The elusive art of *postmerger* leadership

Mergers that appear to be successful in the short term often destroy value later on. By concentrating on five issues, CEOs and top teams can increase the odds of a genuinely happy ending.

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*Integrating two companies* following a takeover or merger has become a highly sophisticated exercise in recent years. Businesses are more disciplined and systematic about identifying and capturing the available synergies. Project tools and techniques are now more subtle and refined.

Yet for all the "scientific" advances, senior executives remain deeply frustrated about their ability to master the art of the takeover. They are less concerned about the familiar and widely documented finding that most mergers fail because acquirers wildly overpay for their targets or ignore the basic rules of integration. What bothers, indeed alarms, an increasing number of thoughtful managers is that integration efforts regarded as beneficial by the standard of synergy targets met (or even exceeded) may justifiably be reckoned as failures from a wider and longer-term perspective. An apparently successful merger can ultimately weaken the combined enterprise—its brand, customer relationships, ability to introduce new products and services, and the morale of its employees—thereby offsetting any short-term financial and operational gains.

Our research, involving a detailed survey of 167 deals and in-depth conversations with nearly 30 CEOs who are veterans of the merger scene, has convinced us that what's often missing is a well-defined, imaginative, energetic, and outward-looking role for the CEO and senior managers—a role that complements the efforts of the formal integration team. (For a discussion of how to plan and execute mergers, as opposed to integrating companies once the deal is complete, see "Habits of the busiest acquirers: ")

Leaders are crucial in any large-scale organizational change, of course. But when we dug into the archives and asked our global panel of experts to reflect on what creates a truly healthy combination, we found a number of critical issues that can be properly dealt with only at the top. Left unaddressed, they may not hamper the immediate integration effort but are likely to sap, even undermine, the merger's longer-term potential.

We therefore believe that CEOs and other senior managers should think about their roles in the context of five separate and inescapable challenges: creating a new and effective top-management team (as opposed to the merger integration team) early on, developing a credible and inspiring corporate "story" to propel the communications effort, shaping a strong performance culture, championing the interests of key external stakeholders, and balancing speed with time to reflect on and absorb integration-specific learning.

The academic literature deals with all these issues, but the lessons learned are easy to misunderstand and misapply in the specific and highly charged environment that follows the announcements of mergers. In our view, however, they represent a coherent and logical agenda for CEOs and senior executives. Since they are largely intangible, mostly nontechnical, and often unexpected, they require a degree of experience and perspective that the formal integration team typically lacks. If they are neglected—or, worse, overlooked—a merger's chances of ultimate success will be substantially lower.

**Why does the problem exist?**

Given the obvious demand for leadership during a merger integration effort, why do senior managers so often fail to define a high-impact role for themselves? In our experience there are three common reasons.

Perhaps the most fundamental is that many senior managers simply do not know how to add real value during a merger integration. The factors that distinguish a truly healthy combination from an unexceptional one seem so numerous and elusive that they defy clear definition. Such
managers must play the role of merely turning up at steering committees to deal with problems as they arise.

Perhaps the most basic problem is that many senior managers don't know how to add real value during a merger integration effort. Then there are leaders who believe that it's enough for them to be on the defensive: to protect the company from committing the colossal errors, so colorfully documented in the business press, that make mergers fail. Think of all the big-bet deals based on exciting but illusory synergies, of the premiums that were so inflated as to be unrecoverable no matter how well integration was executed, and of the companies that blatantly failed to prepare for it or lacked the experience to do so intelligently. Worse still is arrogance (sometimes reciprocated) toward a merger partner—arrogance that inhibits learning, obscures opportunities, and engenders mutually destructive friction between the two sides. It is well to avoid these blunders, but simply denying journalists the opportunity to write stories about them is a limited aspiration that will do little to guarantee the real success of a merger.

Finally, some executives are more positive about setting performance goals but see integration as a predominantly technical challenge that can be delegated to middle managers and specialist teams. Large-scale merger integrations have indeed taken on the appearance of complex IT projects, and some corporate manuals on merger integration resemble the documentation for developing and rolling out a new IT infrastructure. Moreover, the temptation to delegate is all the greater when the integration team is experienced. But our research shows that technical expertise cannot prevent many threats to corporate health during a large merger.

**Leading from the top**

Let us now consider the CEO's merger agenda in greater depth. Before embracing the five challenges, leaders must understand why they, rather than the integration team, should handle these issues. The answer, in part, is a matter of seniority, clout, and breadth of strategic vision, but there is more to it than that. The environment of a merger inevitably becomes inward facing—teams of technical specialists work against the clock to combine two sets of resources and thereby realize the synergies promised to investors and analysts. In such circumstances, companies can overlook vital strategic levers and drivers of long-term value. Only the CEO and other senior managers, who are free from the nitty-gritty of integration, have the time and attention to focus on the important issues: a cohesive top team, a credible and inspiring corporate story, a performance-driven culture, happy external stakeholders (notably customers), and corporate learning and self-awareness.

