

Achieving an M&A's strategic goals at maximum speed for maximum value

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Over the last 20 years, mergers and acquisitions activity has been one of the chief methods for organizational growth. But some of the all-too-common negative consequences of mergers and acquisitions are:

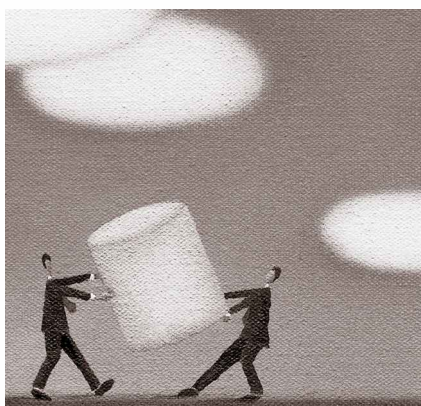
- *Billions of dollars of shareholder wealth disappears when the integration process fails.*
- *Stockholders desert when the claims of "synergy gains" that used to justify complex mergers fail to materialize.*
- *After being told, "Together, we will be stronger", key employees are demoralized when downsizing begins a few months later without a clear strategic rationale.*
- *An attractive acquisition becomes a "spin off", sold for a fraction of its original cost.*

What happens to M&A adventures after the executive ego trip of the deal making? Will the integration period reveal management's folly, or can it reliably produce shareholder value? A model for rapid integration of the merged entities presented here may help executives who are engaged in making acquisitions and making them work.

Speed is essential to successful M&A integration, but so is strategic planning. Only 25 to 50 percent of deals create shareholder value, often because those managing the integration process don't know how to make trade-offs between speed and careful planning. To keep the value of a merger from evaporating, leaders need to manage the integration process actively, and steer a course that leads the new organization to its stated strategic goals as swiftly as possible.

Start with the strategic goals

When Internet equipment maker Cisco Systems completes an acquisition, it aims to assimilate the technical know-how of the new company under its corporate umbrella within 100 days. Cisco aggressively seeks to keep the highly skilled people that made the target attractive and to incorporate new products into Cisco's development pipeline. With that strategic goal, Cisco has developed a comprehensive approach to integration that works. And although the company's market value has shrunk in the 2001 technology downturn, its track record for merger integration stands strong.



Cisco integrated more than 60 acquisitions from 1996 to 2000. During this period Cisco's stock price rose by an average of more than 50 percent per year.

Consistent with Cisco's approach, acquirers need to have a clear strategic rationale for a merger in order to set integration priorities. Some companies merge to increase market share and to improve efficiency through increased scale. Others use acquisitions to gain access to customers, products, or markets that complement their existing business. Some companies choose a more strategically complex path, broadening the scope of their business by buying entirely new capabilities – on occasion fundamentally altering the rules of competition in their industries.

Customize the plan

For every merger integration the companies involved must pass three basic milestones, marking three phases that require active management. These phases include: establishing the vision, planning the integration, and executing the plan. But before integration begins, leaders need to consider the strategic rationale behind the deal and tailor their plans to address the particular challenges associated with achieving their stated goals (see Exhibit 1).

A. Going for scale

If you're merging to capture benefits of scale, "you must act fast", says Tony Johnston, Regional Director of British American Tobacco (BAT) Asia Pacific[1]. Johnston led the regional team in the integration of Rothmans with BAT's Asia Pacific operations. "The longer you take to make decisions, the more risk you take". He would know. The BAT-Rothmans total effort spanned more than 70 countries and

Exhibit 1 Strategic rationales

Play by the rules		Transform the rules	
Active investing/ performance improvement	Scale	Adjacency expansion	Scope
		Redefining business models	Redefining industries
High predictability of value			Low predictability of value
High functional overlap			Low functional overlap
<ul style="list-style-type: none"> • Speed is critical • Focus on operational issues • Plan actions pre-close to realize 80% of deal value 		<ul style="list-style-type: none"> • Sacrifice speed for most strategic issues • Focus equally on strategic and operational issues • Develop new business opportunities • Plan for impact on rest of organization • Rationalize and cost-cut where beneficial 	<ul style="list-style-type: none"> • Sacrifice speed to get right strategic outcome • Focus on strategic issues • Seek operational improvements quickly • Retain talent • Develop strategy • Cut costs opportunistically • Create flexible action plan

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involved numerous plant closures, three major antitrust queries, and the melding of two head offices. He completed most of this mammoth task in a year.

