Why Do So Many Mergers Fail?

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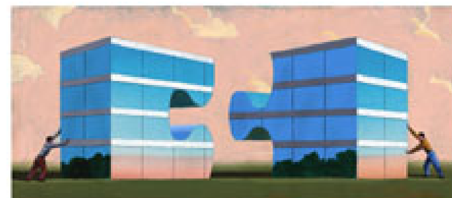

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With the recently announced mergers involving Procter & Gamble and Gillette, and SBC and AT&T, it's time to ask one of the most common questions about mergers: What does it take for a company to be successful, post merger?

After all, many mergers ultimately don't add value to companies, and even end up causing serious damage. "Studies indicate that several companies fail to show positive results when it comes to mergers," says Wharton accounting professor Robert Holthausen, who teaches courses on M&A strategy. Noting that there have been "hundreds of studies" conducted on the long-term results of mergers, Holthausen says that researchers estimate the range for failure is between 50% and 80%.

Management professor Martin Sikora, editor of *Mergers & Acquisitions: The Dealmaker's Journal*, agrees. "Companies merge and end up doing business on a larger scale, with increased economic power," Sikora says. "But the important questions are whether or not they gained competitive advantage or increased market power. And that will be reflected in the stock price. "The truth is," he adds, "mistakes happen. The accepted data say that most mergers and acquisitions don't work out."

"What Went Wrong?"

According to Sikora, the kinds of problems companies face with mergers range from poor strategic moves, such as overpayment, to unanticipated events, such as a particular technology becoming obsolete. "You would hope these companies have done their due diligence, although that isn't always the case," he says.

Aside from those extremes, however, many analysts view clashing corporate cultures as one of the most significant obstacles to post-merger integration. In fact, a cottage industry of sorts has emerged to help companies navigate the rough terrain of integration -- and especially to help them overcome the internal inertia that comes with facing change.

"It's like changing a wheel on a bus," says Cari Windt from Access GE, which offers GE best practices to clients who are undergoing M&A transitions. "You can't skip a beat for your customer." Windt says the earlier a company attempts to plan, the better. Often times, however, companies don't plan as thoroughly as they should: "It's unusual that companies work on developing quality solutions for the acceptance side of mergers."

Wharton management professor Harbir Singh, who has done extensive research on mergers, says that the crucial distinguishing factor between success and failure in a merger is a sense of objectivity on the part of executives -- a "realistic outlook" that needs to be maintained from the initial transaction through the entire integration process. The danger, it seems, is when executives "fall in love" with the idea of the acquisition, wanting it to work no matter what the cost.

Sikora agrees. "The most important question is whether or not the deal is strategically well conceived. If

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it is, that covers a lot." For his part, Sikora feels the make-it-or-break-it emphasis on merging corporate cultures to be "vastly overblown." "Culture integration is certainly important," he says, "but it's always the excuse when something doesn't work out."

"Look, company A buying company B is really buying people," he says. "You need to realize that and be aware that certain issues exist." Negative outcomes -- such as employee layoffs for the target company -- are "invariable" and "must be handled humanely." For example, companies can help these individuals to find other jobs and provide acceptable severance. Sikora also advocates immediate and clear communication on the part of management with regard to any problematic issues. "You need to create a good impression," he says. "Good employees will quit if they feel their fellow workers are treated poorly."

Losing good employees is part of what a colleague of Sikora's refers to as "merger syndrome." "There is a natural distrust of the acquiring company, which leads to the development of fear and morale issues," he says. For this reason, people will often leave post merger, even when they have been treated well. Likewise, he notes that acquiring companies need to be aware of a "conquering army mentality." "That happens more often than it should. If one company is acquiring another, there needs to be some realization that the employees of the target company make it what it is.

"Sometimes employee anxieties at the target company are misplaced, and sometimes they are not," he adds. For the most part, Sikora views these problems as part and parcel of any merger -- successful or not. "Reality says these things are what you need to pay attention to and address. If you can't handle them, don't do a merger."

And Don't Forget the Customer

Sikora views corporate culture as one piece of a much larger puzzle. "There are lots of buckets to carry," he says, adding that it's important that much of the transitional planning take place before the deal is closed. Everything from apprehending antitrust hang-ups ("some companies proactively submit proposals for divesting to the government," he says) to decisions about the physical plant have to be considered along with employee issues.

