Integrating Acquisitions: Keys to Unlocking the Value of Synergy

by

Albert K. Killen
Ph.D. Aerospace Engineering
Mississippi State University
(1994)

and

Kevin P. Lawlor
B.S. Accounting
Fairfield University
(1979)

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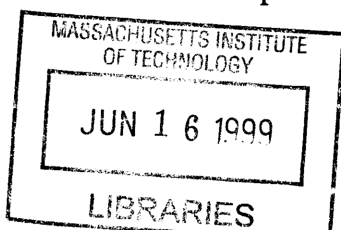
Signature of Author: ______________________
Alfred P. Sloan School of Management
May 5, 1999

Signature of Author: ______________________
Alfred P. Sloan School of Management
May 5, 1999

Certified by: ______________________
Arnoldo C. Hax
Thesis Supervisor

Accepted by: ______________________
Toby W. Woll
Director, Sloan Fellows Program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Submitted to the Alfred P. Sloan School of Management
on May 5, 1999 in Partial Fulfillment of the Requirements for
the Degree of Master of Business Administration

ABSTRACT

The ability of mergers and acquisition transactions to generate enhanced shareholder value often hinges on successful integration. Our thesis examines this critical phase of merger activity. Through six discrete case studies and interviews with the individuals who led those transactions, we identify the important discriminators that differentiate success from failure. In addition, we highlight the firms and processes that are emerging as benchmarks in this area.

Thesis Supervisor: Arnoldo C. Hax
Title: Alfred P. Sloan Professor of Management

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CHAPTER ONE

INTRODUCTION

The next wave is on! For the first time in history the value of merger and acquisition activities will top $1.3 trillion (U.S.) in 1998. Surging like the tides of the ocean, this fifth wave (there have been four other surges since 1901) will be dramatically larger than any of the others. The scale of these new transactions also shatters previous records. In one week alone in November 1998, four major transactions worth over $100 billion were announced: Exxon merging with Mobil ($76B), Deutsche Bank merging with Bankers Trust ($9.5), Tyco merging with AMP ($11.3B), and Netscape merging with AOL ($4.2B) -- and the list continues to grow.

This current wave of transactions ranges in scope from small synergistic drop-ins to industry-changing mega-deals covering such industries as banking, oil, software, and aerospace. The corporate giants once thought to be too large to ever be threatened with takeovers are now very much up for consideration.

The common denominator that links all of these deals is an expectation on the part of the acquirer that, once executed, these transactions will add value for shareholders and/or enhance the firm's competitive position.

Most will fail. Depending on the criteria used, empirical studies have pegged the failure rate for mergers at between 50 and 70 percent. Some define failure as the inability to earn more than their cost of capital; others look to the pre- and post-transaction market

capitalization of the firm. But regardless of what criteria is utilized, the majority of these transactions will not deliver on their promise.

While the casualty rate for most of these transactions will be high, there will be notable exceptions. Some mergers will add value and some will substantially improve the competitive position of the companies involved.

The difference between these two outcomes often will be determined by the way in which the two firms are integrated. Of all the building blocks that together create a successful merger, the integration process is perhaps the least analyzed. Many M&A textbooks either do not cover the topic or cover it superficially in a chapter at the end of the text.

Integration, and the decisions made during the integration process, call into play many of the most popular themes of contemporary management bestsellers. At their core, integrations are massive **change projects** that require numerous **teams** working at peak efficiency. They necessitate **re-engineering** of fundamental processes, and they bring up challenging problems of **organizational design**. The success of these transactions hinges on strong **leadership skills**, **stress management practices,** and clear, concise **business communications.** To be effective, merger integrations must combine the best practices from numerous management disciplines. They require the successful orchestration of a broad array of skills, personalities and management styles..

This thesis examines one fascinating piece of the merger puzzle. We explore integration as a process, a core competency, and a source of competitive advantage. We disaggregate the various elements in the process and then highlight those elements that make integration work.

Our analysis is drawn not only from the body of academic and business literature that exists today, but also from the reflections, insights, and lessons learned from the people who have led recent integration efforts.

We have tested our hypotheses in the context of six case studies drawn from recent transactions, including discussions and interviews with some of those involved in the process.

We begin by outlining why these transactions were embarked on, the strategic foundations upon which the deals are built, and how the parties' integration objectives related to those strategies. We then discuss briefly the other stages of the acquisition process and relate them to their impact on integration.

CHAPTER 2

STRATEGIC POSITIONING: THE ROLE OF MERGERS AND ACQUISITIONS

> ***"All competitors who persist over time must maintain a unique advantage by differentiation over all others. Managing that differentiation is the essence of long-term business strategy."***
>
> --Bruce Henderson, Founder, The Boston Consulting Group

The competitive environment in most industries today is becoming faster and more intense. Sources of competitive advantage that once sustained market leadership for decades now have a half-life shorter than ever before. Corporations that previously enjoyed pre-eminent market positions are being challenged from many different directions, both traditional and non-traditional. Airlines, for example, now face a real threat from video teleconferencing; cable television companies worry about threats from telephone companies, and the venerable bookseller, Barnes and Noble, is losing sales to Amazon.com, an Internet pioneer. Top management of these firms needs to adopt what Fred Smith at Federal Express calls "kaleidoscope thinking"(i.e., looking at issues and challenges from lots of different perspectives) or risk being blindsided and left poorly prepared to face these new threats.[25]

The companies that thrive in this environment have a clear view of the marketplace, a thorough understanding of their relative strengths and weaknesses, and a carefully thought out battle plan. They know the basis on which they are going to compete, and they have the internal discipline and alignment to optimize their enterprise to compete on that basis.

The first step in this alignment process is to identify a strategic position or value discipline. The best way to compete in a market can vary from firm to firm and industry to industry, and no one model is superior by definition. The discriminator appears to be how steadfast and resolute the companies are at configuring themselves to excel. Such intense focus does not preclude efforts to remain competitive on other dimensions, it merely defines the dimension on which the companies will differentiate themselves. They develop a strategic position and stick with it.[26]

While debate continues in the strategic literature about how to specifically define these positions,[27] there is no debate about the perils of what Michael Porter calls being "stuck in the middle". He explains:

> The firm that is stuck in the middle is in an extremely poor strategic situation. The firm lacks the market share, capital investment, and resolve to play the low cost game, the industry wide differentiation necessary to obviate the need for a low cost position, or the focus to create differentiation or a low-cost position in a more limited sphere...the firm stuck in the middle is almost guaranteed low profitability. [51]

Porter has been questioned about the validity of his position that competition takes place along only two competitive dimensions. However, his warnings about the perils of "being stuck in the middle" are broadly endorsed.

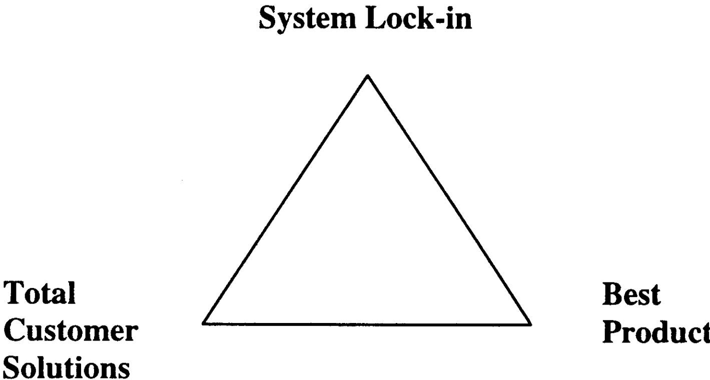
Similarly, Hax and Wilde warn of "the trap of the commodity syndrome, namely, ignoring any strategic purpose other than low cost." They go on to explain that "if a product is not subject to any differentiation, and perceived not to add any distinctive value to a customer, then the logical conclusion is that the low cost strategy is the only way to win".[38]

Such admonitions merely underscore what the casualties of these competitive wars have already shown us: undifferentiated products are forced to compete, as de-facto commodities, solely on the basis of cost.

Given this critical imperative for a firm to find and leverage its strategic position, it is important to now define those relative positions and discuss the way firms operating in each position differentiate themselves. In that way we can more clearly illustrate the strategic rationale behind mergers and acquisitions and show how they can help enhance a firm's competitiveness. While some debate on the subject remains among today's leading authors, a comparative analysis of the relative merits of each is beyond the scope of this thesis. We will limit our discussion to a brief description of each.

Hax and Wilde use a triangle (see Exhibit 2.1) to describe the three competitive positions (Best Product, Total Customer Solutions, and System Lock-In) in their model.

Exhibit 2.1(a)



This model, unlike Porter's two-dimensional model, has three dimensions on which a firm can choose to compete. Best Product has a product-centric view of the market, Total

Customer Solutions has a customer-centric view, and System Lock-in seeks to define the *de facto* standards for the industry.[38]

Exhibit 2.1(b)

	BEST PRODUCT	TOTAL CUSTOMER SOLUTIONS	SYSTEM LOCK-IN
Scope	Defeatured/ Fully featured Low Cost/ Differentiated	Broad Product Range	Nurturing Complementor Open Architecture
Scale	Product- Market Share	Customer share	System Complementor Share
Bonding	Link to Product	Link to customer	Link to System

Michael Treacy and Fred Wiersema[65] offer a third position. They assert that there are three different types of value disciplines that companies can adopt: operational excellence, product leadership, and customer intimacy. We have summarized the attributes for each below.

VALUE DISCIPLINE	PHILOSOPHY	EXAMPLES
OPERATIONAL EXCELLENCE	LOW COST	WAL-MART
PRODUCT LEADERSHIP	PUSHES PERFORMANCE BOUNDARY	INTEL, 3M
CUSTOMER INTIMACY	DELIVERING WHAT THE CUSTOMER WANTS	AIRBORNE EXPRESS

These three authors offer slightly different views of the market and the competitive dimensions on which firms can compete. Regardless of which strategic model one subscribes to, these models all have more commonalities than differences. They all recognize that no company can excel in every dimension, that to attempt to do so would

mean compromises in all. The value of these frameworks stems from the discipline they add to the formulation of the firm's strategic plan and organizational structure.

CHAPTER THREE

STRATEGIC RATIONALE FOR ACQUISITIONS

Once a basic value proposition has been established, a careful scan of the company's internal and external environment is required. That scan should provide an objective assessment of the firm's competitive position within the value proposition – what strengths, weaknesses, and opportunities the firm has, and how best to capitalize on them.

Mergers and acquisitions are often high on the list of opportunities. They are important strategic options available to management to help achieve the company's goals or enhance its competitive position. These initiatives must be carefully aligned and tightly integrated with the firm's strategy in order to improve its chances for success.

