HighPoint
INSIGHTS

HighPoint
INSIGHTS

HighPoint InSights taps into the expertise of HighPoint Associates' 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 **InSights@HighPoint-Associates.com.**

HPA HighPoint Associates

Founded in 2002, HighPoint Associates (HPA) has developed an impeccable reputation for providing clients with exceptional advisory, consulting and interim executive resources at competitive rates to meet their most important business challenges. Drawing from its network of over 500 extensively vetted professionals, HPA is able to precisely match the right individual or team of consultants to the specific skills, experience and interaction style demanded by each unique client situation.

HPA has worked successfully with clients ranging from mid-sized businesses up to Fortune 100 corporations, as well as investment firms with stakes in companies of similar size.

HPA has offices in Los Angeles and New York.

To learn more about HighPoint Associates, call 310-616-0100 or go to **www.HighPoint-Associates.com.**

WHY DO INTENTIONS MATTER IN MAKING MERGERS WORK?

Part 1 of a two-part InSights article on post-merger integration

By Bennett E. McClellan with Alex Nesbitt of HighPoint Associates

OVERVIEW

Mergers and acquisitions (M&A) represent substantial opportunities for companies to consolidate, grow or diversify their strategic positions. M&A also represents a significant level of economic activity across the global economy. Market watchers estimate that 2011 global M&A activity increased to $2.75 trillion, up from 2010's activity of $2.25 trillion. U.S. based transactions typically constitute about one third of global M&A value. Global M&A activity is expected to exceed $3 trillion in 2012. The U.S. will account for $1 trillion of that figure.

That's a lot of opportunity. But a great deal of expected value from M&A never materializes. Various studies estimate that between 40% and 80% of all M&A ventures fall short of achieving their stated objectives. Few mergers fail so spectacularly as those of Time Warner-AOL, Daimler Benz-Chrysler, or HP-Compaq. Yet no industry sectors appear immune to M&A disappointments, whether such events materialize as quiet failures or public debacles.

For this article, Bennett McClellan asked HighPoint Associates' Senior Advisor Alex Nesbitt, "What makes post-merger integration efforts work?" Nesbitt has assisted companies as an organizational change agent and post-merger integration specialist for the past 25 years. Based on his experience, Nesbitt suggests that merger outcomes should be judged by at least two sets of criteria.

The first set of criteria focuses on how well a merger achieved the intentions of those who instigated it. The second set of criteria addresses the question of how well the process of post-merger integration was handled. Nesbitt works to help merger managers keep both sets of criteria in view as they work through post-merger integration issues.

In Part 1 of this article, HighPoint Associates' Senior Advisor Alex Nesbitt addresses the question, "What separates those mergers that work as intended from those that do not?"

In Part 2, which will follow next week, Nesbitt takes on the question of "What are the mechanics that make post-merger integration efforts work?"

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

Business combinations represent unique events in the history of companies. They typically also represent once-in-a-lifetime events for the people involved. According to Alex Nesbitt, Senior Advisor with HighPoint Associates, "A merger is a big change. It needs to be recognized as such. It's not just an acquisition of assets."

In this article, Nesbitt addresses three questions to help managers lay the foundations for post-merger success. First, what is the intention of the company instigating the merger? Second, how does acquirer intention inform a merger's outcome? And third, what should managers do to achieve their merger intentions?

Nesbitt's view of mergers as a significant event has evolved through his twenty-five years of helping executives guide their mergers to success. He notes, "Companies that complete mergers that achieve sustained success recognize they have one opportunity to get it right." That also means successful companies understand the risk of getting it wrong. Those that succeed 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 end-stage of the merger helps managers avoid missteps and backtracking.

FOCUS ON WHERE YOU INTEND TO FINISH FOR SUCCESSFUL POST-MERGER INTEGRATION

InSights asked Nesbitt the question, "What are the most important things merger managers need to get right?"

Nesbitt responded, "The first thing of importance is having a clear end-state objective in mind. Whatever your intention is – from a strategic standpoint, cost reduction, capacity expansion – whatever it is, if you don't have a clear view of what it is and what you want to accomplish, it is highly unlikely you will realize that goal."

At a basic level, Nesbitt's view of the importance of intention reflects the common wisdom that, "If you don't know where you are going, any road will get you there." However, his view challenges the common wisdom in a subtle but important way. Nesbitt points out that, "Too often people confuse motion and activity with progress. Just because you're moving does not mean you're making progress towards achieving your intended goals."

