Chapter One

The Elusive Equation

One plus one equals three. Billions of dollars and millions of jobs hinge on fulfilling this equation and the hope that a combination of two organizations can produce something more than the sum of the parts. Whether it's called synergy or leverage, the prospect of creating value through a combination is touted vigorously in boardrooms and executive suites where top managers and their financial, legal, and strategic advisers conjure up and put together deals.

The concept is alluring: combine the strengths of two organizations to achieve strategic and financial objectives that neither side could accomplish as easily or affordably on its own. The reality, however, is often woeful: up to three-quarters of corporate combinations fail to attain projected business results.[1] In fact, most produce higher-than-expected costs and lower-than-acceptable returns. Meanwhile, executive time and operating capital are diverted from internal growth; morale, productivity, and quality often plummet; talented crew members jump ship; and customers go elsewhere. In the great majority of combinations, one plus one yields less than two.

Why do they fare so badly?

Price is a factor. If you pay too much to buy a company or join a partner, the resulting debt load requires massive cost cutting that prevents companies from investing in innovation and growth. Naturally, a flawed business strategy and poor choice of partner can also destroy value. Several studies find that an ill-conceived strategy and inadequate due diligence undermine even sensibly priced combinations.[2] Our own research program spanning more than thirty years documents how mismanaged human, organizational, and cultural dynamics on one or both sides can also spell doom. As executives compete for top appointments and clout, as functions do battle over procedures and turf, and as employees angle for better opportunities (or simply to keep their jobs), even well-intentioned pledges of camaraderie and fair play give way to self-promotion and flank protection.

Of course, planning makes a difference. Bankers, lawyers, and industry consultants can variously help executives gauge whom to partner with or buy, how much to spend, how to structure the transaction, and where to position a new mix of products or services in the marketplace. But when it comes to sorting out who gets which jobs, deciding whose methods and systems to use, and actually shaping a combined company culture that will create value, plans don't make or break the combination. It is fundamentally up to the two managements to make their deal work.

From the outset, let us face squarely the reality that most mergers, acquisitions, and alliances have human costs. Stress levels can be acute, and workloads exhausting; former colleagues may be fired and careers derailed; corporate cultures often clash; new structures may not align; and selected systems might fail to mesh. These are the typical, predictable, and troubling trials that people face when they join in a combination. Managers have to work their way through myriad traumas and tribulations to achieve a combined organization that is more competitive, efficient, and effective than its prior components. As one senior executive we worked with put it, "Buying is fun; merging is hell."

But the upside is enormous. Certainly megamergers grab all of the headlines and for good reason: these give companies the scale and scope needed to compete on a global playing field. But the real growth story in the past decade is how top companies like GE, Johnson & Johnson, IBM, Cisco, Tata, and others have adopted what Booz & Company call a "merganic" strategy—a combination of organic and M&A-based growth.[3] This translates into building businesses through smaller, focused, and rapid-fire deals in current or adjacent markets, or by acquiring complementary technologies and product lines.

This book shows how to make one plus one equal three. Our focus here is not on financing deals, the legal ins and outs, or corporate strategy per se, but rather on the flesh-and-blood factors that make combinations succeed. Using principles and practices derived from successful cases, we describe why and how executives have joined forces successfully. We also select some unsuccessful cases, as these can be instructive and humbling. The companies we profile achieved their strategic and financial objectives by building productive capacities and by searching for and capitalizing on better ways of growing their businesses. They were led by executives who took care to understand what it takes to put companies together; united two groups of managers to plan for and build their new organization; and were sensitive to the human, organizational, and cultural issues that had to be addressed along the way. Most important, many of these executives used M&A to grow their businesses and create added value for their shareholders, customers, employees, and themselves.

M&A Scale and Scope

The global value of merger and acquisition (M&A) deals rose from US$462 billion in 1990 to over US$4.6 trillion in 2007, slowing the next two years with the financial meltdown. Who makes out financially on the deals? Acquired company shareholders typically do very well, especially in cases where the buyer pays a premium to forestall competitive bidding. By contrast, investors in buying firms frequently experience share price underperformance in the months following acquisition, with negligible long-term gains. Indeed, nearly two-thirds of companies lose market share in the first quarter after a merger; and by the third quarter, the figure jumps to 90 percent.[4]

Analyses reveal that there have been only modest improvements in the failure rates over the thirty years that serious research has been conducted on M&A performance.[5] We've noted how erring on *price*, *purpose*, and *partner* factors into failure. Our particular expertise is *process*—how companies set their M&A objectives, study and select a partner, prepare to combine, manage integration, handle people, and build the "postcombination" organization. Let's start then with the process of creating value through M&A.

Creating Value

Many motives prompt executives to acquire, merge, or forge alliances with another organization. Perhaps a combination can help a company to extend its product lines or gain a toehold in a new market where it is too costly, risky, or technologically advanced to do so on its own. Other times, deals are opportune, as when a competitor can be purchased to gain scale or scope, or opportunistic, as when an unwelcome bid puts an attractive company into play. Still other times, M&A can be a defensive move to protect market share in a declining or consolidating industry—or to avoid being swallowed up by someone else.

The overarching reason for combining with another organization is that the union promotes attainment of strategic goals more quickly and with less risk than if a company were to act independently. In this era of intense and turbulent change, when market niches open up quickly and whole industries transform on a global scale, combinations also enable two organizations to gain flexibility, leverage competencies, share resources, or create global reach.