Even assuming good alignment, the success/failure statistics are sobering. Various surveys estimate that over 50% of M&A transactions fail to achieve their stated objectives.[26] Many actually end up destroying shareholder value by failing even to earn their cost of capital. In order to be able to discuss the issues and strategies required to complete these transactions, it is important to first look at the strategic rationale that justifies them and how these rationales are nested in the positions we just discussed.

In a 1971 study, Ansoff, *et al.*, identified the following list of motives for entering into a merger or acquisition:

1. A desire to limit competition or achieve monopoly profits
2. A desire to utilize unutilized market power

3. A response to shrinking opportunities for growth and or profit in one's own industry due to shrinking demand or excess competition
4. A desire to diversify, to reduce the risks of business
5. A desire to achieve large enough size to realize an economic scale of production and/or distribution
6. A desire to overcome critical deficiencies in one's own company by acquiring the necessary complementary resources, patents, or factors of production
7. A desire to achieve sufficient size to have efficient access to capital markets or inexpensive advertising
8. A desire to more fully utilize particular resources or personnel controlled by the firm, with particular applicability to managerial skills
9. A desire to displace existing management
10. A desire to utilize tax loopholes not available without merging
11. A desire to reap the promotional or speculative gains attendant upon new security issues or changed price/earnings ratios
12. A desire of managers to create an image of themselves as aggressive managers who recognize a good thing when they see it
13. A desire of managers to manage an ever-growing set of subordinates. [9]

This thirty-year-old study, while somewhat dated in terminology, still captures the key motives for "doing a deal". Two current dimensions not covered explicitly on the above list are speed to market and globalization. Modern transactions are often initiated to accelerate the pace at which the acquirer, by itself, would have been able to achieve the same

objectives. This strategy is manifested in several ways: buying access to new markets, buying new technology, and/or buying new distribution channels.

To focus our analysis more precisely, we have aggregated the previous list to what we call ***prime motivators*** and we will discuss each in turn.

A. Growth and Scale

B. Vertical Integration

C. Diversification

D. Product Line/Geographic Expansion

E. Gap Fillers

F. Portfolio/Financial Additions

G. Market Inefficiencies

A. Growth and Scale

Earnings growth has become a particularly critical parameter in attracting the attention of Wall Street's analysts. Companies with significant current growth and high-growth potential, trade at significantly higher multiples than their slower-growing peers. Earnings trajectory has almost become more important than specific results. During the mid to late 1990s, the fuel for earnings growth was the **productivity surge** generated by the massive restructuring programs launched in the late 1980s and early 1990s. Now, as those restructuring annuities start to dwindle, real earnings growth becomes increasingly more difficult to produce. But many slow growth industries do not yield the kind of growth that the market expects. So, managers must look for other ways to boost sales. The most popular answer recently has been to buy growth.

Given the favorable accounting treatment associated with pooling of interest type transactions or the long amortization period for acquired goodwill in purchase transactions, mergers and acquisitions are a means of generating growth while delaying the resulting earnings penalty.

A second motivating factor in this growth category is **scale**. In a recent article by Lyons, Lowell, and Rosenthal,[62] the authors explain that as markets become more global, a large market capitalization "provides these companies with a real edge in acquiring other companies and capturing global growth opportunities, while protecting them from acquisitions at the same time." Companies like Coca-Cola, General Electric, Procter & Gamble, and Citibank are just a few companies currently leveraging such power.

Scale can also provide benefits beyond just market power. Economies of scale in manufacturing and service chains can be critical in a market governed by cost. Companies that compete in that particular strategic position often search for opportunities to capture the maximum scale efficiency. Scale can enhance negotiating power with suppliers, distributors, and advertisers. It can provide internal sources of capital for investment and vast pools of intellectual capital unavailable to smaller firms. Resident within many of these giant companies are leading scientists, economists, and strategists who give those companies an inherent edge.

WorldCom is a good example of a company that used acquisitions to build scale. Over the past decade the company made over fifty acquisitions leading up to their 1998 $37 billion purchase of MCI. The scale built via these acquisitions has put WorldCom in a position to compete with global telecommunications leaders like AT&T and NTT.

However, scale can also be a competitive liability, inviting special regulatory scrutiny, legislative interference, and/or trade issues. Microsoft's ongoing anti-trust litigation that began in 1998 is one illustration of this phenomenon. Likewise, Lockheed Martin's recent attempt to acquire Grumman failed to gain regulatory approval because of the enormous potential scale and market power of the new entity.

B. Vertical Integration

In the 1990s vertical integration became a less prevalent motivator for mergers or acquisitions. With the advent of the Internet and advanced telecommunications technologies, companies can now become "virtually vertical." This eliminates the need for a permanent commitment to capacity. Companies like Dell Computer, Wal-Mart and the retailer Marks and Spencer today achieve a tightly integrated supply chain without the commitment of capital.

Stuckey and White[63] list four reasons that might justify vertical integration:

> "(1) The market is too risky and unreliable-it fails; (2) Companies in adjacent stages of the industry chain have more market power than companies in your stage; (3) Integration would create or exploit market power by raising barriers to entry or allowing price discrimination across customer segments; and (4) The market is young and the company must forward integrate to develop a market, or the market is declining and independents are pulling out of adjacent stages" (pg. 4)

The message implicit in this list is that such entries should be rare and well thought out. Other options for gaining better control of the supply chain are generally available and offer comparable leverage with less risk.

C. Diversification

Economists point out that firms need not diversify since investors have a more efficient diversification option available to them via the capital markets. Corporations, however, have long recognized the discount in market valuation at which companies with volatile earnings streams trade. They seek opportunities to diversify their portfolios in order to stabilize their volatile image and show an uninterrupted earnings stream.

But these strategies often require corporations to move away from known industries and core competencies. They challenge the depth and breath of the acquirer's management talent. The middle-ground approach, taken by such companies as Allied Signal or United Technologies, limits diversification to a small number of selected industries.

D. Product Line/Geographic Expansion

Similar to the issues addressed in our discussions of scale, certain industries require a global presence and/or a complete product line in order to remain competitive. Customers in those markets want suppliers that can support their global operations and provide them with a complete portfolio of products. The recent merger between Chrysler Corporation and Daimler Benz helped solve the weaknesses each had in the other markets. The combined entity now has an international presence similar to Ford or General Motors. Similarly, Netscape's merger with Sun and AOL gave the new entity the necessary scope to compete with Microsoft.

Moving across borders however is a path full of peril. It adds an additional layer of complexity to the already formidable challenges inherent in acquisitions.

E. Gap Fillers

Successful companies not only recognize their strengths but also acknowledge their weaknesses and vulnerabilities. Most CEOs continually watch for opportunities via alliances, acquisitions, or mergers in order to close off those vulnerabilities and strengthen the enterprise. After the break-up of AT&T, the company was left with limited access to a critical link to their customers. AT&T controlled most of the value chain but had to surrender a disproportionate amount of profit to local network owners. One attempt to diminish that exposure was AT&T's $48B merger earlier this summer with TCI. This national cable company's value to AT&T was its cable connection to the homes of millions of U.S. households. That transaction, coupled with joint ventures with IBM and Time Warner, will help AT&T close that final mile and enhance its long-term profitability.

F. Portfolio/Financial Additions

The financial deals of the 1980s, when leveraged buyouts were so popular, are less frequent today but have not disappeared completely. Financial buyers specialized in buying undervalued companies, inserting tough, profit-oriented managers, then selling the companies at a profit once they were turned around. Kohlberg Kravis Roberts & Co, and T. Boone Pickens, two leading raiders, terrorized the management of under-performing companies in the 1980s. They were financial or portfolio buyers who seized on valuation anomalies in the market either through acquisitions, proxy fights or green mail.

Statistically, however, there is no proof that these types of nonsynergistic deals yield any greater returns than transactions pursued for reasons of synergy. Copeland and Anslinger (1996) identified "a diverse group of organizations, including Thermo Electron

corporation, Sara Lee Corporation and Clayton, Dubilier & Rice, that have grown dramatically and captured sustained returns of 18% to 35% per year by making nonsynergistic acquisitions.[23] Berkshire Hathaway is another notable example of this phenomenon.

G. Market Inefficiencies

All of these motivations, when properly nested in the strategic position of the firm, are defendable reasons for pursing an acquisition. But in a marketplace regarded as efficient, how can the expected benefit from an acquisition exceed its cost? Doesn't the firm's market price already reflect the future opportunities?

The answers to these questions are " it depends". Porter explains that there are imperfections in the market for companies that create profit opportunities not already factored into the price. These imperfections arise as the result of superior information, distressed sellers, poor economic conditions, or a limited numbers of bidders. Beyond that, a buyer may possess a unique ability to realize value from the acquisition via internal synergy that others in the market do not possess.[52] These opportunities are rare, however, and are often not apparent until the deal closes. Many companies have over-estimated these opportunities and ended up with losing transactions.

Discipline, speed, and market knowledge are all essential to recognizing these valuation opportunities as they arise. Successful companies leap on such aberrations and execute transactions before others in the market even learn of their existence. Companies like GE and Cisco have seasoned dealmakers ready to negotiate such transactions in short

timeframes. Such speed requires that companies know the market, know the companies that meet their strategic criteria, and have a disciplined approach to valuation.