According to Johnston, success depends on speedily identifying the key people to lead the organization, and removing the people likely to block the process. During the early stage, says Johnston, a sense of urgency is essential. “Don’t allow endless debate; an 80 percent right solution is almost always better than delay”. In tandem, merging companies need frequent, two-way communication with employees and affected communities to air concerns and alleviate anxiety.

Acquisitions intended to achieve scale or operating improvements are the simplest to plan. Since (by definition) a high overlap exists between the two businesses, there is often a common technical understanding between the management teams. This understanding makes it possible to map out essential actions in advance and delegate tasks to transition teams. But senior executives need to remain engaged to arbitrate on delegated issues that have become difficult to resolve. Johnston recalls, “There were times when too much was at stake, and it was impossible for the country guys to be neutral. I had to intervene more than I would have liked . . . to break logjams”.

Mutual understanding makes scale-based integrations simpler to manage, but that doesn’t make it easier. If the benefits of merging are easy to spot, the acquisition price usually reflects the value of these benefits. As a result, managers, under pressure, make deeper cuts and drive further performance improvements than the market expects. In these cases speed becomes most critical.

In the BP and Amoco merger, chief executive John Browne met the speed challenge. Working out of a “war room” in London with an around-the-clock integration team, Browne filled all the senior management jobs and completed most of the cuts in the first 100 days of the merger. By reducing headcount more than originally planned and divesting a variety of assets, the company completed the projected \$2 billion savings in one year.

B. Broadening scope

In a merger aimed at expanding into adjacent markets, customers or product segments, the big prize comes from growing revenue. This often comes atop opportunities to benefit from economies of scale. To win the revenue prize, a good part of the integration effort needs to focus on defining the new entity’s value proposition to customers and determining how to bring it to market. Teams from both sides must work together to develop a new marketing plan for the combined company.

Witness baby transporting equipment makers Graco and Century’s integration approach: Part of the integration team tackled opportunities to increase scale and reduce cost – in this case, administrative headcount cuts and consolidated sourcing in Mexico. The rest of the team focused on the revenue opportunity, wrestling with such issues as: Would customers accept a Graco-branded car seat – one of Century’s core

products – despite the Graco brand’s strong association with strollers and baby carriages? Would trade customers value the combined product offering enough to maintain or expand shelf space? Was there a customer-driven reason to keep two like products, or should the company reduce the number of different models it sold?

After hammering out answers based on each side’s customer knowledge, the combined company expanded product lines under one another’s distinctly positioned brand names. Together they now serve a broader range of customers and command expanded shelf space. Graco and Century tempered their urge for speed with careful consideration of critical strategic issues (see the “Quaker Oats and Snapple” sidebar to see what can happen if companies overlook the need for a market strategy).

C. Redefining the business

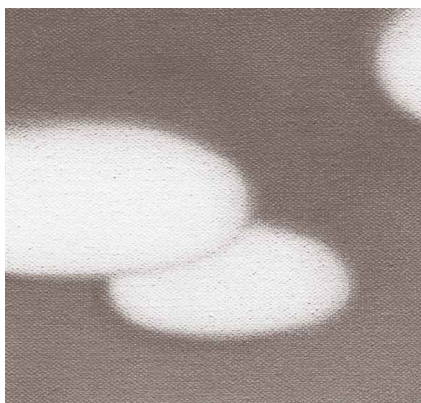
Executives who use mergers to take a business in a fundamentally new direction face further integration challenges. Typically, opportunities exist post deal closure to both reduce costs and expand into highly related market segments. Executives must divide their energy between these and the more elusive sources of value. To create something entirely new from the two companies, leaders need to communicate the new company’s vision, and motivate people to channel their energies in the direction desired.

Retaining talent, then redirecting it towards new goals beyond the immediate horizon requires high-level leadership – something not easily delegated. John Roth, former president and chief executive of Nortel, created three guiding principles to help his employees make a “right-angle turn” towards the Internet in 1997. He encouraged his people to focus on leading-edge customers, to make decisions quickly, and to look for ways to lead change in the marketplace. By doing this, he provided a framework to help people judge when to make a decision quickly, and when to take time to get things absolutely right.

Roth reinforced this new set of values through his approach to compensating managers. He ranked executives according to their level of contribution to the new organization and rewarded them (or not) accordingly. All employees received stock options. Roth also strengthened loyalty through regular communication. By clarifying individuals’ roles, shifting incentives, and inspiring change, he motivated the managers of a slow-moving telecom giant into action. The result: although Nortel too has suffered much in the 2001 technology downturn, it has nonetheless become the company that market leader Cisco considers its closest rival.