**Move quickly to mold the top team**

Many top-down change initiatives meant to cascade down the hierarchy have produced disappointing results, so there has been growing interest in a more dispersed approach. When it comes to mergers, however, the whole spirit of the project must be determined at the top, and quickly. An entrepreneurial business unit, an innovative functional unit, or the front line cannot drive the changes required during integration.

Top-team cohesion is therefore vital to avoid deferred decisions, bad compromises, and mixed messages. Even sophisticated integrators should move much faster than they do now to create a team at the apex of the combined entity before the formal merger negotiations close. "If you don't have a clear understanding, from the very beginning, of who calls the shots, of roles and responsibilities, and of how well the integration team works together, then your chances of success are minimal," says Steve Boehm, who comanaged Wachovia's 2004 integration of SouthTrust.

Speed in the selection of the top team's members is not enough. Many companies settle for a superficial integration process that allows problematic characteristics of both sides to fester. As one manager said, "For months we were really two teams and we knew it. But we just didn't want to deal with it, so no one raised the issue." A top team that emerges before the close, demonstrating the kind of company being created and top management's commitment to it, is the ultimate template for the whole integration effort.

Dick Evans of Alcan calls top appointments "the toughest part of the integration"—and he should know. Had the aborted three-way merger between Alcan, Algroup, and Pechiney gone through in the late 1990s, each of these companies would have been allocated two of their six business groups, no matter which of them was best positioned for the role. "That's probably the way we would have allocated capital and a lot of things," he told us in an acknowledgment that value creation would have been sacrificed to politics.
Achieving unity in the top team is difficult enough; achieving it across a merger boundary is a much bigger challenge. One way to deal with friction, according to many of our interviewees, is to turn attention toward the external environment: customers, competitors, business partners, and regulators. As Michael Kay, the former CEO of LSG Sky Chefs, said of the 1995 Cater Air acquisition, "Whenever there were any tensions on the team I would change the subject to customers. They got the message after a while."

Communicate the corporate story

Armed with business writers and consultants urge managers to overcommunicate in the wake of a merger. But efforts still falter, despite the commitment of resources and supposed best practice. The main problem, we found, is a failure to precommunicate, in the form of a simple and compelling corporate story that puts the merger in a broader and longer-term context. As UBS president Peter Wuffli (whose global bank has grown on the back of a string of acquisitions) observes, "One of our criteria for a deal was that it had to be strategically obvious—not just explainable but obvious."

The key is the big picture. Much as companies tend to focus on the composition of technical integration teams and neglect the role of top executives, highly tuned and meticulously planned merger communications for different stakeholder groups may not be clear or effective. Many executives we spoke to emphasized the importance of realism and authenticity. The challenge, they said, is not only to communicate the story in a richer, more compelling way than journalists and analysts can but also to present the merger as an episode in a much longer story. By communicating the "why," companies can convey the nuts and bolts of the "what" and the "how" much more effectively.

Yet executives must still strike a delicate balance. One error is to present the story in an abstract way that does not connect with employees and other people who have immediate and practical concerns such as "Will I have a job?" and "Who will be my new boss?" The error at the other extreme—focusing too much on the nuts and bolts—can be equally enervating.

Establish a performance culture

General agreement about the importance of corporate culture doesn't always generate a consensus on what to do about it. Sophisticated managers may understand that both sides are likely to possess strengths, but hard-nosed executives often maintain that the acquiring company's culture is objectively superior in most or all relevant respects.

At one extreme, companies adopt a laissez-faire approach on the assumption that the best outcome will emerge naturally through interaction between the merging companies. At the other extreme are the companies that adopt a strongly interventionist style, running workshops that explicitly discuss cultural issues. Most businesses we know fall somewhere in between.

Two common myths retain a firm, if often unconscious, power. The first is "survival of the fittest"—the idea that the stronger culture will prevail. But this supposition doesn't always hold, especially in mergers of equals. The second myth is that the merged company can readily reshape its culture: after all, if it can redesign and fully integrate product lines, business processes, retail networks, and IT systems, why not culture?

Such reasoning overlooks the scale and complexity of the challenge. Our merger veterans say that the wisest course is to establish a strong performance culture: the subset of cultural features that will drive the new company's creation of value. The objective is not to identify and reconcile every conceivable us-versus-them cultural difference but to emphasize what it will take to be successful in the future (and the more concrete, externally oriented, and businesslike the description the better).

At the heart of a performance culture is the performance contract—standards governing quality levels, the way to serve customers, and how to manage processes and deal with colleagues. According to John McGrath, the former CEO of Diageo (created in 1997 to combine Grand Metropolitan with Guinness), the company's performance contract mandated the widespread use of value-based management. It "changed the culture on the Guinness side much more than classic cultural-change tools like value statements."

Michael Kay, commenting on Sky Chefs' integration with Cater Air, argues that mergers provide an occasion for leaders to demonstrate that cultural traits really matter. Steve Jones, Suncorp's CEO, agrees: "You can't just stand up there and tell people what the new culture is going to be. You have to define in your own mind what you want the new culture to stand for, do it for a little
while, and then talk about what you have done."

