CHAPTER 1

The Elusive Healthy Merger

Academic researchers and consultants have consistently shown that on average mergers and acquisitions deliver at best mediocre performance outcomes. The typical merger is therefore a bet against the odds.[1]

Readers who have witnessed the deals in their own industries over a period of years are not likely to be surprised by these findings. Informed observers can point to egregious errors that have pulled down the merger performance average. The most important of these is deal terms that have made a merger's economics unachievable from the start. Other common mistakes include poorly-quantified synergies, lack of specific accountability for synergy realization, underresourcing of the integration team, and lack of attention from senior management during the integration.

All of these mistakes reflect insufficient managerial discipline. A disregard for how difficult it is to create value from M&A has always dragged down the averages. There will probably always be companies that grossly overpay and then undermanage the integration of what they have bought.

However, there is now a sizeable group of senior managers who have learned through extensive integration experience that these common mistakes can and must be avoided. Integration experience is much more important for this learning than selection and negotiation practice. Nothing can substitute for the experience of putting two companies together in developing a manager's sense for viable M&A strategies and realistic deal terms. Managers who have been directly involved in past integrations are more wary during negotiations and ask more probing questions about how value will be created.

Some of these managers have compiled remarkably impressive M&A records. They wind up on the positive side of the merger performance curve much more frequently than their peers.

One might expect these managers to be relatively satisfied with their merger performance, but in our experience few are. Deep integration experience actually instills in them a gnawing sense that their mergers are less successful than they might have been. Praise from financial analysts for, say, hitting a synergy target several months ahead of schedule is of course gratifying. Yet post-mortem discussions with colleagues may quickly surface a consensus view that the merging company underwent more strain than necessary during the integration, and that the full potential of the transaction was not realized. 'Overall, that merger was a success – *but*…'

During the integration itself, trouble signs may have been limited to slightly higher customer attrition and the loss of a few more talented managers than expected. Since then other problems may have appeared: The rate of introduction of new products may have slowed down. A quality program may have lost momentum. It may have proven difficult to fill skill gaps in a key capability area. Customers may have come to see the brand as less distinctive. Operating costs may be running higher than planned. Suppliers may have become less forthcoming with sharing cost improvements from new technology. More generally, the combined company's culture may seem to be marked by less accountability, collaboration and hustle.

Even in mergers where there have been few negative effects, valuable opportunities may have been lost. Anticipated revenue gains through cross sales or integration of product lines may be disappointing. The sleepy corporate culture of a large acquirer may not have received a salubrious jolt from the greater entrepreneurialism of its acquisition. Plans to use the shock of the merger event to 'unfreeze' some bad corporate habits may never have got off the ground. Few best practices may have crossed the merger boundary even after the boundary formally disappeared. Hopes that putting two creative management teams together would lead to fresh strategic thinking for the combined company may not have materialized.

In our experience, CEOs and senior executives who are skilled at integration are keenly aware that *synergy targets and a few other publicly announced integration project goals do not give a full picture of the outcome of a merger*. It is straightforward to measure the 'performance' of an integration. Much more elusive is the ability to gauge whether a merger is as *healthy* as it could have been.[2]

A healthy merger makes a major contribution to the corporate health of the surviving company in multiple dimensions such as operating and financial performance, business and technical capabilities, the strength of stakeholder relationships, corporate culture, the pace and focus of learning, and the ability of the company to renew and enhance its strategy. Whereas a merely successful merger looks impressive on the basis of a few early performance measures and milestones, a healthy merger stands up to searching scrutiny by knowledgeable insiders for years afterwards.

Adopting this broader 'performance and health' perspective on mergers requires you to identify the full range of effects that the integration would or could have on your company and to assess how well you are doing against them over time. That of course is a highly subjective exercise. There is, however, no alternative to this perspective if your goal is to maximize the overall positive impact of mergers on your company. Neither the project perspective with its emphasis on milestones and targets nor the financial perspective with its focus on readily quantifiable value-creation is rich enough to support the quest for healthier mergers.

We are not, of course, suggesting that the project and financial perspectives are irrelevant. Far from it. Visible achievement of project goals is essential not just for maintaining the confidence of investors but also for building momentum towards value creation. The importance of value creation requires no comment.