D. Re-inventing an industry

Bold transactions that endeavor to change an industry’s rules of competition present the greatest risk, and the greatest difficulties for integration. Industries are never



Quaker Oats divests Snapple

Quaker Oats bought Snapple in 1994 to build product depth in the healthy-beverage market segment. But it mistakenly assumed it could simply sell Snapple through Quaker’s Gatorade supermarket channels and Gatorade through Snapple’s small, independent, convenience-store distributors. Distributors and end-customers disagreed with Quaker’s logic. Snapple distributors, who had effectively built the brand, balked at having to give up the profitable supermarket accounts. Loyal Snapple consumers, drawn to its homespun, relationship-focused positioning, felt alienated when Quaker marketed Snapple in the same fashion as its national flagship, Gatorade. Quaker’s failure to closely consider the new customer value proposition proved costly. Quaker divested Snapple in 1997 for less than one-fifth the price it had paid for it just three years earlier.

redefined in a 100-day period, and rarely even in two years. The success of these deals depends on influencing the customer and competitive landscape – a landscape undefined at the deal’s close. So, where should a company start? Ask AOL and Time Warner, as they journey on perhaps the most ambitious merger in history. Vice chairman Kenneth Novack describes the blended companies’ goal: to “combine our unique mix of creative, editorial and distribution assets to connect, inform and entertain people everywhere, transforming the ways in which they communicate and receive information” [2]. Achieving this will not be easy.

In this environment, leaders need to communicate forcefully a clear vision. The challenge lies in quantifying and understanding this type of deal. Therefore, the companies’ leadership must make the case for the merged entity that maintains its market value and retains skeptical employees. Leaders must likewise continue to steward and promote the value of their individual businesses – it’s hard to recoup a drop in standalone performance, particularly if the value of putting the two companies together takes time to emerge.

Beyond presenting the deal to external and internal stakeholders, the management teams need to pursue two initiatives in parallel. The first pursues short-term objectives – for example, cost reduction, overhead consolidation, or divestment of non-core business units – all typical steps in integrating mergers. Speed matters here – indeed, success in this initiative can help win market confidence and buy time to move more slowly on other fronts. Also, cost reductions can provide funding for longer-term strategic objectives. Just a few weeks after AOL Time Warner became one entity in January 2001, it announced a series of ambitious cuts amounting to around \$300 million annually in personnel costs. Since then, it has set more ambitious cost and revenue objectives in a struggling sector. By doing this, AOL Time Warner sent a clear message: shareholders should not have to wait long to see some value in the merger.

The second initiative fleshes out the more strategic objectives of the merger and defines the long-term direction for the new business. Novack, of AOL Time Warner, summarizes the new company’s direction: “Our acquisitions are driven by . . . how our members communicate, what they want, and how we can best provide that”. AOL Time Warner has already sketched out some of its plans – most of which involve using AOL as a gateway to sell Time Warner entertainment. Novack comments that this clarity of direction helps the merger integration process. As analysts clamor for more detail, AOL Time Warner must continue to make visible progress, all without rushing this part of integration.

Citigroup, too, adopted this dual approach. Created by the merger of Citibank and insurance giant Travelers Group, Citigroup’s stated merger objective was to rewrite the rules of the financial services industry by selling just about any customer (business or consumer) nearly any type of financial service almost anywhere in the world. Commentators raised concerns over whether customers would see value in broadening the range of products they buy from Citigroup.

Sensibly, Citigroup didn’t sit around waiting to find out. It tackled several short-term objectives immediately. It consolidated credit card operations, cut cost out of Citibank’s marketing and information technology departments, and slashed overhead costs. With these moves, the group bought itself some breathing room for the next, more difficult challenge: to capture more of its customers’ spending on financial

products. Two years later, Citigroup – still short of its original revenue objective – has satisfied shareholders with its cost-cutting success.

Manage the three phases

Once executives have considered the particular challenges posed by the strategic rationale behind the merger or acquisition, they can move ahead with active management of the three phases of integration (see Exhibit 2). Phase 1 sets the stage by articulating the vision and naming key leaders. Phase 2 designs the new company's organization and operating plans. Finally, phase 3 makes the integration happen by aggressively implementing plans that bring the vision to life.

Phase 1: set the stage

The leader or leaders of the merger should articulate a compelling strategic vision for their combined companies and identify their top leadership team before announcing their intention to merge. This will comfort and mobilize constituents by answering four big questions straight away: Where are we going? Who will lead us there? What are the obstacles along the way? How might this impact each stakeholder, individually and collectively?