A compelling performance contract, embodying a company's long-run appeal, is essential for retaining talent. "Buying loyalty with golden handshakes and similar devices does not work," observes Don Argus of BHP Billiton. "People stay because they like the place and because they have a career. If they don't like it they will leave anyway as soon as the options vest."

Lynne Peacock, who led the integration of Barclays with Woolwich, in 2000, warns about the risks of generating an "integration culture" as opposed to a performance culture. M&A deals, she says, "are really exciting, so everybody really wants to pitch in, and that is actually where you get a performance dip. People want to be involved, but what they need to understand is that the way they can give us most value is just to get on with it and do their jobs."

Champion external stakeholders
Integration teams tend to be good at engaging the attention of employees, investors, and analysts. But in the frenzy to merge, companies frequently neglect a second set of stakeholders—customers, business partners, and communities.

The risk is that in the dash to create internal energy and support, the new organization's external focus gets lost, opening the way for competitors to woo customers and other key stakeholders. Disruptions involving IT, the harmonization of prices, and the reallocation of sales territories are particularly sensitive.

Most of the time, the new stakeholders who come in with a merger seem deceptively like the old ones—a feeling reinforced by the loose and complacent way the verb "acquire" is applied beyond the other company's legally owned assets. As 3Com's Eric Benhamou cautioned, "'Acquiring customers' is a very arrogant phrase. The customer has to want to be acquired."

CEOs and experienced senior managers ought to view external stakeholders as a force to make mergers more successful. The opportunity of a major integration effort should be used to strengthen as well as protect key external relationships, since outside stakeholders almost always have valuable information and insights to offer if CEOs and their lieutenants take the trouble to ask. Benhamou told us that some of his customers would disclose where, other than 3Com, they were buying components to solve their network problems. They would suggest that he buy these companies to give them a single service contract and the security to operate in foreign markets.

Leaders must show the same energy and interest to suppliers, distributors, and joint-venture partners. They should be prepared to take on those in their own organizations who arrogantly assume that external stakeholders are docile and predictable.

Reinforce momentum with selective learning
The practice of capturing and applying lessons from an integration effort is one of the strongest differentiators between merely competent integrators and those that get better each time they integrate. Indeed, our analysis of mergers over the period from 1996 to 2001 showed that what most distinguished successful mergers from the rest was the prior existence of an established routine for systematically examining both the integration process and its outcome. By contrast, extensive integration experience in itself was an insignificant predictor of merger results. What really matters, it seems, is less how many mergers a company has chalked up than how methodically these employees who have lived through them learn from the experience.

Under the stressful conditions of a merger—and in the interest of speed and momentum—companies understandably tend to defer the acquisition of new knowledge and the undoing of bad habits until after the integration phase ends. The CEO veterans we talked to cited occasions when less haste can be helpful.

A good example comes from the way Arrow Electronics handled its 1994 takeover of Anthem Electronics. Up to then, Arrow was noted for its quick-fire integration style, but CEO Stephen Kaufman soon realized that time would be needed to change Anthem's more costly, relationship-based, and decentralized business model. "I was prepared to leave it [Anthem] separate until their management said, 'We don't want to be separate any more,'" he recalls. Had Kaufman defined the endgame and moved toward it too aggressively, he believes, the company would have destroyed value through the defection of employees and customers even if the endgame seemed "right." As Daniel Vasella of Novartis observed in much the same vein, "I cannot change myself in three months. How could I expect a company to change in that time?"
Our research ranked two other traits of acquirers as strong predictors of success: a performance culture and a tolerance of risk and diversity. These underscored the importance, for merger partners, of knowing themselves and of using integration as an opportunity to build up self-knowledge. Indeed, a subtle but powerful benefit of mergers is the ability to reassess the acquiring company’s own capabilities. A close encounter with another business through a merger can sharpen understanding and raise awareness of, for example, the way similar companies run their logistics processes.

What’s more, a merger is a good forcing device for learning that costs can be cut even without a merger. Our research showed that stand-alone cost improvements achieved in the merger partner’s operations exceeded expectations 14 percent of the time, while stand-alone cost improvements in the acquirer’s operations exceeded expectations 26 percent of the time—nearly twice as often.

Mergers should therefore be seen as an opportunity for a company to know itself better and to apply that knowledge productively. One hallmark of a healthy merger is that a wiser company emerges from it.

Merger integration is now much more sophisticated than it was 10 and certainly 20 years ago. But while many combinations extract short-term financial synergies efficiently, they may ultimately fall short of creating a truly healthy new company with strong brands and customer relationships, motivated employees, and a thirst for innovation. By concentrating on five issues—the top team, the corporate story, a performance culture, external stakeholders, and integration-specific learning—CEOs and senior managers will improve their chances of attaining this elusive goal.

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Notes
1 Besides in-depth interviews with almost 30 CEO “merger veterans,” the conclusions of this article are based on an analysis of 78 percent of all postmerger-management assignments completed by McKinsey in all industries and all countries from 1996 to 2001. For each merger analyzed, consultants completed a questionnaire with more than 400 individual items that covered all aspects of mergers, from the formulation of strategy to integration. The performance of the mergers was assessed against many objective and subjective criteria.