CHAPTER FOUR

Pre-Transaction Steps

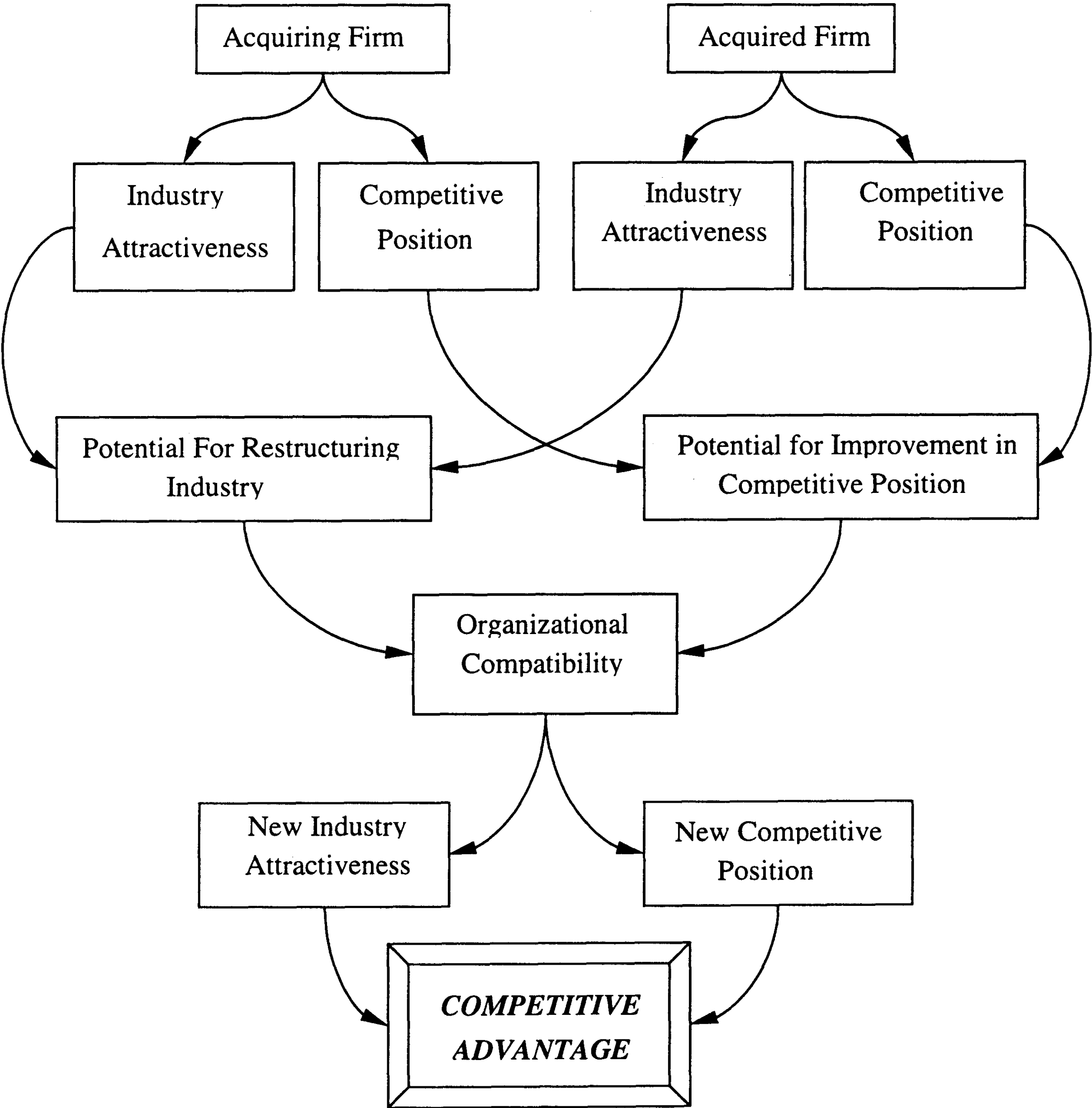
In its simplest form, two things must be known when attempting to value a potential acquisition: the cash flows from the firm, and the value-adding synergies available from the combination. The market has theoretically valued the individual firms considering each of the firms' forecasted growth. It follows therefore, that when the two firms are combined the net present value of the combination is the difference between the new value generated and the premium paid for the acquired firm. Functionally, this could be represented by the net present value calculation of:

NPV = Valued-Added – Premium Paid.[60]

An expanded view of this type of analysis is seen in Exhibit 4.1. The flowchart illustrates the potential impact on the industry and the improvement in competitive positioning possible as a result of the acquisition. This expanded view underscores the need to analyze the impact to both the industry and the firm's competitive position from the perspective of the new organization in order to assess the potential benefits of a merger. This disciplined analysis is critical since the act of merging may itself alter existing relationships with suppliers and customers. For example, after the Lockheed Martin merger, McDonnell Douglas, one of Martin's largest customers, moved their electronics business away from Martin citing a conflict of interest. This change created a windfall for Raytheon and Litton

but resulted in a significant loss of revenue for Lockheed Martin. Acquisition valuations must account for the dynamic caused by the transaction itself.

Exhibit 4.1 Generic Acquisition Framework



Ultimately, once corporate leadership has identified that growth through merger and acquisition is a proper path, then the corporation should ponder questions like the following:

- Who are the important players in the industry?
- Will the prevailing market multiples make a value-adding deal possible?
- What other factors, such as strategic relatedness, relative size, and financial health, should be considered in screening the targets?
- Is the risk-taking behavior of the firms' managers likely to be affected by the acquisition?
- Do we have the managerial bench strength to manage a new addition?

A. ESTABLISH A SCREENING PROCESS

These questions lead to an initial screening process that covers a universe of potential candidates. The focus should be to create a list of eligible firms -- public, private, domestic, and foreign -- which is as close as possible to all-inclusive. At this point, no effort should be exerted to eliminate firms.

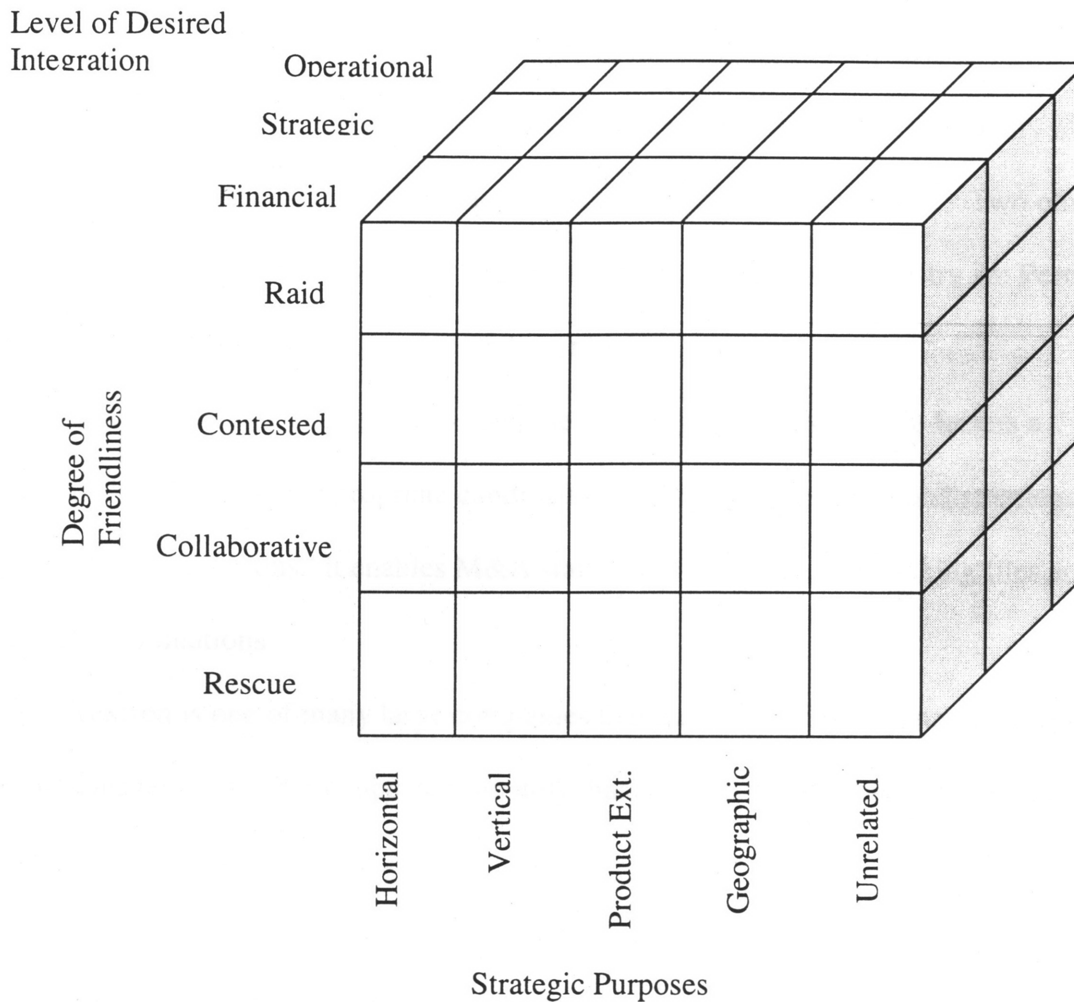
Following the development of the universe of options, an initial screening process should be developed. Top management should be fully engaged at this point to ensure that the vision, strategy, and focus are captured in the criteria. The purpose of the first screening is to eliminate from consideration only those firms that are obviously not candidates for further investigation. Great care should be used when constructing the screening process. Screens can be constructed that are so restrictive that the wrong firms or no firms pass through for consideration. This is self-defeating. The granularity and criteria of the screening must be monitored and updated as circumstances change. The candidate list may

need to be revisited for years before the right set of conditions arise that allow the transaction to proceed.

The screens can be constructed with a multitude of different criteria but all should be consistent with the stated strategy, i.e., Growth by Acquisition, Vertical Integration, Diversification, Product Line/Geographic Expansion, Gap Closures, or Portfolio Additions. Other screens might include: manufacturing capabilities, company size, product line overlaps, revenue growth, or earnings history.

A typology similar to Exhibit 4.2 provides a sense of where the candidates fall in relationship to the firm's current position. Such a typology gives management a mechanism with which to characterize the merger and to begin conceptualizing what integration tactics are needed. This framework combines three independent dimensions into one framework, providing a higher-fidelity model for examining the underlying dynamics. For example, the acquisition dynamics and subsequent integration considerations would be different in a merger where the acquisition is friendly (collaborative), the intention is to broaden the firm through horizontal acquisition, and its connection to the parent is through financial association only. Such an integration would be orchestrated quite differently from one where the acquired firm is in an unrelated business and was acquired with the intention of tightly integrating with the parent company at the operational level. While each category may lead to a successful merger, the approach to the acquisition integration would be significantly different.[22]

Exhibit 4.2. Typology of Mergers and Acquisitions



Source: Adapted from Buono and Bowditch, 1989.

B. PRIORITIZE POTENTIAL CANDIDATES

Once the screening process has been accomplished, the raw target list must be further categorized and prioritized. Again, top management must be part of establishing the criteria for prioritization. Many of the criteria previously mentioned would continue to be used in

this phase. Additional considerations would also be analyzed, and software on the market today can make multivariate analyses involving numerous weighted criteria routine. This prioritization process would include investigating such critical success factors as the managerial infrastructure, the financial condition of the candidates, and the quality of each company's human resources, manufacturing, and marketing management.[37] Two other analytical frameworks that provide a more global perspective of the industry are Porter's Five Forces model[51] and the wheel of opportunity.[56]

This industry targeting process and the resulting candidate list/file fosters a disciplined evaluation of appropriate candidates free from the pressures and emotions of drop-in-type transactions. It enables M&A staffs to develop detailed tracking files and preliminary valuations.

Textron is one of many large companies that maintain an up-to-date target book for senior managers. This book, updated monthly, has detailed profiles on numerous potential merger and acquisition candidates.