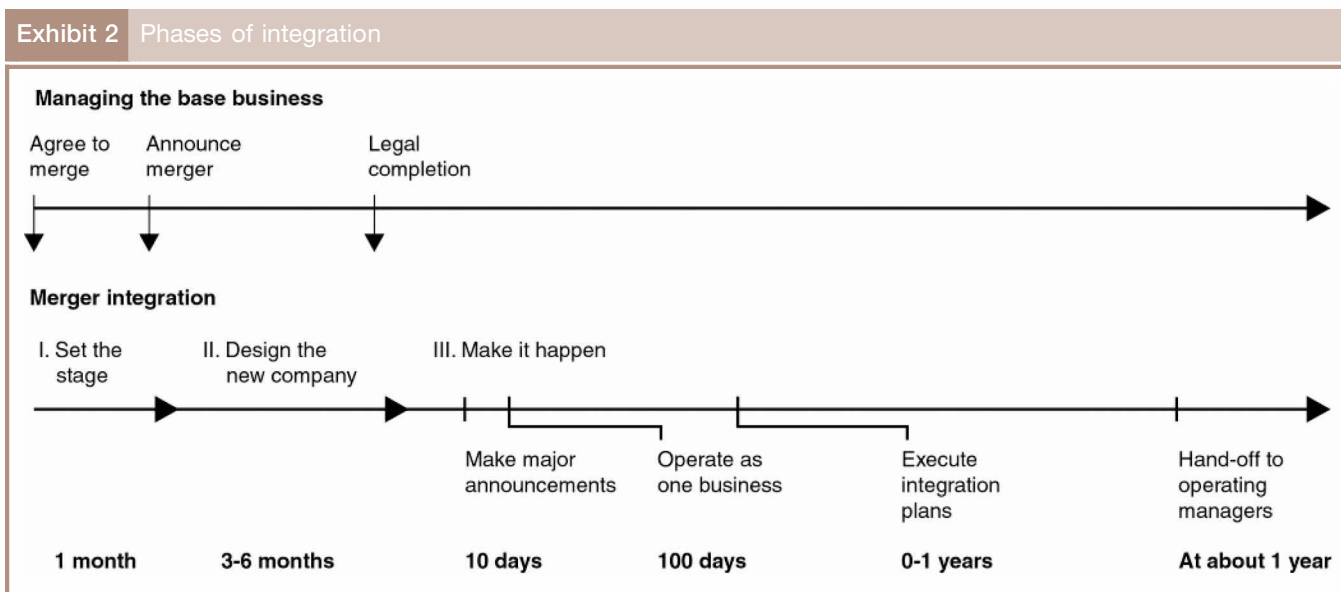
Phase 2: design the new company

After announcing the intent-to-merge and appointing a leadership team, the corner office needs to involve the rest of the organization. Step one: divide managers between those driving the transition process and those running the base business. Make each accountable for achieving specific goals. Step two: design the organization and operating plans to realize the value and achieve the vision[3].

Phase 3: make it happen

Once the two organizations sign the deal, the new company can begin to tackle the challenge of actually merging.

- **Day one** dawns with a whopping to-do list. Hundreds of basic tasks – from registering legal details to changing invoices to editing the receptionists' welcome scripts – must be checked off urgently just to maintain business as usual.



- **Day 10:** Make all the major announcements by this point. If there will be only one headquarters, say so. If factories or other facilities will close, identify how many. Don't shy away from bad news – people would rather hear the worst than be held in suspense.
- **Day 100:** By now, the new company should be operating as one company and well on its way to seeing value from the two to three high priority sources. Within 90 days of an acquisition by Cisco, the integration team has put together management systems, consolidated suppliers, made outsourcing decisions, slapped a Cisco label on the acquired company's products, and channeled new research and development projects into Cisco's pipeline.
- **Beyond 100 days:** Much of the value of mergers and acquisitions appears after the first 100 days. Managers need to turn their attention to opportunities they may not have anticipated when they conceived the deal. At the same time, transition teams may still be working – and must stick to their aggressive schedules. After one year, most integration activities should trail off and those managers in charge of day-to-day operations should take on full responsibility for delivering results.

Chief executives face few challenges more risky than integrating two businesses, and employees face few situations more stressful than mergers. Meeting this challenge requires leaders map a path to integration that aligns with strategic intent. This way, leaders can guide their companies through the inevitable uncertainty of merging as swiftly as possible, and capture the value that prompted the deal.

Notes

1. Tony Johnston, interview by Charles Ormiston, telephone, 18 February 2001.
2. Kenneth Novack, interview by Katie Smith Milway, email, 6 February 2001.