Value is created when organizations join forces in a way that genuinely enhances the capacity of the combined organization to grow and prosper. To get one plus one to equal three, a combination must yield more than synergies based on cost savings and the elimination of redundancies. One study found that in 90 percent of all combinations, initiatives associated with generating revenue drove more value than any other action.[6] Increasing revenue by 1 percent has five times greater impact on the bottom line than decreasing operating expenses by 1 percent. Yet managers in most combinations spend the bulk of their time searching for ways to reduce operating expenses.

Strategy and Synergies

We have noted that M&A is not a strategy. It is a means for a company to achieve its strategy, whether that strategy is to firm up a competitive position in a consolidating market, add products to grow in the same or an adjacent market, move into new territories around the globe, or participate in an industry transformation. What are the synergies sought in M&A?

Economies and Cost Savings

Called "cost synergies," some of the biggest savings in M&A come from reducing payroll and personnel costs. One study finds that on average between 12 and 25 percent of their workforces can be expected to become redundant when two companies merge. Another study of large acquisitions finds that 88 percent of those in acquiring companies remain in their jobs while 64 percent in the target company stay.[7] This is one reason that Wall Street cheers when two companies combine: the short-term savings can be substantial.

The problems with doing a deal to cut payroll costs are multifold beginning with the fact that it doesn't take much business acumen to eliminate jobs and lay people off. The risks, of course, are that the most talented and thus most marketable people leave on their own accord and that the aftermath of downsizing leaves a workforce bitter, demotivated, and fearful—waiting for the next shoe to drop. Moreover, there is nothing distinctive or enduring about downsizing as a strategic move. Competitors, too, can cut staff if required, matching within months any cost advantages gained through downsizing.

There are, in addition, some one-shot savings in M&A that come from the disposal of idle assets, such as a redundant headquarters building, unused plant capacity, or excess inventories. More enduring are the financial gains associated with economies of scale, such as greater purchasing power vis-à-vis suppliers, and slimming down and eliminating intermediaries in a supply chain. In addition, there are financial synergies associated with a reduction in taxes, improvements in working capital, increased borrowing capacity, and the like.

In some instances, such as industry consolidations, these synergies alone may justify M&A activity. But in realizing these cost savings, merging companies risk both staff and customer defections. Moreover, the combined company itself may be in no better position to compete and grow. As our colleagues Philippe Haspeslagh and David Jemison point out, these "value capture" motives are not a sufficient motive for companies that seek "value creation" through M&A.[8]

Resource Combinations

A second set of synergies comes not from simply paring down the size of staff and functions but from configuring them in new ways through a combination. We will see, for example, how the alliance between Renault and Nissan created new value as the two sides shared auto platforms and parts and together built a new engine; contrast this with the merger of Daimler-Chrysler that foundered, in part, because the high-status lead company resisted combining resources with its lower-status partner. Or take the case of Hewlett-Packard and Compaq, which were in comparable markets, had many common products, and operated in a consolidating industry. Naturally, there was extensive cost cutting in this deal and some facilities were closed. But after thoroughly studying their respective strengths and weaknesses, cross-company integration teams worked to reconfigure product lines, preserve key Compaq technologies and brands, redesign sales and distribution channels, and integrate and improve the IT architecture for customers and employees. An "early win" for HP was securing a ten-year, $3 billion contract to provide IT services for Procter & Gamble. It took time, and recovery from some missteps, to mine other resource synergies in this case but the process was set in motion by a well-managed integration process.

A key resource synergy comes from the combination of people. The all-too-familiar scenario in M&A is that people experience "mushroom management"—they are kept in the dark, covered in manure, and ultimately canned. Throughout this volume we will describe an alternative approach of preparing people for a combination, engaging them in transition planning, and empowering them to build a new and better organization in their scope of responsibilities. The combination of Pfizer and Warner-Lambert, in which one of us participated, is a good example of how people can make a difference in the success of M&A. Pfizer intended initially to impose its practices on the target. But during the transition process, it experienced the benefits of some of its acquiree's ways of doing things. Ultimately, aided by interaction with its partner, Pfizer "loosened up" its comparatively rigid culture, sped up its formerly hierarchical and labored decision-making processes, and developed, with its partner, a new system of talent management. It also achieved cost savings of $1.4 billion within eighteen months while its stock outperformed the DJIA, S&P 500, and an index of peer companies.

Revenue Enhancement

Product and market extension deals, by their very nature, create new revenue sources—but this is often just a classic 1 + 1 = 2 proposition with perhaps some cost synergies adding fractional value. Creative integration, however, allows partners to gain more:

- Increase pricing power based on larger size
- Leverage a larger customer base or target countries for export
- Cross-sell products and services
- Streamline marketing and reduce agency costs
- Realize faster and better product development through combined R&D departments

All of these revenue enhancements hinge on holding on to talent and customers and sensibly integrating functions and staff. P&G's acquisition of Gillette, as an example, joined companies selling noncompeting products in related market channels. Warren Buffet, chairman and CEO of Berkshire Hathaway, described it as a "dream deal": "This merger is going to create the greatest consumer products company in the world." To do so, however, would require technology transfer across the two companies. A P&G manager described one aspect of this exchange:

> For those who have been at P&G, there are a number of significant events that have shaped the way they think (such as Deming, Covey, Monitor, Consumer is Boss, etc.). We need to figure out a way to quickly share these frameworks with those joining P&G. This should also include business processes. At P&G people understand them and they are second nature. We need to make them very transparent to those joining P&G from Gillette. We also need to be patient, realizing the time it takes to learn all these systems. Hopefully, Gillette employees will see them as a way to leverage their horsepower versus as a hindrance.