In our experience, however, those senior managers who have been most successful from the project and financial perspectives naturally move on to the performance and health perspective. They aspire to lead mergers that are truly healthy, not merely successful from a project or financial perspective.

The best integrators have the keenest desire to go beyond conventional performance and achieve mergers that are truly 'healthy'.

They recognize that because this is an insiders' perspective it may be difficult to share it with crucial external audiences such as financial analysts. Indeed, many senior managers find it challenging to share this perspective with managers in their own organizations. As we shall see, for example, the impact of cultural change is notoriously subject to contrasting interpretations. Some of the difficult trade-off decisions that you make during an integration may be questioned long afterwards. Even when your colleagues broadly agree with your overall assessment of a merger's health, they may differ starkly on detailed assessments and their weighting.

General managers typically relish such complex judgments, and this is the learning frontier for all the best integrators today. It is one thing for a merger to be publicly praised by financial analysts and business journalists in the crucial months before and after the close. It is quite another thing for members of the top team to conduct a frank exchange about the full effects of the merger after two years have passed and agree it was healthy overall – however much they differ on its detailed effects.

Many CEOs show a keen interest in excelling against this daunting standard. They tell us that surpassing competitors' merger performance and impressing external observers is not enough. They know that they will never achieve a perfectly healthy merger – one without the slightest regrets for lost opportunities or unmanaged risks. They will always leave some money on the table after an integration. Yet they are convinced significantly healthier mergers must be achievable.

But how?

To answer that question, the authors of this book launched what may be the most comprehensive research project of its kind. They brought to this research complementary experience in the field of merger integrations. The two McKinsey authors – David Fubini and Colin Price – have many years of direct experience in counseling senior managers during integrations, and have regular access to colleagues with scores of man-years of additional merger experience. Professor Zollo of INSEAD is a prominent contributor to academic research on mergers and acquisitions and has been training executives on these themes for years.

The initial structuring of the research was based on what we believe to be the largest in-depth survey of merger performance ever completed. We studied 78 per cent of all post-merger management assignments completed by McKinsey across all industries and in all countries between 1996 and 2001. For each merger analysed, consultants completed a questionnaire with more than 400 individual information items covering all aspects of the mergers from strategy formulation through integration. Performance was assessed against multiple objective and subjective criteria.

Building on the results of the survey, we interviewed almost 30 managers who have held either integration manager or steering roles (or both) for major integrations at prominent companies worldwide. Their insights have proven invaluable, and we will quote them heavily in subsequent chapters. They are pioneers in the leadership of healthy mergers, and their reports from the trenches provide the primary support for the book's theme.

Together, the survey results and interviews broadly indicated the theme of this book: *To achieve healthier mergers, senior managers must define for themselves a more imaginative and energetic leadership role to complement the efforts of today's highly capable integration managers and teams.* To put it more starkly, advances in the senior leadership of mergers have fallen far behind advances at the integration team level. It is time to begin closing this gap.

The key to healthier mergers is senior corporate leadership that matches the excellence achieved by many integration managers and teams.

To fill such a gap we must ask some hard questions about why it opened up in the first place.

An Underdefined Leadership Role

There are three common reasons why many senior managers fail to define a high-impact leadership role for themselves. First, some believe it is enough for them to protect the company from committing the colossal errors that may lead to merger disasters. Second, the increasing competence of integration managers and teams and the rising sophistication of integration tools and techniques make integrations appear to be a technical challenge that can largely be delegated away. Third, the factors that distinguish a truly healthy merger from one that merely meets near-term synergy targets are so numerous and intangible that it might seem impossible to define clearly what such a role would entail.

Closer examination of each of these reasons is justified for the light it can shed on what ultimately is required to lead a healthy merger.

'Avoiding Merger Disasters is Enough'

There have been so many spectacular and well-publicized M&A flops that even senior managers with *no* merger experience know the types of blunders behind merger disasters. There are big bet deals based on exciting but illusory synergies. Then there are premiums that are so inflated that they are unrecoverable no matter how well the integration is executed. There are also cases where a company failed to prepare adequately for the integration, either due to a lack of integration experience or because it failed to recognize that the experience it did have was not directly relevant for the integration at hand. Finally, there are cases of dangerous arrogance towards one's merger partner (sometimes reciprocated) that inhibits the critical process of thoroughly learning about integration risks and opportunities and engenders destructive friction between the two sides.