One key stakeholder all seem to agree needs attention, though, is the customer. For Joanna Serkowski, an executive leader in GE's program with a background in M&A, the degree to which customers are part of the integration plan depends on the degree to which company processes are integrated with customers before the merger. One thing is certain, though: Customers must be kept informed. "You need to tell customers about your merger even when it's seamless," she says; in doing so, a company is simply confirming its sensitivity to customer needs.

According to Sikora, the customer should perhaps be viewed as the biggest stakeholder and treated as such. "If the customer is a large one, I'd say they should hold hands with top executives through the transition," he says. "At the end of the day, that's the cash." As an example, he sites a merger between two tech firms in Silicon Valley, both of whom had IBM as a leading customer. When the merger was announced, they both lost IBM's business. "IBM wanted to know why they were not told of the change," he says. He suggests using sales forces to keep customers informed and having communications ready for all customers, with a key message that answers the question, "What is this merger going to do for you?"

Is It Possible to Predict Success?

Still, despite planning and good communication, things can go awry. According to Sikora, one-third of mergers create shareholder value, whereas one-third destroy value, and another third don't meet expectations. For shareholders, these deals can be "a crap shoot," Sikora says, noting, however, that being in the successful one-third can add tremendous value.

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Aside from solid preparation for a deal, then, how can presence in that top third be predicted?

"Companies that acquire with frequency and make it a major core competency tend to do well and perform better than their peers," Sikora says. In fact, he adds, more companies regard M&A as essential for growing value. He cites the recent history of M&A activity as evidence: As M&A activity has cycled over the past decade, the downturns have tended to be less extreme than years before. In other words, even when there's a lull in activity, there are more companies engaging in mergers than there were before during slow periods. In fact, according to press reports, last year's U.S. M&A volume ($886 billion) was almost double the volume of 2001 ($466.5 billion). "It's more of an established structure," he says. "More companies are equipped to do it, and it's more an integrated part of doing business."

Serkowski has spent considerable time defining ways to help companies integrate successfully. Mergers are successful, she says, when they have a "defined plan and process" to blend the operational with the cultural, with "tollgates" -- periodic reviews to make sure the process is working. "In a perfect situation, integration has begun before the deal is done and the money changes hands."

"Integration is really about mobilizing change," Serkowski adds. "The key question is, what is the change dynamic of the companies involved -- how quickly do they adapt?" Although companies may seem similar on the surface and therefore a perfect match, they are often vastly different in terms of change orientation, leadership style, organization systems, and methods of dealing with conflict, she notes. In addition to the ordinary due diligence of getting to know the acquired company and industry thoroughly, speed is essential in these transactions -- especially with regard to anything that will impact employees, including layoffs, benefits changes, location, etc. "Difficult decisions need to be addressed early on so that they are not lingering and hit later."

One of the most important aspects of the process, according to Serkowski, is a strong commitment to change on the part of management. First, there needs to be consistent communication regarding the process; ideally, Serkowski says, there should be a "rhythm" of communications for employees, which might take the form of regular email updates, newsletters, and general visibility on the leadership level. Secondly, management needs to assign resources to complete the transition successfully. Acquiring companies should consider assigning an "integration leader" to help oversee the process. According to Serkowski, this is a "multi-directional ambassador" with leadership skills, "aggressive project management" capabilities, and "exceptional people skills." "Listening is key," she says.

The Market Speaks

And what about the recent wave of mergers? Sikora, Holthausen, and others decline to predict the outcomes. Holthausen suggests watching for negative market reactions as one key indicator. "On average," he says, "when market reactions are negative, changes in subsequent performance are correlated to that reaction." Sikora agrees: "If the acquiring company takes a bath on announcement of the deal, then the market is saying it's a bad deal."

One thing is for sure, though: Procter & Gamble and SBC have their work cut out for them. "Forty years ago, these deals were done on napkins, but today I'd say that mergers and acquisitions are not for the faint-at-heart," Sikora says. "I always tell my students that when it comes to everything that needs to be taken care of during mergers, don't bother prioritizing --get cracking!"

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