New Knowledge and Capabilities

Perhaps nowhere is it more important to transfer knowledge and capabilities than in fast-moving fields of info-, nano-, and biotechnology. Companies like Cisco and IBM use acquisitions as a form of R&D. They then create value by linking small firms together to build a business line. Google's acquisition of AdMob gave consumers enhanced capability to browse the Internet with handheld devices; Electronic Art's acquisition of Playfish enabled it to distribute computer games electronically and thrive in the growth market of social gaming. But the success of both of these deals hinged on the two sides working together to improve and scale new technologies.

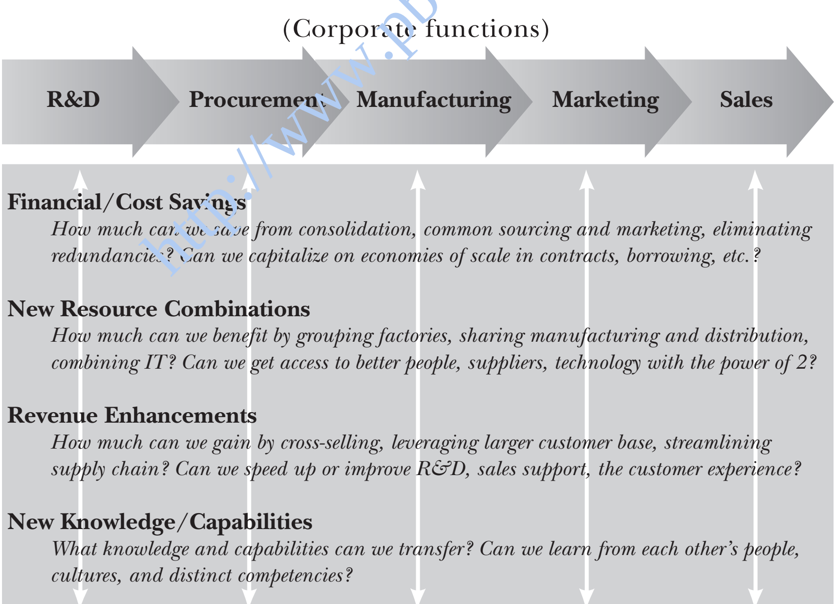
In synergies of this type, it is not enough for an acquirer to "buy" a technology; rather, it has to nurture the people behind it and integrate their knowledge into the combined business. Plans, programs, blueprints, and the like can be bought and transferred from one company to another. But what's involved here is the exchange of tacit knowledge—the experience and judgment that resides within individuals and, often, within a set of relationships among people. The research is clear that the exchange of tacit knowledge between partners in a combination takes a long time and depends on the development of mutual trust and rapport.[9] Interestingly, retention of senior managers may be less important as compared to holding on to top technologists.

Searching for Synergies

The search for synergies is a crucial part of every phase of M&A—from translating business strategy into M&A objectives, to searching for a partner, to planning and implementing integration, to nurturing the combination over the longer term. A few years ago, one of us received a call from the CEO of a computer products company. His firm had a solid niche in the high-margin, high-end range of the market but growth was in the low-margin, low-end segment. The CEO had listened to advisers who warned that internal growth would take too long and made an acquisition of a firm operating in the lower end. Shortly after the deal's announcement, and on their own initiative, several senior executives from the acquiring company spent a weekend holed up in a conference room where they hammered out what they called the "Integration Plan." When the CEO read the plan he found that, among other things, it called for the elimination of the to-be-acquired firm's R&D function. That's when he gave a call. "Think about it," the CEO said, "eliminating their R&D function would defeat the very purpose for doing the deal—it would eliminate all the engineers with expertise in the low end of the product line." The next step, accordingly, was to bring managers together to review the acquisition strategy and to make sure everyone was on the same page about the key synergies in this deal.

Figure 1.1 shows four classes of synergies in a combination matched up against key functions in a firm's value chain. Smart companies search for these synergies at every step of the chain. R&D, as noted, can be a rich source for knowledge transfer synergies. Boston Scientific's purchase of Guidant was described as a

Figure 1.1. Searching for Synergies in M&A.



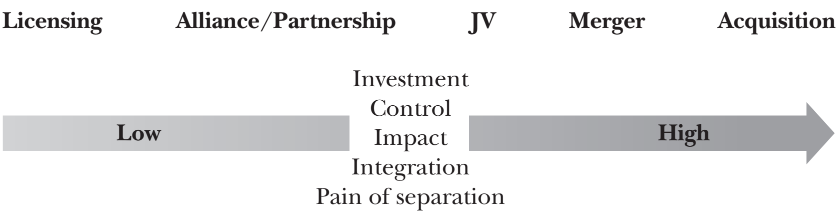
"deal from hell" when first announced but the parent has nurtured its subsidiary R&D to the point that it is now a global leader in medical stents. Procurement and manufacturing are areas for cost savings. One study of multiple combinations estimates the range in savings from M&A to be increasingly significant as you progress from raw material procurement (4–12 percent), to components (4–17 percent), to production costs (5–20 percent).[10] More significant can be the benefits of knowledge-transfer in manufacturing, as we will show in the Renault-Nissan case.