C. CONTACT WITH CANDIDATES

Once a candidate is identified -- and provided the preliminary business case makes sense -- a contact strategy is usually developed. In some transactions that contact can be as simple as a telephone call from one CEO to another. In other cases investment bankers or other third-party intermediaries serve as a contact point.

The timing of such contacts is a matter of strategy. McDonnell Douglas became receptive to a Boeing merger only after they lost the new Joint Strike Fighter competition.

Mobil Oil became receptive to an Exxon transaction when the worldwide price of oil fell to $13 a barrel.

Given the arsenal of potential defenses (poison pill, debt, and golden parachutes) available to target corporations, it is critical to assess the likelihood that an overture would be welcomed prior to initiating such contact.

D. APPROACH CANDIDATES

Once the potential targets are identified they should be approached to determine their willingness to sell. The method of contact is important and fact-specific. Depending on the circumstances, contact may be made through a common acquaintance or a professional intermediary (investment banker). In many of the transactions investigated for this thesis, contacts were made directly between chief executives.

E. MAKE A GO/NO-GO DECISION

Assuming that a willing candidate emerges from the previous steps, a go/no-go decision must be made as to whether to proceed with preliminary discussions. These decisions are usually the responsibility of the board, although smaller deals can often be signed off by senior managers. At this point, the target files become crucial. They should be updated for any changes in assumptions. Provided a "Go" decision is made, the nature of the interaction becomes more formal, with confidentiality agreements and letters of intent exchanged.

F. FORM AN ACQUISITION TEAM

The decision to go forward is the point where an acquisition team needs to be established. Depending on the size of the transaction, this team could comprise a few part-time members or a team of considerable size. Membership generally includes representatives of the business development department, investment bankers, lawyers, accountants, and representatives from the relevant departments, including legal, finance, operations, etc.

The team members are individuals who are there to make the acquisition happen – they must develop the structure, valuation, and strategy to make the acquisition a reality. A clear delineation of responsibilities is crucial to avoid gaps in the evaluation of the target. At this point the detailed valuation begins to take shape.

G. DUE DILIGENCE

The due diligence process must respond to several priorities simultaneously. It must provide a comprehensive, detailed view of the enterprise that validates pricing assumptions, identifies contingencies, and corroborates assertions. It is an opportunity to probe any questionable area prior to the ownership transfer. A healthy degree of skepticism should prevail during the investigation.

Due diligence should also provide the acquirer with insights and preliminary strategies for harvesting the value of the firm. The team should include individuals who will ultimately have responsibility for integration. By having the ultimate general manager of this profit and loss center involved in due diligence, greater ownership and continuity are achieved.

H. VALUATION AND STRUCTURE

As the teams in the field conduct their investigation, new data is fed into the valuation models. The business case supporting the transaction is revised as required to reflect the best available data. Various valuation models and sensitivity analyses are generally run to help determine the appropriate price for the deal.

One key element of the valuation is the way the deal will be structured. Tax, legal, and accounting issues all play an important role in defining the optimal structure for the transaction.

As in the case of due diligence, the valuation phase of the transaction is closely related to the integration. Financial assumptions regarding synergy must be tied to a strategy for realizing such benefits. The valuation must factor in not only the size of the available savings but also the timing and costs necessary to realize such savings. Establishing ownership for such assumptions during this early stage is crucial.

I. EXECUTION

Navigating the regulatory and legal hurdles necessary to bring a deal to fruition is not trivial. As Lockheed Martin learned in its aborted effort to acquire Northrup, nothing should be left to chance. This stage of the transaction is often best handled by experts. They bring to the transaction an expertise earned from thousands of prior transaction.

But outside experts fulfill only half of the execution tasks. Selling the deal and the benefits that such a deal would generate are jobs for the firm's management. Coordination between these two efforts is important.

The terms and conditions embodied in the ultimate deal document are also critical. Details of environmental indemnities, pension fund adequacy, and product liability issues are all standard provisions. Less obvious but equally important are clauses dealing with the retention of key executives, the vesting of stock options, or the settlement of employee claims. Regardless of what was said or assumed during the negotiating process, the document is the deal.

CHAPTER FIVE

INTEGRATION

Integration is the stage of the acquisition process where most deals fail. Some of the frequently identified causes for such failures are:

- the inability to successfully combine large corporate bureaucracies;
- "smothering" of small companies with added layers of the large company's bureaucracy;
- weak management;
- poor pre-acquisition research and planning;
- an exodus of key employees; and
- declining morale and motivation of the remaining employees.

According to most statistics, acquisitions fail more often than they succeed. A 1980 *Fortune* magazine study of ten conglomerates that acquired companies in a new line of business indicated that all had failed. Another long-term study by Michael Porter which examined 33 companies over 36 years found that more than half of all "unrelated" acquisitions were eventually divested.[54] A McKinsey & Company study reported an acquisition failure rate of 61%, where failure is defined as the inability to earn returns equal to or greater than the cost of capital.[61]

So what is it about these deals that make them fail so often? One reason is their failure to adequately plan and execute the integration process. The Boston Consulting Group

identified what may be the Achilles' heel of the acquisition process. They found that *less than 20 % of the firms considered it necessary to integrate the new acquisition into the organization prior to consummation.* A survey by Touche Ross also cited integration as the key to a successful merger. One symptom of integration failure is the statistic that less than 60% of the acquired company's top management remained after the closing, and those who leave do so within twenty-four months, often taking key line managers with them.[54,61]

As these surveys indicate, corporations are having extreme difficulty making one plus one equal three. In order to create value for the stakeholders it is crucial to establish a process wherein objectives are clearly stated and the results of actions are easily measurable. However, many aspects of this process are difficult to measure since they deal with soft variables such as employees' attitudes. At the heart of this stage of the process is the ability to stay flexible and to manage uncertainty. In order to minimize any potential erosion of business results, the integration structure must be designed to respond to the issues of customers, suppliers, labor, as well as management.

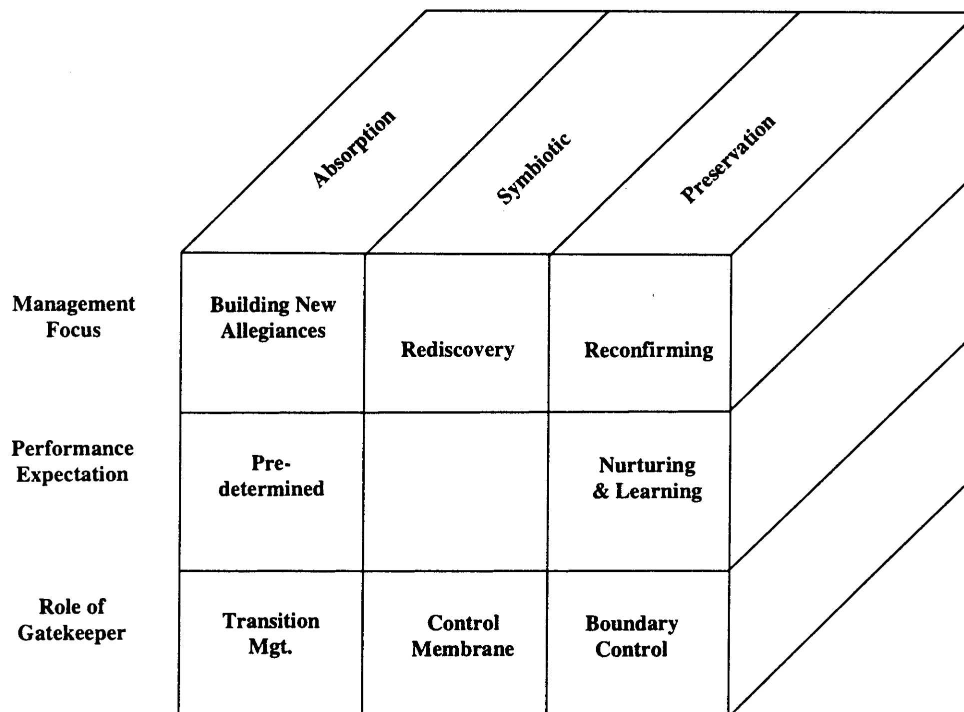
The integration process must be tailored to the particular industry and circumstances surrounding the acquisition. There are no silver bullets that guarantee success in acquisitions. In principle, the integration process should have three stages:

- Phase I: Integration Planning
- Phase II: Implementation
- Phase III: Control and Review

A. PHASE I: INTEGRATION PLANNING

In Phase I two major activities must take place: (1) the creation of the integration team, and (2) integration planning. The scope of the intended integration defines the process. A framework that helps to clarify the various issues surrounding such integrations is seen in Exhibit 5.1.

Exhibit 5.1 Integration structure framework



Source: Adapted from Haspeslagh and Jemison, 1991

From management's perspective there are three distinct types of integrations. The three types are distinguished by the relative size of the acquired company and the depth and breath of the integration required:

1. The first type, absorption, is the acquisition of a firm that is generally smaller than the acquiring firm. The acquired firm will be absorbed into the existing firm.
2. The second type, symbiotic, is the acquisition of a similar size firm (mergers of equals), and the intent here would be to capture the best aspects of each system.
3. The third type, preservation, is the acquisition of a firm whose culture, systems, or processes must be preserved. The role of a gatekeeper in this type of transaction is critical.

These definitions are helpful in providing guidelines for management as it builds its integration plan. In absorption deals, management will have to build new relationships and allegiances with the employees of the acquired firm (e.g., ATT- TCG). In symbiotic acquisitions, management has to create a 'Best of the Best mentality' in the organization and rally the two organizations under a new banner (e.g., Lockheed Martin, Citigroup). In preservation situations, the fragile culture must be protected from what Lotus' former CEO Mike Zisman termed "being kissed to death" (e.g., IBM-Lotus).

The acquiring firm's management should work with the management of the newly acquired firm to clearly communicate expectations and explain how the acquisition will add value to the new extended enterprise. Management has to build trust in the organization through a nurturing/learning approach in order to create an environment that fosters knowledge transfer.

The interface between the newly combined firms must be maintained differently depending on the acquisition type. The individual(s) responsible for coordinating such interactions are referred to as *gatekeepers*. Gatekeepers need different kinds of skills depending on the size and scope of the integration. In the case of a small firm being absorbed, the gatekeeper functions more as a facilitator, giving the newly acquired firm greater access to the resources of the parent company. In contrast, the gatekeeper for a symbiotic deal will provide order and focus to the interface. There will be emotional topics dealing with legacy issues that must be dealt with. In some areas the gatekeeper will have to accelerate the integration process, and in other areas the gatekeeper will have to slow the blending in order to prevent overloading the process. Lastly, the gatekeeper of the newly acquired in a preservation-type acquisition must protect that firm from being overwhelmed by the larger parent. The gatekeeper must ensure an environment that enables the new addition to grow, develop, and establish its own identity in the overall culture.