These are the big blunders that feature so prominently in books and articles on merger disasters. One could write an entire book filled with big-blunder stories and threaded with the admonition 'Don't let this happen to you.'

Senior managers can take justifiable pride if none of their mergers has ever provided journalists with promising material for a big-blunder story. Yet this is a very limited aspiration, for unhealthy mergers that fall short of disaster status are common. Managing well the risks of significant value destruction is not equivalent to maximizing value creation.

'Integration is a Technical Challenge'

Most senior managers do not settle for avoiding big blunders, and recognize that they must also ensure that the integration meets its formal performance goals – typically embodied in synergy targets – and prevent any major adverse effects such as the defection of major customers or the loss of key talent.

Unfortunately, they often see this as a predominantly technical challenge that can be delegated to their integration managers and teams. This is understandable as the project management tools and techniques become ever more refined and sophisticated. Large-scale merger integrations have indeed taken on the look of complex projects in such technical fields as information technology. Reading some large companies' integration process manuals, for example, is not unlike absorbing the documentation for developing and rolling out new IT infrastructure.

The temptation to delegate the integration challenge away is all the greater if the integration manager and team have substantial practical experience and strong managerial instincts. The reasoning is: 'After all, if they run into some problems they cannot cope with, they will let me know. It is best to let them get on with it, attend the regular steering committee meetings, and keep my door open.'

Consider, however, a merger that has had enough troubling side effects to deny it the status of a healthy merger. Is there really any reason to believe that these could have been avoided through greater technical virtuosity on the part of the integration manager and team? Despite its many technical aspects the integration of two companies is first and foremost a general management challenge. Perhaps no event in a company's history has as many varied and subtle impacts on its corporate health as a major merger.

'No Coherent Leadership Role can be Defined'

In a surprising number of cases, senior managers simply do not know how to add real value. This is so even for many CEOs who have held the integration manager's job themselves in the past and could step into it at a moment's notice. Such CEOs might not be at all clear about what they could do to make a merger healthier. It is indeed a grand paradox that for one of the most taxing of general management challenges – the leadership of a healthy merger – the impressive mountain of integration literature that we have built up over the years has very little to say about what the general managers at the top should be doing.

This book has been written to meet this need. Leaders know that they must do more than prevent big blunders and recognize that an integration is not a delegatable challenge. Yet they may be overwhelmed by the Pandora's box that this opens up for them. A merger can be unhealthy in so many ways! Where does one begin?

The factors that contribute to an unhealthy merger are not narrowly technical, and so do not lend themselves to focused and straightforward management solutions. They tend to be highly intangible, such as deterioration in customer relationships or a loss of focus in a key organizational function such as R&D. Moreover, their emergence is unpredictable, and there are always false alarms. It is therefore tempting to just keep showing up at the steering committee meetings to check for problems that may be spiraling out of the integration team's control.

Admittedly, your role must always include such pulse-taking, because a merger integration is a complex and dynamic process that will throw up surprises for even the most seasoned veteran. However, given the stakes involved in a major merger and the crucial importance of getting a strong start for the integration, it is obvious that a fully defined role that includes anticipation of risks and opportunities is required. Reactive management of variations from plan is hardly enough.

On the other hand, it is not at all evident how you should track the success of your leadership interventions, even if those risks and opportunities are clear from the outset. In the real world of corporate performance, a merger is never an isolated event whose impact can be cleanly separated from the corporate context. A host of external factors affect performance during and after the integration, such as technology developments, moves of competitors and business partners, and fluctuations in customer demand. Within the corporation as well, there will generally be several other initiatives underway, and some earlier ones may be bearing fruit just as the merger takes place. Who is to say, for example, how much of the credit for newly focused business unit leadership goes to the merger experience as opposed to, say, the leadership development program that has been running for the last two years?