In the marketing end, the full range of synergies is present. We'll see P&G, Pfizer, and Unilever mining these possibilities throughout this volume. How you brand the combination can also be a source of value creation. When SBC Global acquired AT&T, for instance, it adopted the acquiree's name. Why? CoreBrand, a communication firm that studies brand equity, estimated that the AT&T name alone was worth $2.4 billion at the time. Finally, cost and resource synergies can be found throughout the corporate functions in a combined company. The template of synergies by functions helps companies to think about value capture and value creation in every phase of their dealings.

Combination Forms

Organizations can link together in many forms of legal combinations, ranging from a relatively informal network to outright absorption of one entity by another. The kinds of combination vary by the depth of commitment and level of investment between the organizations joining forces (Figure 1.2). At the lower end of the continuum is the relatively simple relationship of organization A *licensing* a product, service, or trademark to organization B. Next, a *strategic alliance* is a cooperative effort by two or more entities in pursuit of their own strategic objectives. A *joint venture* (JV) goes further, by establishing a complete and separate formal organization with its own structure, governance, workforce, procedures, policies, and culture—while the predecessor companies still exist. At the far end of the continuum are mergers and acquisitions. A *merger* usually involves the full combination of two previously separate organizations into a third (new) entity. An *acquisition* typically is the purchase of one organization for incorporation into the parent firm.

Figure 1.2. Types of Strategic Combinations.



Important differences distinguish these forms. Financial investment and risk increase along the continuum, as shown in Figure 1.2, but so does the control held by the lead company. Along this same line, the impact on the target company or lesser partner grows, as do the requirements for integration. If, for whatever reason, a combination does not live up to expectations (or if the needs of either party change), then the formal bonds of a merger or acquisition are much more difficult to undo than are the relatively time-bound and looser ties of an alliance or JV.

These forms of combination differ in psychological as well as legal and financial terms. In an alliance, for instance, you do not own the other company, nor do you unilaterally control decision making. So key questions need answers: Where is the authority? Who has more power? The alliance between Disney and Pixar was fraught with conflict over these answers. Merger implies some level of cooperation between companies, but what may be announced as a merger is rarely perceived as being a combination of equals by the members of at least one of the partnering organizations. People from one side are likely to feel a sense of superiority and greater entitlement, while those from the other side may see themselves in a relatively weak position and perceive threat to themselves and their way of doing things.

Psychologists Sue Cartwright and Cary Cooper use the metaphor of marriage in describing varying types of combinations.[11] They liken an alliance to two people living together; the partnering organizations accept each other as they are and maintain their independence. In a traditional corporate marriage, by contrast, one partner assumes a more dominant role—although there may be considerable debate as to which partner perceives that role as rightfully its own. In these cases, differences in style and culture identified early in the courtship are apt to be regarded as novel and may even enhance the attractiveness of the partner. However, once the contract is legalized, the dominant partner "conforms" the acquired firm to its structure and culture. And, as happens in many marriages, this is likely to be resisted, passively or aggressively.

What Cartwright and Cooper call a "modern marriage" is still the rarest but most desirable way to join forces. Each side brings distinct strengths and characteristics that, when combined, produce synergies. The essence of this modern organizational marriage is shared learning: the partners are stronger and more successful together than if they continue to operate separately. Differences in organizational procedures or cultures are seen as potentially adding value to the partnership and are respected and built upon as their partnership unfolds.

Combining Organizations and Cultures

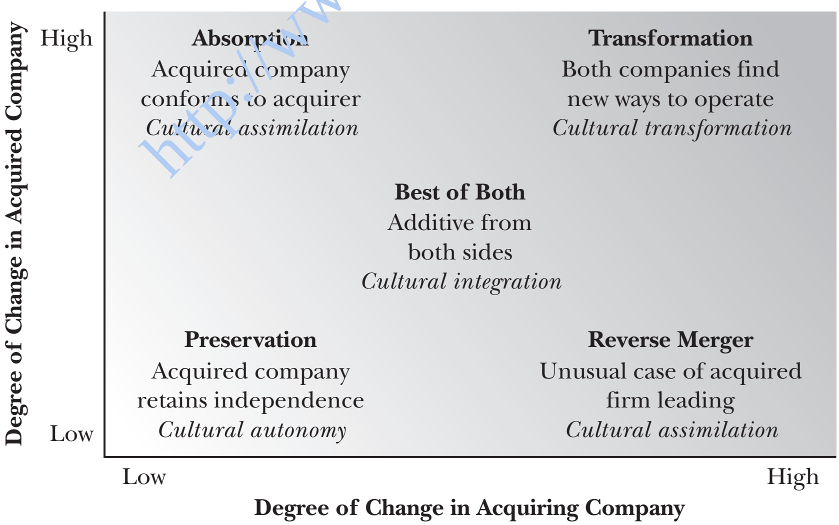
At the broadest level, senior executives need to decide how much to integrate two firms in a combination. When it comes to putting together, say, manufacturing or marketing, the synergies therein may dictate different levels of integration. For instance, in many high-tech acquisitions, marketing and sales in a subsidiary are absorbed into the parent company—which often has more competence and better distribution channels. But the acquiree's engineering and manufacturing may be given high levels of autonomy to "do their thing." In health care combinations, back office functions may be consolidated, and systems and procedures standardized, but the delivery of care is left to each of the providers. In oil industry mergers, in turn, refining and distribution are often consolidated yet each company's dealerships and brand kept separate. In all of these cases, decisions about integration ought to hinge on the impact on value creation.