With management's integration strategy firmly established, the creation and makeup of the integration team membership must be designed to support that approach. Some key considerations are:

- It is highly advantageous to have members of the due diligence team participate in the integration effort. Many of the variables that went into the business case may be questioned during integration, so having insight into their genesis is helpful.
- Ideally, the team should be led by the next general manager of the new firm. By including the potential GM, integration decisions are made by the individual who will be charged with making it happen. That person will own the decisions.

- There also should be an individual from human resources to assist in handling personnel issues across the two companies, including health and compensation plans.
- An individual from the information systems organization is vital. It should be someone who can identify and evaluate the current systems in each company and then develop a plan to build a cohesive structure between the two. The complexity of this task will vary depending on the level of integration intended. If the new organization is relatively autonomous and only linked to the parent through budgets, then this planning effort may not be difficult. However, if the newly acquired firm is to be integrated at the operational level, then the level of sophistication required to integrate the two undoubtedly different IT structures will be quite complex. The cost of this effort should be considered in the valuation process.
- A communications expert is critical. Communication links between the two firms should be established as quickly as possible. These links will be vital to the integration tasks and should therefore be among the first actions taken.
- The team should include individuals from the finance, legal, environmental, engineering, and manufacturing organizations. Existing plans and functional strategies should be carefully coordinated. Unintended consequences often arise from failing to consider the effects of system changes. A continuing effort is required to eventually assimilate the acquired firm into the business.
- Finally, the top manager of both firms, i.e., President, General Manager, or CEO, must devote whatever time is necessary to resolve issues quickly. That person must be prepared for the rapid-fire decision making associated with such efforts.

This core group of individuals may not be sufficient to ensure a successful transition. Individuals who can bring additional insights from a broader group of stakeholders should be added as necessary. This broader group is difficult to assemble in the early stages of negotiations because of the confidentiality needed, but tradeoffs between confidentiality and critical inputs must be carefully weighed.

As the integration team begins its efforts, a list of critical issues should emerge. These issues should be prioritized on the basis of value. A disciplined focus on value drivers from the start of the process will go a long way toward delivering on the value of potential synergies. The list should be followed by a clear and detailed plan for how to resolve each issue with individual owners and the expected timelines. While difficult to plan, estimates of the resources that will be required to get the job done should be attached to each issue.

B. PHASE II: IMPLEMENTATION

As the integration process moves into Phase II, the tasks will become increasing difficult and the timetable more frantic. At this point, the team must specifically identify those areas where synergy and duplication exist. It is easy for teams to bog down here, mired in minutiae. They must guard against this loss of focus and deal primarily with the value drivers of the merger. These value drivers will vary by the industry but the usual areas of investigation are production, distribution, warehousing, marketing, support staff, headquarters staff, and R&D. A helpful framework for key integration issues is presented in Exhibit 5.2.

Exhibit 5.2 Critical Success Factors

Source: Authors

This hub-and-spoke model identifies eight elements that must be addressed during integration. While a successful integration may be accomplished with one of these elements poorly executed or missing, each element not performed well increases the probability of failure. As the model depicts, each spoke supports the overall integration game plan. Woven through all these issues is the fragile cultural linkage that must be developed. Early victories should be captured and communicated to the employees as a way of building team spirit. By *collecting the low-hanging fruit*, and celebrating early victories, the teams gain confidence and the process builds momentum.

Leadership

The leadership of the new organization should be identified and put in place quickly. Wherever possible the existing management should be preserved to provide continuity and psychological support. Significant efforts should be expended to ensure management is aligned and focused on the same value structure. Too often deals go awry because of misunderstandings at the top. This coordination tends to be an onerous task. Third parties can often be useful in diplomatically bridging the inevitable differences.

Once aligned, management should clearly and precisely articulate the vision and goals of the organization. The vision and goals should be publicly shared through open forums, firm meetings and other face-to-face communication vehicles.

Communication

Communication is critical. The paranoia of employees involved in such transactions can never be under-estimated. The rumor mill will be at its peak, leaving employees frozen and focused on personal concerns. In a 10,000-employee organization, if one hour each day is consumed with rumors and gossip, it will result in production losses of 50,000 man-hours per week, 200,000 man-hours per month. At even modest hourly rates that productivity loss can be staggering. And at those rates, any synergy contemplated during negotiations will quickly evaporate. Hence, it is critical to unfreeze the organization quickly. During one month Dan Tellep and Norm Augustine, CEO and President of the newly formed Lockheed Martin, met with 62 different employee groups to communicate their vision for the new firm. Communication strategies also need to include; customers, regulators, and shareholders. Matrices are often constructed to prevent any key stakeholder from being left out.

Employee Selection

Proper employee selection, retention, and motivation will pay huge dividends in the firm's future operations. Selection of the employees to be retained and those to be dismissed is always an emotional issue, but an unavoidable one. Displaced workers should be treated fairly and with dignity. Treatment of the dismissed employees signals the remaining employees about the character of the new organization. If it is handled properly, it can be a motivating force. Mistakes will of course be made, and mid-course corrections will be inevitable. One common mistake is not securing and retaining key employees. Left alone, key employees may be wooed away by the competition during the turmoil. The cumulative impact of changing management, layoffs, and uncertainty can drive highly marketable employees away. The best way to secure key employees is to tell them early and often where they stand .

Resource Allocation

During the transition process, resources should not be constrained. A temporary organization may be needed to help facilitate resource allocation and handle nonrecurring tasks. Resources should be made available with more leniency than usual to ensure that critical tasks are handled in a timely basis.

C. PHASE III: CONTROL AND REVIEW

Phase III is the point in the integration process during which the firms attempt to standardize key processes. These processes include managerial reports, accounting standards, inventory controls, personnel evaluations, compensation, and personnel policies. Also included in this phase is establishing the metrics for the merged enterprise, the evaluation of completed tasks, tracking performance against objectives, and the monitoring of human resources' retention ratios.[48] Crucial to this phase of the integration is accountability. The integration manager should have the authority and responsibility to move the process forward. He should be held accountable for the pace of the overall process.

Ideally, integrations should be a process of discovery and adjustment. Original perceptions and assumptions must give way to facts and the game plan adjusted accordingly. Too often executives treat transaction assumptions as dogma, failing to acknowledge and react to changing internal and external conditions. Teams should be encouraged to uncover faulty assumptions or incomplete logic in the business plan. They should be challenged to plan for such eventualities and respond to creatively to them.

The decision-making process also requires a degree of formality. Models that decide issues based on gut feel or instinct may lead the organization in the wrong direction. To the extent possible, emotionalism should also be removed from decision making. Establishing early in the process a decision-making discipline, grounded in facts and numbers, will help to avoid future problems.

It is critical for merging companies to maintain the focus on the firm's stakeholders, especially its customers and employees. The firm must not become inwardly focused. This

customer focus was illustrated in the Merck-Medco merger. In its Report to the Shareholders, the firm stated: "*The merger will allow us to link payers, patients, doctors, pharmacists, other health-care providers, and pharmaceutical companies for the best patient care at the best prices regardless of which company makes the drugs.*" From the outset of the merger, Merck remained focused on the business while successfully planning and executing the merger.

As we have seen, mergers are not easy. They can be incredibly wrenching to an organization and often require enormous effort. As discussed earlier, there is no single methodology or technique that ensures success in integrating two firms, but a well-planned, well-managed merger will minimize the distractions and anxieties of all the stakeholders.[17]

Firms have to be diligent in their integration planning and execution. Those who contemplate working in this arena will need to build the required competencies. With billions of dollars at stake, acquisition policies must be keenly attuned to making the transition as successful as possible, recognizing that the ultimate confirmation will be made by the market.

PREFACE TO CASE STUDIES

INTRODUCTION TO THE CASES

The motivation for including these case studies in this thesis was to make it possible to analyze integration from various perspectives. The firms in the case studies vary by size (dollar value), relative size of the target firm to the acquiring firm, industry type, tempo/ timing of the transaction, and the overall success or failure of the merger. The cases became our laboratory for validating certain assumptions and theories.

The size of the transactions ranged from $30 million to $73 billion. The form of these acquisitions varied from friendly to hostile and the relative size varied from companies of comparable size to acquired firms that were 1/100 the size of the acquiring company's size. From these diverse transactions -- both successful and unsuccessful -- the salient features involved in the process emerged.

The methodology used to generate the case studies was first to gather information from existing literature on each acquisition. Second, we built a dossier of pertinent facts regarding the merger itself, and identified the people who were most closely involved in the transactions, and then we conducted interviews with these individuals. Interviews with the transition managers and others involved in the process focused on implementation mechanisms as well as lessons learned during the transition.

A generic set of interview questions was generated (see Appendix) as a basis for starting each discussion. The conversations focused on the particular attributes of each

acquisition. By analyzing available literature on these transactions, followed by insider interviews, we believe we obtained an accurate and intimate view of how these transitions actually happened.

The reader should note that due to issues of confidentiality, in some cases the names of the companies in the case studies have been changed.

We begin, then, with the first of six case studies.

CHAPTER SIX

CASE STUDY NO 1: American Standard and Windsor Corporation

Sometimes big integration issues arise even in small transactions. This was the case with American Standard's (American) 1996 acquisition of Windsor Controls Corporation (WCC), a small $30 million manufacturer of aerospace electronics. American Standard is a multi-billion dollar division of Aerospace Incorporated (AI) which manufactures and sells a wide array of aerospace components to both the commercial and defense-related customers.

A. COMPETITIVE ENVIRONMENT

Like many of its aerospace counterparts, American experienced a dramatic downturn in business volume following the end of the Cold War. For the first time in memory, both the commercial and defense sectors of the aerospace industry turned down together. Historically, these sectors had counterbalanced each other. This "double dip" forced aerospace suppliers to scramble to find alternative sources of business and ways to mitigate rapidly building excess capacity.

This drop in volume, especially in their electronic product lines, hit American's manufacturing facilities hard. The company had three electronic facilities: two in New Jersey and one (its newest and most modern) in Colorado. These facilities, each of which had run at output levels exceeding $150 million, were now running at about one-third of that volume. These capital-intensive businesses were being choked with fixed cost. They were

forced to amortize (under U.S. Cost Accounting Standards) their fixed costs over a continually shrinking base. This raised the cost of their remaining work and created what is known as a *"death spiral"*.

Manpower adjustments (i.e., layoffs) could not completely offset the eroding base so Ray Moore, American's President, asked his staff to study various consolidation options, including plant closures. With significant amounts of specialized equipment in each facility, the estimated cost of closing any of them ran between $13-15 million. Plant closures also stood a good chance of exacerbating a fragile labor management peace that had just set in recently after years of bad blood.