Except in clear-cut disaster cases, the impact of a merger on corporate health is always open to interpretation. An extremely healthy merger will lead to a whole raft of positive changes after the integration, but each of them could be explained in multiple ways. You may well have a single aggregate synergy number at hand to simplify the task of keeping score, but if offers a false precision. In fact, as we shall see, leading mergers for corporate health requires a willingness to recognize the value of a whole set of intangible factors – such as the quality of relationships with business partners or the commitment of managers and employees to the new company's direction – that a spreadsheet in the integration team room will never adequately capture. In a field like integration management, where progress towards rigorous quantification has been so impressive, this blurring of the scorekeeping may seem to be a step backward. Yet it is actually a prerequisite for moving forward.

The Leadership of Healthy Mergers

Senior managers create value during integrations by crisply defining and energetically tackling leadership challenges that the integration team is poorly positioned to handle. They continuously ask themselves where the opportunities lie for a step-change in the health of the merger. Then they direct their energies there.

Our research reveals that it is possible to generalize about these challenges. In fact, five leadership challenges came up regularly in our interviews. All five depend upon senior managers' ability to understand the diverse corporate health implications of an integration. In-depth discussion of these challenges forms the body of this book, and in this opening chapter we offer a brief overview of them.

Create the New Company at the Top Before the Close

Successful integrators emphasize the importance of preparing well for the merger close and achieving significant momentum by that date. Many argue that the game may be won or lost in this early period: Recovery from a poor start may be impossible later.

This view is reflected in the currently widespread practice of naming the top team, and sometimes another level or two, as early as the date of announcement of the deal. Yet in many cases this new team then turns to the concrete work of integrating down the line even though its own integration is at best superficial. It is trying to create elsewhere what does not yet exist at the apex – the new company.

As the new top team is the ultimate template for the integration, it must embody every characteristic that is crucial for the success of the merged company. In a deep sense, in fact, it must *become* the new company. The quality of company you create early on at the apex is the best that you are likely to achieve anywhere else later on. Tackling the people issues at the top around appointments, alignment and role clarity will have a multiplier effect across the merging organization and beyond. It sets the pattern for everything that follows. In practice this means that you may need to cope rigorously with these issues at a point when the temptations to put them off or paper them over may be close to overwhelming.

Place the Merger Communications Within the Context of the Corporate story

The importance of communications for merger success has been very well codified. Merging companies often have communications customized for each stakeholder group ready at the announcement. They also have a supporting plan with well-specified communications roles for managers at every level, use of multiple channels, and elaborate feedback and monitoring systems. The 'overcommunicate' theme of the integration literature has been turned into an impressively elaborated communications machine at many companies.

Yet despite all this effort, managers often report that their merger communications are less effective than planned. They often conclude that they simply did not 'overcommunicate' enough, and consequently go on to build a yet more impressive communications machine for the next integration.

We believe that most companies can indeed make progress through upgrading the quality of their communications efforts, but there is often a deeper problem. The 'corporate story' – what the company means for its stakeholders groups, and how they interpret its past and present and anticipate its future – is often neither well-defined nor compelling at the point when the merger is announced. The various audiences of the merger communications cannot place the merger in context if that context is unclear to them. The merger communications thus must bear the double burden of explaining at a high level 'who we are and why we did this merger' as well as at a concrete level 'what will happen and how this merger will affect you'.

The ideal here is to convey the corporate story so well on an ongoing basis – and through actions as much as communications – that the 'who' and 'why' of the merger are evident to all and the merger communications can focus on the 'what' and 'how'. Some companies, particularly those that acquire frequently, have achieved this stage where each merger is 'strategically obvious' (as Peter Wuffli of UBS puts it). If, however, the reach or clarity of your corporate story is limited in a crucial way, then you must put extra effort into communication of it to overcome that limit. If, for example, employees of your merger partner have an ingrained negative view of your corporate story and feel defensive about their own, then you must carefully tailor your communications approach to deal with this problem. The concept of the corporate story can be useful in distinguishing where you have a straightforward communications challenge from where you have a daunting one. It can also help to counteract the deadly routinization of merger communications that bedevils even some sophisticated integrators.

