The CEO Refresher

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Look Beyond Value Creation When Considering Potential of Success in a Merger

by Stephen M. Dent

The most critical aspect of planning a merger is making sure the two organizations are the right business combination. While it seems obvious that this would be necessary for success, the fact is many companies do not determine up front whether their cultures and operating models are compatible. In addition, individuals must be compatible or, at a minimum, have an agreement as to their behavioral expectations.

Numerous studies by research and analyst firms over the last decade reveal that from 50 to 80 percent of mergers fail to produce the expected value, and these incompatibilities are a major cause of failure.

A merger is a game-changer in that it quickly re-positions the executive suite and organizations in the marketplace. A merger strategy fits well with the corporate push to accelerate growth and acquire products and services that decrease time to market with new competitive offerings. But a merger carries a high degree of risk and, if it fails, can greatly damage both companies. This was the concern of two companies in the food and beverage industry when they retained me as a consultant for their potential merger.

Preliminary Due Diligence

Both companies are very different but, on the face of it, this appeared to be a merger of equals with much synergy in their product lines. One company manufacturers sports energy drinks and is looking for a lower-cost source of fruit ingredients as well as a more cost-effective way to distribute its product. This company excels in innovative product development. The other company sells high-protein energy bars with fruit as an ingredient and had been looking to expand its product line to include healthy beverages. It excels in sales and marketing.

Both are profitable businesses operating in neighboring regions of the United States. While the transactional relationship seemed to be a perfect match with each enabling the other to accomplish more, the CEO of the energy-drink company had doubts. He was proud of the business culture his company had forged and wanted to maintain the high level of employee involvement, product quality, and community philanthropy it had achieved.

The two companies considered their merger for a number of months and engaged in some due diligence on various operational aspects and marketing opportunities. Both are small, family-owned businesses that value honesty and mutual respect and have strong business principles. They discussed the fact that both use their family-centric cultures to differentiate themselves in a highly commoditized and mega-company business arena and believe this is a key factor in their ability to compete with larger enterprises.

Their intent was to merge but keep the leaders of both family businesses in their existing positions over what would become the two divisions of the merged company. Preliminary discussions reinforced both companies' belief that there were future growth opportunities by combining their product lines and expanding into other markets. They also saw value creation in building on each other's core expertise, as well as leveraging their combined economies of scale to achieve a lower cost when purchasing the fruit for their products and in distributing their products jointly.

However, it is essential, when considering a potential merger, to look beyond how two companies will create new value and be better able to compete in the marketplace by combining their businesses. My role as a third-party consultant was to determine and enhance their chance for long-term success. Key initial components of the project included conducting cultural-fit and trust assessments at both organizations.

On the surface, from their preliminary due diligence, it appeared there would be a good fit between the two in their operations. For example, the two companies shared a similar communications approach that values open, honest, proactive oral communication. But the assessments we conducted revealed there were significant obstacles that they would need to overcome in order to successfully blend their businesses.

Shedding Light on the Real Issues

By exploring each other's business culture, they learned some issues that indicated significant business risk but that would never turn up on a CFO's report.

The first risk was that their decision-making styles are very dissimilar. The sports-drink company's CEO is collaborative and values others' expertise and input, to the point of encouraging dissenting opinions to his own viewpoints. He will often go to the sales people, production staff, and others to seek as much information as possible before moving forward, building collaboration and ownership of the decisions along the way. The president of the energy-bar company uses an informal decision-making process but limits it to the executive staff and reserves the final decision for him.

The differences in their conflict-resolution styles were another business cultural aspect that did not match. The sports-drink executive's focus is on finding commonality in issues and then negotiating to achieve a win-win outcome. The energy-bar company tends to debate every aspect of a decision, almost to the point of overkill; when decision time comes, they move to a compromise.

Another significant risk was a difference in their business attitudes. The sports-drink company operates formally, with a total-quality management philosophy, process maps, productivity measurements, and formal communication forums and feedback loops. Although the energy-bar company manages business carefully, it tends to have a more casual than formal approach. In a merged business, this difference would affect their interactions and their change-management processes and likely would cause management clashes.

In addition, potential conflict could arise because the energy-bar company values immediate transactions while the sports-drink company takes a long-term view of decisions.

A greater complicating cultural factor and obstacle to success was their vastly different perspectives on their employees. The sports-drink company places a high value on its workforce and is proud of its employees. It provides a generous compensation and benefits package and invests in employee-development programs. The company fosters teamwork and collaboration among its employees, as it believes this provides a competitive edge for customer service, innovation and developing new products.

In contrast, the energy-bar company takes a laissez-fair approach toward employees, perceiving them to be expendable commodities. It also wants to keep labor costs as low as possible. These differences in attitude toward value of employees would prevent these companies from working effectively together and would definitely make it difficult to remain aligned around business objectives that might impact employees.

Up-front Assessments Eliminate Potential Failure

The value of conducting cultural-fit and trust assessments is clear. Like many companies, these organizations' due-diligence discussions failed to identify their risks in merging their businesses. This is a common scenario; management sees a starry vision of growth and competitive advantage and seldom objectively considers all the potential weaknesses in the merged business.

The importance of doing up-front assessments of cultural fit, trust and other relationship elements to uncover risks that could cause a merger to fail cannot be overstated. Once contracts are signed, it's hard to change course. A better approach is to identify and mitigate known risks up front. In this particular case, the up-front assessments, analysis and follow-up discussions resulted in the companies deciding their differences in decision-making and conflict-resolution styles and their perspectives on valuing employees posed significant risks, and they decided not to merge.

To ensure objectivity and also provide insight into merger challenges, an independent consultant should facilitate the review of both companies and conduct the analysis of the assessment findings.

In addition to assessments, a holistic consulting approach will include developing strategic and tactical integration plans for the two companies, helping develop a strategic framework for the merged business, and providing management and team training to establish partnering behaviors that will support the merged business.

Key Learnings

1. Doing traditional due diligence is not enough. In the wrong environment, something that

looks good on paper can create disaster.

2. Organizations need complementary business cultures to sustain merged transactions. This does not mean they need to be identical; in fact, that may not work to the organizations' advantage. However, broad leadership and managerial philosophies must be compatible, or conflict will reign.
3. Get unbiased outsiders to analyze the cultures of companies considering merging. Internally, people are mesmerized by the transactional benefits and fail to see the incompatibilities that will impact the relationship long term.

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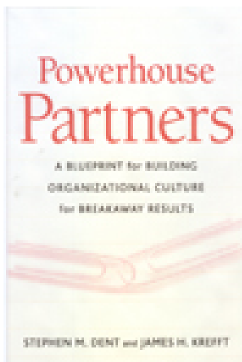

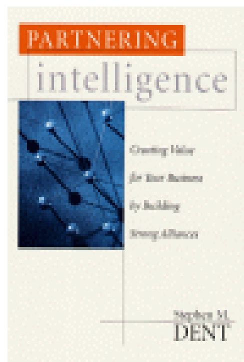

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