B. STRATEGIC RATIONALE

As these various consolidation options were being evaluated, American's M&A staff was alerted to the fact that Windsor Controls Corporation (WCC) was looking for a buyer. WCC was a closely held business with annual revenues of approximately $30 million. They operated a small plant less than ten miles from American's site. WCC manufactured and sold electronic black boxes (a complementary product line) to many of the same customers (e.g., Lockheed Martin, Bell Helicopter) as American. The principle owner was over 70 years old, had no heirs, and operated what was historically a profitable business.

Moore authorized preliminary discussions while formulating a strategy to acquire the WCC business but not its facilities. He envisioned dropping this acquisition into one of American's existing electronic facilities thereby soaking up most of the excess capacity and eliminating the need for a plant closure. Because WCC's workers were represented by the same national labor union, the acquisition had another potential benefit of actually improving

labor relations at the plant. The lawyers liked the plan because, as structured, it would eliminate the potential environmental liabilities inherent in acquiring an existing plant.

This potential for various synergies excited Moore and his management team, and he instructed his CFO, Tom Ryan, and his Division Counsel, to make the deal happen.

C. EXECUTING THE DEAL

Negotiations began on two fronts, one with the representatives of WCC and the other with American's parent, Aerospace Inc. (AI). At the time AI had identified a finite pool of acquisition funds which were made competitively available to any corporate unit that brought forward an acquisition candidate with the best strategic fit and potential payback. Delivering on the first criteria was easy, but delivering a business plan that would meet that competitive payback hurdle required capturing all the sources of synergy available.

An appropriation request and related business plan were prepared based on the data available at the time (which was limited) and including all the potential sources of synergy. That appropriation ultimately became the basis upon which the deal was authorized.

On the other front, negotiations were moving slowly. As is often the case with closely held businesses owners take negotiations very personally, and as a result minor issues kept surfacing. While not involved in the day-to-day negotiations, Moore kept pressure on the team to get the deal done.

In order to get something memorialized and avoid losing support for the deal, an interim agreement (a Letter of Intent (LOI)), was executed which was to be followed shortly by a definitive agreement. The LOI allowed the due diligence work to commence while the final document was being drafted and negotiated.

D. DUE DILIGENCE

American had made few acquisitions in the prior ten years and therefore many members of the team who were assembled to conduct the due diligence process lacked prior deal experience. In addition, due to the size of the deal and the aggressive payback commitments that had been made, the use of expensive outside lawyers and accountants was limited. The team was supervised by the CFO and the Chief Counsel, with representatives from each discipline: HR, Manufacturing, Engineering, etc.

Complicating the due diligence process was the insistence by WCC's owner that due diligence interviews be limited to a handful of his employees. The owner feared a negative employee reaction if rumors of the impending deal began to circulate prematurely. He explained that as members of his management team, the individuals he made available would be more than capable of handling any questions that came up.

As the due diligence process, began the CFO and the Chief Counsel struggled to balance their daily agendas and priorities with the demands of this acquisition. They attended daily team briefings as often as possible and delegated leadership to alternates when it was not possible. Other staff and line VPs sat in on the briefings when time permitted.

The reports of the due diligence teams raised only minor issues with the exception of some unspecified concerns raised by American's engineering team leader. He was uneasy with WCC's development backlog, which was at an all-time high. When pressed, the American engineer (who had never been part of such a process) categorized the backlog as a watch-list matter and not a deal breaker. He was subsequently reassured by his WCC counterpart that WCC had things well in hand.

The due diligence process wrapped up and the sales agreement was finalized. It called for a stepped transaction with two closings. After the first closing in November 1995, American took title to the business technically but not physically. They earned commissions from WCC on work WCC continued to perform. The second closing took place in April 1996. This closing triggered the physical transfer, which took place over a weekend.

E. OPERATION COMMENCE AND INTEGRATION ISSUES

Not long after the start of combined operations, numerous integration issues began to surface. These issues can be grouped into these five major categories:

1. Operational
2. System
3. Engineering/Development
4. Cultural
5. Financial

We discuss each of these categories below.

1. Operational Issues

WCC had operated in a relatively informal or unstructured style, often making markups on production drawings or other changes without a rigorous redraft of documentation. This style worked fine in WCC's small, close-knit operation where innate knowledge was passed from operator to operator. But the same style was disastrous when dropped into American's more structured and formal environment.

Former American production foremen were aghast when they discovered that the operation sheets and drawings they had inherited in the acquisition did not match the currently required configuration of the product. Production acceptance testing ground to a

halt as both teams scrambled to unravel the problems. The earlier presumptions that no major process audit or reprocessing would be required turned out to be a costly and time-consuming mistake.

Wage rates at the acquired firm were on average $4 to $5 dollars lower than American's current contract. When the transferred workers were brought up to American's scale, contract cost issues surfaced that were not accounted for during the due diligence process nor factored into the business plan that supported the committed payback.

Due diligence had assumed that WCC's purchases, when combined with American's existing purchasing leverage, would yield lower material costs when the existing purchase orders were renewed. However, this never materialized. Instead, the WCC vendors were replaced because they failed to meet American's higher quality standards. The replacement vendors turned out to be both more expensive and often late in delivery.

A third surprise came when operations management discovered that the planned build ahead of production requirements, which was intended to buffer the transition, had not in fact happened. Many critical components were transitioned while in a dangerous "line on line" position with customer requirement dates. Production disruptions, as they occurred, left the new entity overdue in supplying product to its customer. The telephone to Moore's office soon began to ring with disgruntled customers, raising the specter of penalty clauses and default provisions in their contracts. It was not the smooth beginning that American's management team had planned.

Responding to this developing problem, American's Executive Vice President, Bob Minor, held daily coordination meetings in Building Three, often involving many of American's best manufacturing, quality, and engineering people. The meetings often went

on for hours, pulling this critical management team away from countless other priorities. What was originally planned as a small $30 million operation became a black hole for management resources with no immediate end in sight.

2. System Issues

Compounding the already formidable operational issues was American's implementation of a new JD Edwards Enterprise Resource Planning (ERP) system. The acquisition of WCC hit right in the middle of a three-year upgrade of American's main operating software, something that had been planned for months before the acquisition even came on the radar screen.

The implementation caused confusion even in American's base business as associates struggled to come up to speed on how to do routine tasks inside the new software. The implementation was going as planned but that plan never envisioned simultaneously integrating a new entity. Reports that would have previously highlighted these new production problems had been discontinued in the old production system and not yet been launched in the new system, thus leaving factory managers blind to the extent of their problems.

3. Engineering/Development Issues

The transition between the two engineering staffs was expected to be relatively painless as a separate walled-off area was prepared to house the WCC engineers. They had been promised by various members of the transition leadership that they would operate as an autonomous group within American's facility, and would remain very much as WCC. This

pledge had calmed the nerves of those affected, who had feared becoming lost in the big American bureaucracy.

That autonomy did not last long, however. As American's managers began recognize the size of WCC's development backlog and compared it to their manpower, the potential performance gap became obvious. The need to recruit critical engineering skills quickly was patched temporarily with an increasing American engineering presence at WCC. The promised but now fragile cultural integration rapidly grew unstable.

This rapidly changing environment was enough to cause the departure of some of WCC's most talented engineers who found other jobs quickly. As more critical skills were lost, the gap between customer commitments and the existing ability to perform grew. American's recruiting staff worked feverishly to find replacement software engineers – at the same time as companies like Boeing and General Motors were scouring the country for just such talent. Mandatory overtime was put in place and the lines between WCC and American blurred even more as anyone who could help was pressed into action.

Cost estimates were blown through as the scramble to meet critical milestones became paramount. The modest transitional losses planned for WCC were consumed at an alarming rate and the need for major excess cost provisions began to be whispered.

4. Cultural Issues

As these parallel disasters (operations and engineering) continued to develop, the fragile cultural integration that management had worked so hard to put in place began to crumble. Each side blamed the other for the situation. WCC's president, someone who had

formerly run their engineering group, was forced to resign, and the first of what turned out to be a series of write-offs was recorded.

Critical departures continued to occur, and the remaining personnel grew increasingly agitated. Dialogues (AI's internal complaint system) poured in complaining of bad faith and broken promises. Dick Pace, American's most experienced senior engineering manager, was named to replace the departing president.

5. Financial Issues

Any hope of capturing the synergy originally intended by the transaction quickly gave way to the question, "How bad can it get?" Controllers, scrambling to contain the damage, were faced with a WCC engineering population that was unable to generate dependable cost estimates. These engineers confessed that precise earned value estimates, which American's team generated routinely, had never been part of their job at WCC. The restricted due diligence had not surfaced that fundamental difference. The 1997 Plan that had called for a modest $4.6 million profit turned into a $10.9 million loss with no real assurance that the bleeding had stopped.

Further adding to the mounting list of critical issues were new government program slips. Large-growth programs that WCC had counted on, moved out for 3-5 years.

The combined impact of all these factors made the new entity an enormous threat to the balance of American's businesses and its ability to cover from this burgeoning loss. More importantly, this small acquisition was becoming a management drain disproportionate to its size.

F. POST MORTEM

American's experience with WCC illustrates clearly how easy it is for a good strategy to be overwhelmed by poor integration. The case also illustrates that small acquisitions can carry risks that are disproportionate to their size. American's management under-estimated the resources and time necessary to complete this integration. They tried to do too much simultaneously: physically move the operation, convert the ERP systems, integrate disparate cultures, and offset the skills lost in transition.

The yield from synergy, which appeared so promising in the initial evaluation, proved to be elusive. Like thousands of similar deals, the possibility of negative synergies and reverse learning was never factored in.

Broader access to WCC during due diligence and more seasoned personnel on the due diligence team might have identified some of these issues earlier, but that is only conjecture. Performing some type of cultural due diligence and mapping the informal and unwritten processes would also have helped.

What is apparent is the long-term costs of not naming a full-time integration manager early in the process, to both plan and then execute the complex series of tasks that this integration required. Part-time managers could not spend the hours or get into the issues the way a full-time manager could. As the process "went critical" there were not enough people on the field.

CHAPTER SEVEN

CASE STUDY NO. 2: General Dynamics and Bath Iron Works

The acquisition of Bath Iron Works (Bath) illustrates the fundamentally different integration challenge that arises in a corporate rescue. A rescue is an acquisition where the target is in need of restructuring and support. The target's management invites the acquiring corporation to intervene and the tenor of the integration is friendly. It also often involves a commitment to inject critically needed resources either in the form of cash, expertise, or a combination of both.