The corporate story, however, is useful in another way besides facilitating communications. The story is also a prism through which value-creation opportunities can be identified throughout the integration. It can play this role because it is in effect a narrative of how the company has created value in the past and will go on doing so in the present and in the future. As such, it is a forcing device for perceiving the merger above the level of the integration project with its emphasis on the nuts and bolts practicalities of putting the company together.

Focus Attention on the Performance Culture Needed for the New Company

Cultural integration is the most vexed topic in the field. Here there is practically no consensus around what best practice is. Instead, we find a spectrum of approaches here ranging from an intensive, explicit engagement with the challenge of merging cultures to a more traditional focus on the business goals of the integration with limited or no discussion of culture at all. We have seen approaches at both extremes and at intermediary points both succeed and fail.

There are two common myths about cultural integration that inhibit clear thinking about this challenge. One myth holds that the stronger of the two cultures will naturally emerge from the process in a sort of survival-of-the-fittest competition, so no explicit management of cultural integration is required. Unfortunately, under the hothouse conditions of an integration the less desirable of the two cultures may in fact prevail. Moreover, in most cases the optimal outcome is more complex than the victory of one culture over the other. Often both sides have important cultural traits that are worth retaining in the merged company. In some cases, in fact, the best course for the merging company is to maintain the cultural contrast for the future. Many large acquirers, in particular, are rightly concerned about preserving the culture of their acquisitions.

The second, starkly contrasting myth is that the new top team can readily implement whatever cultural change it desires across two merging companies, each of which may have tens of thousands of employees in scores of countries and a dozen or more distinct professional subcultures. This is hubris of the first order. Corporate culture emerges over time from the full set of actors in a company. It cannot simply be programmed by the corporate center. Moreover, there is always much more cultural differentiation within a company than a blithe summary of its culture would suggest, and a high level of differentiation can be very healthy. Who would want their marketers and their engineers to think and act in precisely the same ways?

We believe the most promising approach is to intervene actively to shape the cultural outcome but to focus these efforts on what we call the 'performance culture', that is, the crucial set of attitudes and behaviors that are required to create value in the merged company. The key here is not to dwell extensively on the numerous cultural contrasts between the two companies. Doing so could make the merger unhealthy by actually reinforcing the pre-merger corporate identities. Indeed it might even lead to a debilitating negotiation over cultural traits that has nothing to do with how you plan to create value in the future. As former Sky Chefs CEO Michael Kay told us, you should focus on the cultural foundations for success in the future, and the description should be as concrete, externally-oriented and business-like as possible.

All companies continue to evolve after a merger, and those that achieve significant marketplace success naturally tend to evolve in a way that reinforces that success. During the integration you should therefore focus on creating the cultural conditions for such success. How positively a company evolves after the integration is a strong indicator of the merger's health.

Become an Active Champion for Crucial External Stakeholders

Most integrators in effect divide stakeholders into two groups. There is one set – generally employees, investors and analysts – with whom managers engage energetically in order to secure their support for the merger. There is then a second set – often customers, business partners, and communities – that managers try to shelter from the merger's effects as much as possible. They may need reassurance on some key points, but the general message is that they should relax because the merger will not affect them much in the short run and in the long run might even leave them better off. So the most talented employees get a bear hug, while the best customers get a form letter.

The determination not to burden customers and other stakeholders with integration mechanics represents a real advance, and we applaud it. We agree that they should not be impressed as laborers in the integration project. Yet the two merging companies do interact routinely with these stakeholders, and the inevitable turmoil of the integration process will affect that interaction despite your best efforts to isolate the integration from the normal business of the company. More subtly, as 3Com's Eric Benhamou emphasized, your knowledge of the new set of stakeholders that the merger brings with it is extremely limited. For example, you may have integrated a dozen sales forces in the past, yet you still may be unable to identify immediately the pivotal, tacit features of the customer relationships of a new merger partner's sales force. You never know exactly what you have just bought – at least not like you know your own company – and must undertake the integration without such exact knowledge.

In fact, to achieve a healthy merger it is best to begin with deep humility about what you know in a number of areas. Where your competitors might strike during the integration, which customer relationships are vulnerable, what features of your company's and your partner's brands require the most diligent protection, in what ways your business partners are recalculating their options, what the reaction to the merger will be among relevant governmental authorities and communities – these and a host of other questions cannot be immediately answered with any confidence.