In the same way, there needs to be a "business case" for combining cultures. It is very likely that senior executives will see a need for a common and unified culture in some areas of the combination and for more pluralism in others, as in the high-tech, health care, and oil industry examples above. Occasionally, executives will be ready to articulate their case for combining cultures; more frequently, however, they will need prodding to make explicit what has been implicit in their thinking about the combined organization. Four “end states” need consideration:

1. Where the lead or parent company’s culture will prevail
2. Where the partner’s cultural autonomy will be honored
3. Where the two sides’ cultures will be blended
4. Where new cultural themes need to be developed through a transformational process

In our opinion, companies joining forces need a high-level vision of this end state before agreeing to a deal. That way decisions about how to put manufacturing, marketing, and other functions together can be weighed against the desired end state. However, executives do not need to have an intricate or fully worked out cultural end state from the get-go. To the contrary, combination partners learn a lot about each other and their cultures only after they work together and the two sides become better acquainted. Figure 1.3 shows a grid of different

Figure 1.3. Define the End State.



organizational and cultural end states that can help executives to think through their options and clarify their intentions for the combined organization.

- *Preservation.* This is the case where the acquired company faces only a modest degree of integration and retains its ways of doing business. This end state is desirable in diversified companies that promote cultural pluralism among business units and in acquisitions where the intent is to secure and build on human and social capital. To succeed, parent company management has to protect the boundary of the subsidiary, limit intrusions by its corporate staff, and minimize conformance to its rules and systems. Strategic synergies generated in a preservative combination come from the eventual cross-pollination of people and their work on joint programs.
- *Absorption.* Here the acquired company is absorbed by a parent and assimilated into its culture. This is the classic model used by GE Capital and, until recently, by Cisco—companies that regularly buy and culturally assimilate small companies. Lead companies often have to bring in new management in these cases and conform the target to corporate reporting relationships and regimens. This end state is often workable in horizontal mergers that join companies in the same industry. Acquisitions in the U.S. airline industry, such as Delta's absorption of Northwest, are classic examples.
- *Reverse takeover.* This is the mirror image of the absorption combination. Here the buyer wants to adopt the ways of the seller. The acquired company dictates the terms of the combination and effects cultural change in the lead company. When this unusual type of combination occurs, it typically involves an acquired business unit or division absorbing the operations of a parallel unit in an acquirer. For example, REO Motor Company acquired Nuclear Consultants and, ultimately, folded its operations into the acquiree that became the modern-day Nucor.
- *The Best of both.* This is the case of achieving synergy between companies through their partial to full integration.

Geographical expansions or roll-ups in fragmented industries often seek this end state. Historically, these additive kinds of combination tend to be more successful than others—but also bloodier. Financial and operational synergies are achieved by consolidation. This means crunching functions together and often leads to reductions in force. The optimal result is full cultural integration—the blending of both companies' policies and practices. The "merger of equals" between SmithKline and Beecham (and of these with Glaxo Wellcome to form GlaxoSmithKline) and the combination of Canada's Molson Breweries with Australia's Carling O'Keefe are examples.

- *Transformation.* Here both companies undergo fundamental change following their combination. This end state is desired when an industry is radically evolving or emerging. Synergies come not simply from reorganizing the businesses, but from reinventing the company. This is the trickiest of all the combination types and requires a significant investment and inventive management. Transformation poses a sharp break from the past. Existing practices and routines must be abandoned and new ones discovered and developed. In the integration of Pfizer Incorporated's Animal Health Group and SmithKline Beecham's animal pharmaceutical business in Europe, two orthodox country-centric operations were transformed into a new organization aligned with the realities of the European Community. Traditional country-specific structures and cultures were broken down and forged into a pan-European strategy, structure, team, and identity as the pre-combination parties merged.

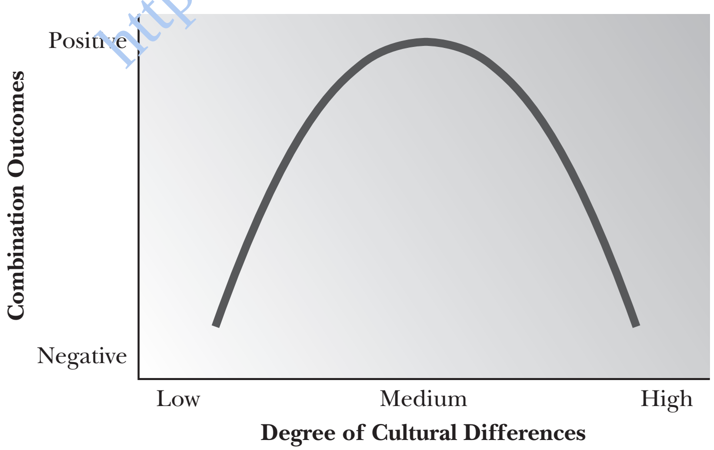
Cultural Fit

Culture is a lot like breathing: you don't think about breathing, you just do it. You may be aware of your breathing now, because it's been raised to your attention. But if someone came up from behind, cupped their hands firmly around your mouth and nostrils, and threatened your ability to breathe, then you would certainly pay attention to breathing. The same holds true for a culture clash in a corporate combination. People don't regularly notice their corporate culture, but when thrust into a merger, employees become aware of how their ways of doing things differ from those of the other side. When they feel threatened by a combination—often because they see themselves on the weaker side—employees not only see differences but also feel a sense of vulnerability and fear over losing their accustomed way of doing business.

Just as an organization cannot effectively run with multiple incompatible information systems, it cannot succeed with multiple incompatible cultures. The key is to get people in the lead company to act not like missionaries landing in the new world with the intent to convert the heathens to religion, but like diplomats who are charged with bringing disparate factions together. Companies like Scheering, BP, and AT&T now proactively alert managers to the fact that culture clash is inevitable and prepare them with steps that can be taken to minimize its impact.