Bath Iron Works had produced ships on the eastern coast of Maine for more than 100 years but deep defense cuts in the late 1980s and early 1990s, coupled with insufficient capital investments, threatened its very existence. Bath's owners, Prudential Insurance, approached General Dynamics (GD), which built submarines in another location a couple hundred miles down the coast and asked them to consider adding Bath to their portfolio.

The resulting $300 million acquisition marked GD's first step back into the defense business that they had abandoned in the early 1990s. It signaled new leadership at GD with a different agenda. We will examine in this case the dramatic shift in strategy at GD and how timing played an important role in the decision to proceed. We will also consider how integration in the context of a rescue differs from other types of transactions.

A. STRATEGIC RATIONALE

General Dynamic's 1995 acquisition of Bath marked a strategic turning point for GD, a firm that had once been the Defense Department's top contractor. For the three-year period immediately prior to this acquisition, GD had been divesting defense-related businesses at a furious pace. They had pared their once proud portfolio of companies until only two remained: Electric Boat in Connecticut and the Land System Division in Michigan. The corporation's management, which was led at the time by former Apollo astronaut William Anders, believed that the end of the Cold War marked the beginning of what would be a brutal consolidation in the defense industry. They further believed that the company that responded first to this impending change would enjoy a substantial "first mover" benefit. Anders was quoted at the time as saying, "Weapons makers can no longer count on fears of the Commies pouring through the Fulda Gap to help fuel a new arms buildup. To pretend otherwise could spell ruin". He went on to say, "It's like being a fighter pilot, and one of your engines is on fire...You can't just wish it wasn't that way. You've got to shut the thing down and try to land on one engine." [7]

Based on that philosophy, Anders divested, in a rapid-fire sequence of transactions, Cessna Aircraft to Textron, Military Electronics to the Carlyle Group, Jet Fighters to Lockheed Martin, and several other units to the highest bidders.

The company piled up cash as it shrank its annual revenues from a high of $10 billion to a low of $3 billion. During the divestiture process, Anders also attempted to sell Electric Boat (its nuclear submarine company) and the Land Systems Division (its tank-building subsidiary), the two pieces of GD that they ultimately retained, but he found no suitable buyers.

Having completed his mission of reducing GD's exposure to military spending, Anders gave way to James Mellor who replaced him as CEO. Mellor was an operational specialist who focused on improving the core profitability of GD's remaining businesses. Mellor moved a promising executive, Nicholas Chabraja, into the role of President and charged him with building the corporation's future strategic direction. The former Chicago trial lawyer followed Mellor into the top job in 1997 and began to implement the strategy he had put together in his previous role.

Chabraja faced immediate pressure from Wall Street analysts to do something with the huge accumulation of cash built during the great selloff. He also knew that the firm, as currently configured, could not deliver the kind of earnings growth that Wall Street had come to expect. Chabraja knew the time had come to reverse course and begin to re-grow the company. "He fashioned a new plan. It called for redeploying capital into niche acquisitions and expanding the company's ability to handle complex integration of weapons systems."[7]

B. TRANSITION

General Dynamics decided to involve third-party consultants, Booz Allen Hamilton (international strategy consultants), to aid in the integration. GD had used Booz extensively at their Electric Boat subsidiary and had grown comfortable with their re-engineering capabilities. Knowing of the substantial restructuring work required at Bath to make it viable again and limited by a lean corporate staff, Booz became a natural choice. They joined forces with an experienced corporate team from GD to plan and then execute the integration. This blended approach brought two important elements to the integration: (1) skilled experienced people, and (2) an integration framework

As in most successful integrations, the combined team focused on important value drivers. They triaged the task list to ensure that resources were properly focused. The drivers they identified were improved cost management capabilities, a prioritized approach to process re-engineering, and way to "build and leverage joint capabilities within an extended enterprise framework"[18]

The first initiative was managed via a process called Integrated Business Management. It was a detailed target costing process that exploded overall system targets into hundreds of subsystems and components. An executive steering committee served as the coordination and oversight board for this initiative. The second driver was also coordinated through this executive panel. All initiatives to enhance Bath's competitiveness and meet these exploded targets were coordinated by this group.

Next, Bath leveraged the work that its sister division, Electric Boat (EB), had done on an Integrated Product Development (IPD) process. The IPD process linked the value chain virtually, giving all team members access to a common data warehouse. Rather than reinventing that process, Bath simply joined forces with EB

Perhaps one of the most valuable contributions of the consultants was the advanced market simulation capability they brought to Bath. This complex simulation capability gave Bath management a powerful what-if capability.

These frameworks, tools, and discipline helped Bath cut through the delays and uncertainties that acquisitions usually entail. They enable the new management team to capture and redirect energy that is often wasted on anxiety and instead channel it to a revitalization of the company. The confidence and experience added by blending the team of

Bath, Booz Allen, and Electric Boat limited the false starts and substantially reduced the transition timeframe.

C. CRITICAL TRANSITION ISSUES

General Dynamics' re-entry into the defense arena was not without risk. Bath had a proud tradition but a serious competitiveness issue. GD knew going in that they not only had to integrate the company but they had to re-engineer it at the same time. They also knew that the $300 million invested to acquire the company was just the start of their investment.

Bath also had an active union with a non-competitive labor contract. The fear that the facility would be shut down and moved to fill idle capacity at Electric Boat made that union very nervous.

A third issue was the forecast for defense spending on ships. Although Bath had a healthy backlog at the time it was acquired, their ability to maintain and grow that backlog in this budget-cutting environment was questionable. The company had to regain its competitiveness quickly if it was going to preserve its current level of business.

D. RESULTS

General Dynamics' CFO, Mike Mancuso, called the integration effort at Bath a huge success. It enabled GD to improve on the forecasted business case and bolster management's ability to get subsequent deals approved by the board. The model created in the Bath deal was utilized in subsequent acquisitions, including GD's most recent purchase of NASCO, another large shipyard in California.

Booz Allen's involvement was not the only cause of the integration's success. GD's management arrived in Bath on Day One and worked hard with employees to restore confidence as well as productivity. They committed to the union that they would not shut Maine down nor attempt to restructure the labor contract. They made the communications link to stakeholders and stayed on the air waves throughout the process.

GD also tightly linked the valuation of the deal with the cost of the turnaround. They mapped the integration process early in the negotiations and had their integration strategy laid out before the deal closed. They also used executives involved in the due diligence efforts on the integration team. They captured that critical learning and leveraged it in the integration process.

CHAPTER EIGHT

CASE STUDY NO. 3:
At&T and Teleport Communications Group

A. TRANSACTION RATIONALE

In 1996 the Telecommunications Act changed the competitive rules for both the local and long-distance services market and threw open the doors for the telecommunications merger mania of the late 1990s. The forces driving these mergers are competition, convergence, and consolidation. Industry analysts believe that only three or four mega-companies will remain after the consolidation is completed. Customer demand for "one-stop shopping" for a complete suite of communication services has fueled a fire leading to this drastic restructuring of the telecommunications service industry.

After the breakup of the Bell system in 1983, AT&T lost 49% of its market share in long-distance service. Only recently has it found a new lease on life through the 1996 legislation. These regulatory rule changes allowed the broadening of AT&T's reach. That growth has been accomplished through several ventures: the $11 billion acquisition of a competitive local exchange carrier, Teleport Communications Group (TCG); the $48 billion acquisition of the cable provider, Tele-Communications Inc. (TCI); and the $10 billion joint venture with British Telecom. These acquisitions and joint venture are part of AT&T's integrated strategy to expand into local, long distance, cable, and international industries.

The July 1998 AT&T/TCG merger encompasses more than 300 communities with more than 10,000 miles of fiber optic cable and 50 local switches. The TCG acquisition

allows updated products and services while reducing dependence on the former Bell companies for direct connections to homes and businesses.

The new company began by providing integrated services to Boston, Houston, Chicago, Ft. Lauderdale, Milwaukee, and New York City. However, it intended to expand into 34 cities by the end of 1998 and to 66 cities early in 1999. C. Michael Armstrong, AT&T's CEO said, "Completion of this merger accelerates our entry into the $21 billion business local service market because we're reducing our dependence on the Bell companies for direct connections to businesses." Armstrong further indicated that, ".... the strategic value of these mergers positions AT&T for growth and undisputed leadership in three of the fastest-growing segments of the communications services industry – consumer, business, and wholesale networking services." [10]

Armstrong also said that the mergers give AT&T a platform that will enable it to double its revenue growth for the next two years. He identified the pillars of growth as (1) business services, (2) a Solutions unit, (3) Internet services, (4) wireless, and (5) frame relay and data services.[2,3]

B. COMPETITIVE ENVIRONMENT

Since the Bell system breakup, the competitive telecommunications arena has been growing ever more fierce because inter-exchange carriers, such as AT&T, have been held at bay by the incumbent local exchange carriers, such as the Baby Bells. The Baby Bells firmly retained local access to both business and residential customers, and then sold access to the inter-exchange carriers (IXCs). The IXCs resold these services, thus making the long distance service so competitive that it is difficult to sustain sufficient profitability.

This exclusive hold by the Baby Bells over the local lines, coupled with dissatisfaction among customers, ultimately led to the Telecom Act. Ken McGee of the Gartner Group said,

> We've been hearing for a long time, mainly from the Fortune 1,000 companies that they cannot wait to fire their Local Exchange Carrier. They don't want to move services to a Competitive Local Exchange Carrier; they want their IXCs to handle everything. That's been the overpoweringly consistent message we've been hearing for two years before the Telecom Act." [47]

In 1997 the IXCs, like AT&T, were rated 22% better overall in providing services than Incumbent Local Exchange Carriers (ILECs) like Bell Atlantic/Nynex.

Prof. Jagdish Sheth of Emory University, founder of The Center for Telecommunications Management, believes that the IXCs can capture no more than 25-30% of the local market from the ILECs. However, he believes that the ILECs can potentially capture 45% of the IXCs' business. This adds to the focus, drive and determination of firms like AT&T to get into the local markets – and it depends highly on near-term rulings by the FCC.

The wireless market is a wild card in the overall competitive mix. AT&T currently has the largest infrastructure and the only national footprint. A recent study by BellSouth found that 16% of new personal communications service customers in Louisiana dropped their conventional wire service. In addition, 56% of wireless customers use their wireless phones for receiving and making phone calls at home.

AT&T is pushing a scenario in which a wireless phone is the only phone needed for home. Other competitors are working feverishly to catch up. MCI/World-Com has a wireless service but does not have a network of its own. Sprint is busy developing such a service. Bell Atlantic, SBC Communications, and GTE are large wireless service providers.