One of Nesbitt's clients used to call this approach the "ready, fire, what did we hit?" syndrome. While such characterizations may be amusing, Nesbitt asserts, "If you don't have a clear goal, it's hard to know whether you're going anywhere." In other words, if you don't know where you are going, you are likely to end going nowhere. Or worse.

WHAT IS THE INTENTION OF THE COMPANY INSTIGATING THE MERGER?

Nesbitt insists that mergers should 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. Nesbitt says, "That's not necessarily progress. It's just setting the stage for a bigger fiasco."

During his first meeting with an executive planning a merger, Nesbitt typically asks, "What's your goal? What do you need to accomplish here?" He encourages the would-be merger manager 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, Nesbitt's experience suggests 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?

Nesbitt identifies three broad categories of end-stage goals associated with intentions. Obviously, there can be a lot of reasons one company may wish to acquire another. Nesbitt's end-stage categories therefore serve as a starting point for considering the desired outcome of a merger. These three end-stage goals for mergers are efficiency, extension and enablement. We'll elaborate on each of these categories in turn.

The goal of ***efficiency combinations*** is to achieve cost reductions. Cost reductions come in the form of reduced internal costs or in the form of reduced market friction, or both. The intention behind an efficiency combination is to reduce something, typically with the measure of success being improved profitability. The merger of Exxon and Mobile provides an example of an efficiency combination.

In 1999 Exxon, the largest U.S. oil company at the time, purchased Mobile, the No. 2 company in the field. The combined company achieved efficiencies across exploration, production, refining and marketing. The merged company reduced its workforce significantly, saved billions of dollars over the following five years, and maintained its position as a global leader in the energy industry. While the merger did not fundamentally alter the strategic position of either parent company, it generated enhanced profitability for the combination compared to the profitability of the parent companies.

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 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.

IBM has used an extension strategy in developing its software business. From 2002 to 2009, IBM acquired 70 companies for a total of roughly $14 billion. IBM estimates that it increased the acquired companies' revenues by about 50% in the first two years after each acquisition. IBM achieved this spectacular revenue growth by selling the acquired companies' products through its global sales force.

Johnson & Johnson also used an extension strategy to move into the medical device sector in the 1990s, acquiring midsize companies and growing them at a rate much faster than they could have achieved on their own. For example, orthopedic device manufacturer, DePuy, had about $900 million in revenue in 1998 when J&J acquired the company. By 2007, DePuy achieved sales of $4.6 billion, at an annual growth rate of nearly 20%. DePuy grew to $5.6 billion in revenue in 2010. J&J extended DuPuy's reach and helped fill in gaps in its own product portfolio.

Enabling combinations arise when the business combination gives birth to new capabilities neither parent firm had, nor could fully develop or fully exploit, on their own. Enabling combinations typically build on the core competence of the acquiring firm, but result in a combined firm that can do more than either of the original firms could have done solo. Enabling combinations create new opportunities and new kinds of customers. A key metric for enablement is differentiation. Enabling combinations often take the resulting entity far beyond revenue enhancement or cost reduction. Enabling combinations give the merged entities strategic advantage.

For example, in 1996 Ciba-Geigy and Sandoz merged to create Novartis. The new CEO of Novartis and his management team subsequently undertook a broad-based transformational effort. The transformation redefined the company's mission, revised its strategy, reconfigured its product portfolio, and realigned key processes from research to sales. The company also captured over $1 billion in cost savings. Novartis shifted its strategy to focus on innovation in its life sciences business. Novartis restructured the R&D division with a therapeutic focus rather than by geographic area, and spun off its chemical activities. This shift enabled Novartis to create a leading oncology business. In the end, the combination allowed a new kind of company to emerge that would not have been possible without the merger.

The acquisition of Pixar by the Walt Disney Company represents a similar enabling combination. 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 machines. As a combined entity, both companies were able to open new frontiers.

WHAT SHOULD MANAGERS DO TO REALIZE THEIR MERGER INTENTIONS?

The requirements for managing post-merger integration are different depending on the motive behind the merger. According to Nesbitt, managers need to handle post-merger integration differently for different kinds of combinations. One size does not fit all. While the story of the Disney-Pixar combination may be inspiring, not all mergers should be designed to achieve differentiation.

Here are Nesbitt's tips for achieving success with each kind of intended combination:

EFFICIENCY COMBINATIONS: BE QUICK

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 focused on doing their jobs 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.