Keep in mind that successful combinations do not require the partners to be "cultural clones." In fact, a moderate degree of distinction between the partners' cultures usually results in the most successful integrations—the parties have enough similarities to take advantage of the differences, but they are not so disparate as to be like "oil and water." As depicted in Figure 1.4, a moderate

Figure 1.4. Cultural Differences and Combination Outcomes.



degree of cultural distinctiveness can be a source of creativity and synergy in combinations. If it were possible to find two organizations with completely identical cultures and values guiding their behavior, the combined organization would at best be no better than the sum of the parts. Although too much distinction in underlying values and ways of approaching work is unhealthy, the best alliances and acquisitions occur when a fair amount of culture clash prompts positive debate about what is best for the combined organization. Ideally, this debate includes consideration of cultural norms that may not be present in either organization separately but that may be desirable for the combined organization.

The Human Side of M&A

Employees in combining organizations often find themselves working harder but not smarter. One likened his situation to that of a chicken with its head cut off, frantically moving about with no sense of direction or hope for survival. Another talked of struggling to keep her head above water; she knew what to do but was weighed down by a heavy workload. Compounding the sheer volume of work confronting people in a combination is a lack of prioritization of what to tackle first. Role ambiguity can paralyze people in combinations, too. They wonder who is responsible for what and whom to go to for which decisions.

What most strains survivors of combinations is the perceived loss of control over their working lives. No matter how well you have performed on the job, your track record can be meaningless, and your employment taken away—if not in the combination, then in a subsequent downsizing. Interviewed a year after his telecommunications company was acquired, a midlevel marketing manager articulated this control issue: "I used to think that if I did my job well, completed my projects on time and in budget, I would be able to control my fate. That's no longer true. This merger is bigger than I am. I've seen other managers from our side—people who clearly were good, if not excellent, performers—get the shaft. I didn't ask to be acquired, but now my track record doesn't count for anything. I'm at the mercy of some bureaucrat at headquarters. I'm no longer the master of my own fate."

In a combination, one of the few areas that employees feel they have control over is whether to stay or leave the company. The best and the brightest among the workforce—those with the skills and experience in greatest demand—are the most marketable and most likely to walk away. Recruiters swarm over companies engaged in combinations; talented employees are vulnerable to poaching competitors. Therefore, mismanaged combinations have the potential to destroy a firm's human capital. As an experienced merger manager notes, "An organization can burn down and be rebuilt. If you run out of money, you may be able to borrow more. But, if you lose people, you're dead." Loss of expertise and the departure of key role models further demotivates remaining employees.

The impact of a poorly managed combination lingers for years. It is measured in the drain on both human resources and operational results. "Survivor guilt," a well-documented reaction to reductions in the workforce, leaves employees feeling culpable for having been spared and depressed at their inability to avert future layoffs.[12] If faithful employees feel that layoffs are unfair, their loyalty drops more sharply than that of less-committed survivors.[13] Insensitive dismissals also hurt a firm's reputation, making future recruitment more difficult.

Since the publication of our previous books on this topic, employees' perceptions of loss of control have been intensified by the multiple transitions experienced in many workplaces—an acquisition followed by a downsizing, then a restructuring, changes in leadership, a new strategy, and perhaps another restructuring and reduction in force. All of this leads to "change fatigue" that translates into cynicism about management and robotic responses to the next change initiative. According to one combination veteran, these psychological and behavioral reactions to a combination prompt many employees to "withdraw their personal and professional power from their jobs, while making it look like they're still working." People's bodies show up at work, but not their hearts and souls. As executives exhort their employees to boost productivity, enhance quality, and be more globally competitive, many simply respond with a shrug.

Transition Management

There is no one best way to manage a merger, acquisition, or alliance. Personalities, product profiles, and procedures vary from one combination to another, making a one-size-fits-all prescription for achieving success ill-advised. The objectives in one deal may call for expedient implementation, those in another a more cautious approach. Nevertheless, there are some practical theories regarding transition management that apply in almost every case.

Stages of Change

To begin, successful combinations build on one of the simplest yet most helpful models of organizational change: the three steps of *unfreezing, changing,* and *refreezing* introduced by social psychologist Kurt Lewin.[14] Suppose that your target for change is not an organization or individual, but an ice cube. If you want to convert the cube to another shape, you can proceed in one of two ways. The first is to use a hammer and chisel; with the right skill, you can transform the ice cube into the shape of a cylinder. But there's a cost to this approach: you lose a lot of ice as the cube is chiseled. The alternative is to unfreeze the ice cube, change its mold to that of a cylinder, and refreeze it. Unless you're clumsy in pouring unfrozen water from one mold to the other, you gain the desired cylinder with no loss of volume.

With organizations involved in M&A, then, the first step in the process of change is to unfreeze present behaviors or attitudes. The deal itself shakes things up, but it takes a compelling rationale for joining forces along with information and education on the disadvantages of the status quo to unfreeze mind-sets. Still, companies, like people, are reluctant to abandon habits and accustomed ways. This is why we recommend that people be engaged, early on, in fact-finding about current realities, collectively search for synergies, and prepare themselves emotionally for the combination. We term this *strategic and psychological preparation.*

The second step is moving the two organizations from their original state to a new one. This means, for example, delineating the principles that govern the combination, defining the values that will be embodied in the end state, and stating what behaviors will and will not be tolerated as the two firms combine—and then walking the talk! The companies move toward combination as the two sides plan and take steps to, for example, leverage each other's technology, strengthen the customer service culture, devise a leaner organizational structure, deploy new work processes, or select people with the skills and capabilities required to achieve new objectives. Recognize, however, that although senior executives design the new mold, it is business and functional managers, and everyday employees, who have to do the pouring and manage the inevitable spillage.

