging the best people, products, and capabilities from both organizations. The key to making extension mergers work well is to focus talent from both organizations on how to serve existing customers better, while also capturing new customers based on the combined capabilities of the new organization. Therefore, retaining top performers to maintain momentum is critical to the success of the combined business.

Yet it is the best people who typically have the most opportunity to leave. What does it take to keep the best people in place? The first step is for managers to recognize that even complementary combinations are big events. It is easy to talk enthusiastically about merging cultures, but inevitably this means processes change and jobs change. People who were comfortable in their previous roles have to learn new skills and open themselves up to strangers. There are a lot of unknowns. In other words, a merger designed to extend the business can be just as threatening and disruptive as one designed to gain efficiencies.

Here are some steps to take to mitigate the effects of these monumental changes:

- Communicate clearly and early on about how the merger will create growth and opportunity.
- Let the people you want to stay know that you do, in fact, want them to stay.
- Quickly organize a senior management team and reporting structure to minimize confusion and rumors.
- Establish down-the-line transition management teams to work on how things are done internally to move toward a single, strong culture.
- Set short-term goals about what needs to get done to move toward a successfully combined organization.
- Articulate quick ways to demonstrate the new value proposition to customers.
- Revise the compensation system and related systems to help focus–or refocus–people on achieving the goals of the merger.

The takeaway: If you want to achieve growth and opportunity, you need good people to stick around and remain deeply engaged with achieving the goals of the merger. You need to recognize high performers from both organizations and provide them with tangible evidence that their continued presence matters; that their contributions are appreciated. Change sticks when those most affected by change have a say in what changes and how it changes. Be sure to include them in the process.

TRANSFORMATIVE COMBINATIONS: BE AMBITIOUS

The goal of a transformative business combination goes beyond growth, with the central focus on creating new capabilities, new opportunities, new customer segments, even changing an industry. The challenge is to forge a new organization–with different capabilities–that is more than just the sum of its parts. Experienced executives may regard this statement with cynicism. Many have been burned with the lure of "synergy" only to discover that the motive was efficiency. Those who have lived through such mergers may not be willing to suspend their disbelief a second time.

Managers must set aside any cynicism when considering whether a transformative merger can achieve more than the sum of its parts. Isn't that what mergers, in theory, aspire to? The goal of combining organizations should be to assemble the requisite human skills, technical resources, organizational agility, and entrepreneurial drive to take the company far beyond its initial growth targets.

The key to achieving this vision of greater capabilities is to move from treating people as either assets or liabilities to treating them as creative partners. Not only do you want to retain your best people, as previously stated, you also want to unleash innovative thinking in determining how the merged organization will work differently than its predecessors. The key to making a big, transformative change is engaging the hearts and minds of people throughout all levels of the organization in an ambitious program of embracing that change.

Here are some suggestions for creating an empowering transformative combination:

- View the merger as an opportunity to truly rethink what the fundamental business is, not just how to make it work better.
- Recognize that everybody from both sides of the merger has creative potential and insights/ideas/innovation to add to the discussion.
- Ensure superstars have a role in determining the mechanics of the new organization, but do not allow them to run over lesser lights.
- Engage everyone at a level where they can most productively contribute to the formation of the new entity.
- Look for and publicize early wins achieved by the combined organization to model both what is possible and what is expected.
- Reinforce the intention of transformation consistently and often.

The takeaway: Management's aspirations set the boundaries of what is possible to achieve during a post-merger integration exercise. A transformative merger is a one-time opportunity to re-conceptualize the way a company competes by involving those at all levels of the organization in the process. Management's job is to articulate a vision that is large enough to inspire the internal masses, but still achievable enough to believe. Be ambitious! Go for the big win. But be realistic.

BOTTOM LINE

Though rife with potential, mergers are major organizational disruptions. Merger managers need to clarify their intentions for unleashing the forces of change on their organizations upfront. Beginning with the end in mind will help channel motion and accelerate activity to achieve real progress. Honesty in communications and communicating without delay is essential. Retaining key people during this time of chaos is also essential and depends on management's ability to involve people in an organized, goal-oriented change process. Lasting organizational change is most effectively achieved by those who will be responsible for the organization's subsequent performance. Including people in determining how the combined organization should work effectively also opens doors to thinking creatively about how the combined organization can better serve its customers and confound competitors.

Managing a merger involves keeping tabs on a lot of moving parts. The place to start is in deciding what you intend to achieve with the merger. Intentions form the framework for making the myriad decisions associated with post-merger management.

In Part 2 of this article, I will provide insights into the factors that make the process of post-merger integration successful.

ARTICLE AUTHOR

ALEX NEXBITT is a Senior Advisor with HighPoint Associates who draws on over 30 years of experience as a consultant and senior operating executive. He is a former Managing Director for The Boston Consulting Group, and was one of the leaders of the firm's North American Industrial Goods Practice. At BCG and as an independent consultant, Alex has served clients across multiple sectors, including technology, financial services, automotive, industrial and healthcare, and his work has spanned growth strategy, supply chain optimization, merger integration and organizational restructuring. He also founded and served as CEO of Sameday Technologies, a provider of third party fulfillment services which was eventually sold to Ryder Logistics. He holds a BS from Stanford University.

HIGHPOINT WEST
100 North Pacific Coast Highway, Suite 620
El Segundo, CA 90245
(310) 616-0100
contact@highpoint-associates.com

HIGHPOINT EAST
641 Lexington Avenue, 15th Floor
New York, NY 10022
(212)-634-6496
contact@highpoint-associates.com

HPA | HighPoint Associates