Every integration begins with dangerous knowledge gaps about the world beyond the borders of the merging company. Even where both management teams have profound knowledge of their external stakeholders it will take time before these two pools of knowledge can be combined to form a deeply-shared understanding. This is a major vulnerability, yet many integration plans pay scant heed to the urgent need to overcome it.

What this means in practice varies dramatically from one integration to the next depending on how the merger may affect each group of external stakeholders. In general terms, however, your challenge as a senior manager is to identify those stakeholder groups where the value at stake is significant and to become their active champion. Leadership here requires genuine insight into the issues that may arise beyond the corporate boundary, that is, the ability to analyse corporate health in very broad terms. It also requires real tenacity, because merging companies have a strong tendency to turn inward and make critical integration decisions without robust analysis of the consequences for key external stakeholders.

Identify the Need For and Undertake Integration-Critical Learning in Real Time

Learning is often seen as a valuable objective in integrations that routinely loses out to the even more valuable objective of sustaining momentum. It is so difficult to learn under the stressful conditions of an integration that the standard approach is to minimize the aspirations for learning until after the integration is over. This is intended to ensure that learning efforts do not rob the integration of its momentum.

On the other hand, there have been significant advances in the creativity and rigor with which sophisticated integrators compile lessons learned after the merger is over and apply them to the next merger. The conventional approach is therefore:

> *Just get it done. Hold off on learning until later. Then make sure you do it better the next time.*

This rigid deferral of learning is based on an oversimplified view of the integration challenge. In reality, integration is a learning-intensive activity where a large number of actors need to change a wide array of behaviors. While much of this integration-critical learning is straightforward, some will always be quite difficult. It is no simple matter, for example, to radically modify an integration routine that has proven to be effective numerous times in the past. Yet Arrow Electronics' Steve Kaufman found this unlearning and relearning to be essential for achieving the value-creation objectives of one of the company's acquisitions. At BAE Systems, urgent learning was required to replace a shortfall in synergies with alternative cost savings. In both these cases, learning was actually a precondition for securing momentum rather than a hindrance to it.

Achievement of a healthy merger may well depend on your ability to recognize where the trade-off between momentum and learning does *not* apply. Almost invariably there will be some difficult learning challenges that you must take up in order to achieve the value creation objectives of the merger. Yet few integration plans include any assessment of what these integration-critical learning challenges are – not to speak of concrete steps for meeting them.

Frequently these challenges are daunting because they require that you develop and apply 'corporate self-knowledge'. Even where the logic of the merger depends upon your learning from your partner, knowledge of yourself may be equally critical. The success of UBS' acquisition of O'Connor & Associates was dependent on the bank's willingness to confront the limitations of its own culture. Such hard-won self-knowledge can dramatically expand the range of value-creation opportunities that you are able to identify. Without it, you are trying to put together two companies of which one is new to you and therefore obviously unknown while the other seems as familiar as your own skin yet may be much less well known than you imagine. The pivotal importance of this self-knowledge is the most striking finding to emerge from our survey.

The ultimate people issue may therefore be a merging company's challenge to learn about itself. And the ultimate hallmark of a healthy merger may be that a *wiser* company emerges from it.

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Our research shows that these five challenges provide promising opportunities for leadership. For each of them, crossing the threshold from a merely adequate response to an exceptional one can have a startling effect on the healthiness of a merger.

In our prior experience and in the research for this book, we have encountered many impressive merger leaders. However, as far as we are aware, there are no pentathletes out there that consistently excel against all five of the leadership challenges with each integration. In any case, the senior leadership role must itself be tailored each time, so in terms of merger leadership you really never arrive.

Where any one of these leadership challenges is taken with full seriousness – particularly the first one about creating the new company at the top – a healthy merger becomes less elusive. That is our central claim. A perfectly healthy merger may be as unattainable as perfect human health, but in the integration game shifting the odds in your favor is well worth the effort. Within the covers of this short book you should be able to find several ideas that will help you to do so.