The third step, refreezing, reinforces and locks desired behaviors or mind-sets into the combined organization. This means aligning structures and systems, performance targets and incentives, and action with intentions to support the desired end state and strategic goals. This refreezing creates what Lewin characterized as a new "quasi-stationary equilibrium." Alas, few companies can savor such a steady state for long, as new opportunities and problems, and new deals and combination prospects, beckon. Perhaps a better analogy is to a muscle. Muscles that are well exercised and fit are ready when you need them. In this regard, Larry Bossidy, CEO of Allied-Signal, argues that no one is better prepared to handle complex change than a company that has managed it successfully in the past.

Although the unfreezing-changing-refreezing model is simple to imagine, it is difficult to implement. We will see here how General Electric, as one example, developed a robust model of change applied to M&A that starts in the preacquisition period and extends through to the assimilation of acquired companies. GE's managers are trained in this process and work with counterparts at the fabled Jack Welch Learning Center in Crotonville, New York, to plan and implement their deals. But this is the exception; too often companies simply call on external consultants to lead their transition and use off-the-shelf change management tools. As a result, transition management in M&A is typically no better, and often worse, than the garden variety change programs that operate in companies. A production supervisor, expressing a common sentiment, labeled it BOHICA when it was announced her company was to be acquired—Bend Over Here It Comes Again!

Psychology of Adaptation

Theories of personal change follow the Lewinian logic but focus on the psychological mechanisms of adapting to endings, transition, and new beginnings.[15] People have to loosen their grips on the old before they can accept the new, yet there is a dynamic tension posed by endings—between "hanging on" versus "letting go" of the past. As psychologist Harry Levinson points out, "all change is loss."[16] People often lose identification with their former organization in an acquisition or merger, and lose their ties to colleagues who retire early, leave voluntarily, or are laid off. Even the seeming winners have to cope with uncertainty and loss of familiar methods and routines. In almost every successful combination we have worked with or observed, management has taken steps to help people let go of the past through activities as varied as grieving meetings, rap sessions, and ritual burials of memorabilia.

When it comes to change itself, leaders of combining organizations have to contend with people who may be carrying "baggage" from previously mismanaged deals and downsizings, reengineerings, and other types of change initiatives. Straight talk and active involvement in the combination process are the best means to counter cynics and rekindle people's desires to be on a winning team. We will see, in later chapters, how to set a proper pace for the combination that generates some "quick wins" while giving people more time to study and develop options for longer-term value creation.

Finally, when it comes to new beginnings what is most crucial is "reculturation." New jobs, roles, team members, organizational structures, systems, and such, and new leaders will all change in a matter of months or years. A new culture, by comparison, takes longer to build but provides a more enduring basis of purpose and value to which people can attach themselves. The work of building this new culture starts with defining the end state and nurturing it into being. Woe to companies that don't fully attend to acculturation and the psychology of adaptation—as the cautionary tale that closes this chapter warns.

A Cautionary Tale

The strategy behind Unilever's acquisition of Ben & Jerry's was sound. But the process of integration was not well conceived and the combination foundered for a few years. The story of the founding and growth of B&J's has been well chronicled.[17] The key points are that the founders are ex-hippies who introduced such flavors as Cherry Garcia (named after the Grateful Dead's founder), along with Coffee Heath Bar, Chunky Monkey, and other add-in flavors to the super-premium category of ice cream. They are also "social entrepreneurs," fabled for their support for community interests and creative cause-related marketing. After thirty-plus years of growth, the company hit a wall, and received unsolicited takeover bids from several large, multinational corporations. Unilever entered the fray and bought the company with a tender offer that was a 25 percent premium over the current stock price.

Buying Values

This is only one of many examples from the past few years of large companies acquiring smaller businesses because of their strong brand presence among consumers who favor them not only for their products, but also because of their commitments to corporate social responsibility (CSR). Other CSR-driven acquisitions include the Body Shop by L'Oréal, Tom's of Maine by Colgate-Palmolive, Stonyfield Farm by Groupe Danone, and confectioner Green & Black's by Cadbury Schweppes.

There is, not surprisingly, considerable debate about the gap between people's expressed interest and actual buying behavior in these regards, and certainly as to whether consumers will pay a premium for such goods and services.[18] Still, it is well documented that a firm's social credentials can help differentiate its brands, that consumers will switch brands based on CSR issues, and that when they know about a firm's bona fides in this area, it is a factor in purchasing decisions. Indeed, evidence is that when a product's social content aligns with their consumers' personal interests, it can be decisive in building brand loyalty.[19]

A key question: Are these acquisitions about buying *brands* to gain in a growing market segment? Or about buying *companies* whose DNA will continue to infuse their own offerings and, perhaps, inform how its new owners do business? Evidence suggests that the Body Shop, Tom's, and Green & Black deals have been configured as "preservative" acquisitions. They operate as more or less stand-alone business units with new owners exercising financial oversight and exerting some strategic control. By contrast, teams from Stonyfield and Danone worked together to combine the "best of both" in areas of sourcing and product development.[20]

Ben & Jerry's integration into Unilever was, by comparison, a mixed model. It kept its marketing autonomy, but in several areas (for example, finance, IT, communications, sales, and, crucially, manufacturing), Unilever effected an "absorptive" integration. After a brief period when, under agreement, no changes could be implemented, Unilever undertook layoffs at the B&J headquarters, converted B&J's fun-and-funky Web site to corporate control, and installed one of its own marketers as general manager. The impact was negative: long-service employees who were not laid off left anyway; Ben and Jerry refused to put their personal likenesses and messages on the corporatized Web site; and the new GM, though greeted with a festive B&J parade, was viewed by some as an interloper.