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 toward people. Failing to walk your talk sends the signal "we can't be trusted." Good people – even those who feel secure in their jobs – get nervous when they don't trust their leaders. Nervous people look for more secure situations.

The takeaway: Managers need to prioritize speed to the end result, which requires quick decisions and action. This often means that one company's processes, systems and people will dominate the outcome. It can help to be candid with people about the way the integration is going to work. Integration leaders should communicate 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.

Nesbitt's advice? "The 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 quickly and as humanely as possible."

EXTENSION COMBINATIONS: BE ATTENTIVE

The goal of an extension combination is growth. You want to end up with the best of both parent companies and keep the best people from both organizations. The key to making extension mergers work well is to focus the best people from both organizations on how to serve existing customers better and to capture new customers based on the combined capabilities of the new organization.

That means that keeping the best people is therefore 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?

Nesbitt reminds us that the first step is for managers to recognize that even complementary combinations are big events. He says, "We might talk enthusiastically about merging cultures, but inevitably this means processes change and jobs change. People who were comfortable in their old jobs have to learn new skills. They have to 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 effect of such big changes:

Communicate how the merger will create growth

Quickly sort out the top management structure and people to minimize confusion and rumors

Set short term goals about what needs to get done to move toward a combined organization and quick ways to demonstrate the new value proposition to customers

Establish down-the-line transition management teams to work on how things are done internally to move toward a single, strong culture

Communicate to the people you want to stay that you do, in fact, want them to stay

Get going on revising 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 stay and get deeply engaged with achieving the goals for the merger. You need to recognize these high performers from both organizations and you have to let them know that you know who they are. You do this most effectively by providing people with tangible evidence that their continued presence matters and that their contributions are appreciated.

Nesbitt concludes, "Find as many ways as possible to pay attention to the people you want to keep. Change sticks because those most affected by change have a say in what changes. Include them in the process."

ENABLEMENT COMBINATIONS: BE AMBITIOUS

The goal of an enabling business combination goes beyond growth to creating new capabilities, new opportunities and new kinds of customers. The challenge is to forge a new organization with more capability than the merged organizations had collectively. 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.

Nesbitt challenges managers to set aside their cynicism when considering whether a merger can achieve more than the sum of its parts. He says, "Isn't that what mergers, in theory, aspire to? The goal in 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 capability, according to Nesbitt, 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, you also want to unleash their creativity in determining how the merged organization will work better than the predecessor organizations. The key to making big change is engaging the hearts and minds of people in an ambitious program of envisioning change. This is a unique opportunity to develop momentum for making change happen. It has to be embraced enthusiastically by all levels of the organization in order to work.

Here are some suggestions for helping to create an enabled combination:

- View the merger as an opportunity to truly rethink how the merged organization can better achieve both the routine as well as the extraordinary
- Recognize that everybody from both sides of the merger has creative potential and something to add to the discussion
- Obviously, superstars should have a role in determining the mechanics of the new organization but should

not be allowed to run over lesser lights

- Engage everyone involved 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 enablement consistently and often

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

BOTTOM LINE

Mergers are major organizational disruptions. Merger managers need to clarify their intentions for unleashing the forces of change on their organizations. Beginning with the end in mind will help channel motion and activity into real progress. Honesty in communications 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 could work creatively to 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 of decisions associated with post-merger management.

In Part 2 of this article, Alex Nesbitt provides insights into the factors that make the process of post-merger integration successful.

HIGHPOINT ASSOCIATES ADVISORY TEAM MEMBERS CONTRIBUTING TO THIS ARTICLE

ALEX NESBITT is a senior strategy and operations professional with over 25 years of experience. He has focused on large-scale change, post-merger integration and organizational redesign for clients across a broad range of industries including automotive, industrial, financial services, health care, telecommunications and energy. Alex is a former Managing Director for The Boston Consulting Group where he specialized in helping clients achieve success with large-scale change. Alex holds a BS in Industrial Engineering from Stanford University.

BENNETT MCCLELLAN has over 30 years of corporate and consulting experience. Most recently, he was a Managing Director in PricewaterhouseCoopers' Media & Entertainment practice. Bennett has also held management positions with leading entertainment companies, and has worked as a consultant for McKinsey & Company and Arthur D. Little, Inc. He also serves as a freelance journalist, and has had over 100 articles and editorials published. Bennett holds a PhD from Claremont Graduate University, an MBA from Harvard Business School and a BA from University of California-San Diego.