To make matters worse, the main manufacturing plant—and site of the brand building and the #1 Vermont tourist attraction factory tour—was severed from B&J control and reported into Unilever's North American Ice Cream division in Green Bay, Wisconsin. This began months of political power plays where the ice cream division modified ingredients, challenged longstanding commitments to pay dairy farmers a premium to sustain them through tough times, fought against further use of organic and fair trade ingredients, and pushed constantly to increase margins. Their justification: B&J's product costs, particularly compared to Good Humor and Breyers, the other brands in Unilever's North America ice cream portfolio, were simply too high.

This integration model yielded financial synergies, but over the next two years produced other costs including lower morale, quality problems, a loss of innovativeness, and more. It also created friction that manifested in a culture clash.

Cultural Clash

Unilever's pedigree in CSR dates from its founding in the 1880s by social entrepreneur William Hesketh Leaver.[21] But cultural compatibility wasn't evident to B&Jer's. One commented, "When I started here it seemed like the product and social missions were upfront and the economic mission took care of itself. Now it's all about money ....” Another added, “The cultures of Green Bay and here [Burlington, Vermont] are night and day.”

A more nuanced look at the cultural fit in this case suggests that Unilever was a compatible parent for growing the B&J brand, but that the ice cream division was not a good place to situate the people that make it! As one B&Jer described it, “They didn't figure out that they spend millions on advertising to sell products and that while we spend a little more on ingredients we get a ton of free press out of our social mission ....” The hitch? None of those savings on advertising went into the North American Ice Cream division's P&L.

Learning Together

Then, as sometimes happens in a combination when the two sides learn from each other, things began to change. For one, Unilever's GM on the scene came to see the value of and become socialized in B&J's ways; subsequently he used his influence to gain the acquiree more sway in recipes and sourcing decisions. Second, the parent company learned the hard way about the vagaries of social capitalism in the United States. The Green Bay team had “pooh-poohed” B&J's warnings about growing activism over “battery cage” chickens. When NGOs began to protest the use of eggs from tortured hens, however, higher-ups in Unilever took notice, heeded B&J's advice on ingredients, and began to pay closer attention to what its subsidiary had to say about other aspects of socially responsible business.

Finally, B&J got a new CEO, or self-styled Chief Euphoria Officer, Walt Freese, who had been GM at CSR pioneer Celestial Seasonings and was savvy to corporate mores. Freese put together a “managers of managers” team, or MOM, that spent the next years effecting a reculturation of their company. This included reengaging Ben and Jerry in company campaigns and rehiring select flavor specialists and cause marketers. Soon thereafter B&J, in partnership with the Dave Matthews Band and SaveOurEnvironment.org, launched a “moo-vement to lick global warming.”

Today there is good two-way learning between B&J and Unilever. B&J has learned a lot from its parent on global sourcing and the localized marketing of "fair trade" products. Unilever, in turn, has imported some "fun and funk" into its marketing of other brands. Most significantly, B&J now reports into a new North American marketing group and its factory is reconnected to its headquarters. Reflecting on recent developments, one B&Jer remarked, "It's almost like we're using the social mission to drive the business again." These developments would reclassify Ben & Jerry into a more "transformative" acquisition—where both parties are being transformed by their partnership.[22]

Making One Plus One Equal Three

Our work as researchers and advisers to executives leading the M&A process over the past thirty years has identified insights relevant to all combinations—be they large or small, friendly or hostile, absorptive or transformational. In this volume, we summarize these findings from over a hundred combinations along with the lessons learned from other scholars and consultants who have studied and documented the M&A process. In the next chapter, we examine why so many deals fall short of their financial objectives with the conclusion that actions taken at each of the three phases of a deal—precombination, combination, and postcombination—have a profound impact on M&A results. We then review each phase's strategic, organizational, human, cultural, and transition management actions that matter most in eventual combination success.

Part Two addresses strategic and operational preparation (Chapter Three) in the *precombination phase* along with the psychological and cultural dimensions of doing a deal (Chapter Four). Part Three describes leadership (Chapter Five) and transition management (Chapter Six) of the M&A process in the *combination phase*, with detail on managing people through the transition (Chapter Seven) and minimizing the inevitable clash of cultures (Chapter Eight). Part Four shows what it takes to translate a deal's potential synergies into real enhancements in building the *postcombination* organization and culture (Chapter Nine) and joining together people and teams (Chapter Ten), and, when things don't work out as desired, how to recover from missteps and reroute a combination toward success (Chapter

Eleven). Finally, Part Five tells how companies track the progress of M&A and its impact on organizations and people (Chapter Twelve) and learn from past or current deals to build a core competency to better manage future ones (Chapter Thirteen). As we will see, these are the companies that truly succeed in using M&A to achieve their financial and strategic objectives.

Although we believe that combination management can benefit from the insights generated by ourselves and others, our ultimate objective is to help people be more aware of and skilled in managing the M&A process to create value.