Analysts have predicted that there will be a flat rate and local unlimited calling service; AT&T recently announced their own one-rate offer.[47]

C. TRANSACTION EXECUTION

The AT&T merger with TCG was accomplished through a tax-free exchange of 188 million shares of AT&T stock for all of TCG's shares. The TCG shareholders received 0.943 shares of AT&T for each share of TCG. The total shares of AT&T will be rounded down, with the residual fraction accommodated with a cash payment. The cash payment was necessary to satisfy federal tax considerations. The transaction took only six months from beginning to end.

TCG had 1997 revenues of $494 million, assets of $2.456 billion, and long-term debt of $1.054 billion. AT&T had 1997 revenues of $51.3 billion, assets of $57.4 billion, and long-term debt of $6.0 billion. AT&T services 80 million customers, has 119,000 employees, and 3.5 million shareholders.[47]

D. TRANSACTION APPROACH

The AT&T/ TCG transaction was part of an overall strategy that began under former AT&T CEO Robert Allen but was solidified with the arrival of Armstrong. Although the deal was in it infancy when Armstrong arrived, he brought his own style and a sense of urgency to the transaction and subsequent strategy. According to people close to the transaction, the merger was only the first step in a planned series, and as such, pressure was applied to move the acquisition along swiftly.

The teams associated with the transaction are the kinds common to many acquisitions: a steering committee supported by functional teams, human resources, public relations, networking, and sales. To expedite the operational details, several commercial agreements were put in place as a precaution should the acquisition fall apart or be disallowed by the government.

It is interesting to note that even though this was one of the largest mergers in the telecommunication industry, consultants were not extensively used and AT&T did not have a detailed playbook to follow. The chief guidance given to the teams was not to follow the model of the McCaw acquisition of a few years earlier. While that deal was a strategic success, it was a difficult and disappointing merger from a cultural perspective. The average tenure at McCaw was three years, where the average tenure at AT&T was 15 years. The cultural clash resulted in losing several key people, including McCaw himself.

The participants on the teams were individuals with a good understanding of their discipline but who also had good connections throughout the company. The basis for participant selection was, when a question arose the person would be able to quickly contact someone inside the organization who could provide the pertinent information to resolve the issue.

Following the due diligence process, both AT&T and TCG utilized a "co-lead strategy" for the transition team. These C-leaders also participated in the due diligence process and therefore understood many of the subtleties that were key to and agreed upon in the business case but possibly were not captured in the formal documentation. This insight is invaluable when some aspect of operational effectiveness is questioned during the transition phase. Almost inevitably the forecasts developed for the business case do not become

reality, or perhaps not in the forecasted manner. An understanding of the components that went into building the business model also provides a springboard for discovering ways to recoup system costs or identify opportunities for greater profitability.

This same kind of insight is needed when addressing issues with senior management during periodic reviews of the progress of the transaction. Co-leadership positions can help the acquired employees to recognize that they do indeed have a voice in the transition process.

As mentioned earlier, it is hard to underestimate the paranoia felt by acquired employees, which is only fueled by flames from the rumor mill. Hence, a crucial need is for frequent and honest communications with all employees. Both TCG and AT&T spent significant time with employees in townhall-style meetings, provided weekly and biweekly notes, and installed an employee hotline.

The transition process for AT&T employees was aided by an early retirement buyout that was being executed at the time of the merger. With the exodus of numerous workers, additional opportunities became available for those who remained, which alleviated some concerns about acquiring additional workforce. Attrition between AT&T and TCG during and after the transition was largely minimized due to these efforts. Also, key talent was identified prior to closing the deal, and their services were guaranteed for a period of time by incentives for staying and dis-incentives for early departure. However, this was not true for employees of TCG's recently acquired ACC where attrition was high. The bulk of TCG's management stayed on after the acquisition. The first-tier management structure was populated with both AT&T and TCG management. The second tier was wholly populated with TCG personnel.

The cultural differences between AT&T and TCG were relatively mild. In fact, many TCG management team members were ex-AT&T or ex-Bell employees, so the culture they were being brought into was already familiar to them.

There were no significant governance issues, and the mode of operation was to move as fast as possible. Speed was imperative since there were other deals in the making, namely TCI and British Telecom, so this current transaction needed to be closed prior to moving on to other strategic ventures.

E. RESULTS

When Armstrong arrived, AT&T stock was trading at $47.50 with a market capitalization of $77.18 billion. The market continued to reward his tenure at AT&T, as stock prices moved upward to $65 or more -- until the announcement of the TCI merger. Then the stock price dropped to $60-3/16 in June, 1998. However, in the six months following the announcement, AT&T moved into new territory and as of February, 1999 was trading at 84-1/4. So the market has rewarded the strategy being executed at AT&T as it anticipates greater profitability.[2,3]

This merger has been successful and can be characterized as a collaborative, highly integrated, product extension type of acquisition. Its success was achieved by using the following features of a successful transaction execution:

- Communicate, Communicate, Communicate with acquired and acquiring employees
- Establish a co-leader transition team
  (Sensitivity on both sides required to capture value creating synergy)
- Continuity of transaction leadership throughout process
  Corporate memory of business plan assumptions critical to successful execution of transition integration

- Team Creation (significant line personnel with good networking skills)
- Contingency Commercial Agreements to capture synergy if transaction fails or anti-trust problems halt integration
- Memorialize learning through some "lessons learned" processes
- Key personnel retained, persuaded by incentives and dis-incentives
- Few consultants utilized

CHAPTER NINE

CASE STUDY NO. 4:
Travelers Group and Citicorp

There is perhaps no better illustration of the formidable challenges involved in blending two distinct organizations than the April, 1998 merger of Travelers Group and Citicorp into a new entity known as Citigroup. In what was at the time (since eclipsed by the Exxon/Mobil transaction) the largest merger in history ($73B), these two corporate giants tested the boundaries of the Glass Steagall Act and created the world's largest financial services company with over $700 billion in assets and 100 million customers. The scale of this transaction not only transformed the two participants but changed the entire industry as well.

How could such a monumental undertaking even be attempted? What strategic rationale precipitated it? How was such a grand integration coordinated? We will look at this transaction in detail in the hopes of distilling from this yet unfinished story some issues and strategies common to most merger transitions.[43,44]

Since the merger is so recent it is impossible to determine its relative success or failure, but even at this early stage issues arising from this marriage illustrate the difficulties of knitting together two enterprises.

A. COMPETITIVE ENVIRONMENT

Banking

The recent flood of mergers and acquisitions has focused primarily on just a few industries, and banking has been at the epicenter of this new wave. The most frequent strategic rationales for such mergers are scale and access to a broader deposit base. Terence Pare, who has followed this merger, wrote:

> In 1980 banks and thrifts accounted for 54% of total financial assets of financial institutions in the US. By last December that share had dropped to 33% and by last June it had slipped to 32%. Fifteen years ago consumers left about 34% of their assets in checking and savings accounts and CDs. Now we bank just 17% of savings. Over the same period the share of financial assets that individuals hold in investments like stocks and mutual funds has jumped from 28% in 1980 to 37%.[50]

This slow but steady erosion in deposits and the corresponding profits that such deposits generated has caused mainstay banks to look for alternative sources for deposits and profitability. The industry has encountered what Andy Grove, Chairman of Intel, terms " a strategic inflection point".[34] Competition from non-traditional sources like GE Capital and Merrill Lynch has changed the face of banking, and the industry finds itself struggling to remain relevant despite enormous technological gains.

Large corporations can go directly to the commercial paper markets to borrow funds, Corporations like GM and GE have in-house financing capabilities via their capital corps, and the short-term working capital needs that provided good profitable business to banks is being re-engineered away.

In this transaction, Citicorp's John Reed had the added burden of substantial bad debt exposure in Pacific Rim countries, Russia, and Latin America as well as commercial real

estate and derivative risk. Given these formidable environmental factors Citicorp's options for long-term growth and profitability were limited.[43,44]

Financial Services

Sandy Weill, CEO of Travelers, was grappling with a different set of strategic issues. Travelers Group had evolved as the result of a series of acquisitions over the last ten years, including the 1993 addition of the brokerage firm Smith Barney, a transaction that was executed to build up Travelers' financial services portfolio. Most recently, Travelers spent $8 billion to add Salomon Inc to the mix. That deal blended Salomon's investment banking and fixed income expertise with Smith Barney's retail network. GE's Jack Welch described Weill's transformation of Travelers this way: "*He's been fantastic...He took air and turned it into this big, successful thing, it's been remarkable*".

Despite these additions, Travelers is fundamentally a domestic operation with little international experience. To quote Reed, "*they had a hard time finding Chicago*". To create a truly global financial powerhouse, Weill knew he needed to add another piece to the puzzle. Rumor had it that Weill had previously attempted to address the shortcoming with merger overtures to JP Morgan, then to Goldman Sachs, and then Bankers Trust, all of which declined. But Weill did not give up; he just set his next sights on Citicorp.

B. THE DEAL

Sandy Weill sowed the seeds of the eventual merger between Citicorp and Travelers during a conference he attended with Reed in February 1998. Weill approached Reed and asked if he had ever thought about a merger of equals between the two firms, that he thought

the companies complemented each other well. Reed commented, *"When Sandy said to me it might be something we should do, I knew it was worth looking into".* Reed, who was at the time on a world tour for Citicorp, promised Weill that he would have his team look at the potential and get back to him. Reed's team analyzed the possibilities and reported to their boss (who was still traveling) that the deal had significant potential. Reed then sent Weill a lengthy fax outlining the initiatives he had underway at Citicorp and the absolutes that any deal would have to contain. Weill concurred and substantive discussions got underway in March 1998 leading ultimately to the announcement of the deal on April 6, 1998.

C. INTEGRATION ISSUES

Tying the corporate knot between these two financial giants engendered numerous integration issues. The deal was almost four times the size of the largest deal to date (1997, Cap Cities-ABC-Disney) and would cross fundamentally different industries. The types of issues that surfaced can be grouped into the following five categories:

1. Corporate Governance and Decision-Making Architecture
2. Corporate Culture and Style
3. System and Processes
4. Compensation
5. Regulatory

1. Corporate Governance and Decision-Making Architecture

Reed and Weill avoided difficult leadership decisions during the transition period by deciding to share leadership of the new company as co-CEOs. In addition, this dual leadership model was to be used for most of the top leadership positions in the enterprise, including the heads of Consumer Banking and Corporate Banking. Reed commented, *"Clearly it's not the perfect way to run a company. But when I talked with my key guys, we*

talked about how we would work together and how reporting to us would mean dealing with two people…I'm persuaded it can work. Our sense is it's well worth doing". In a CNN interview, Weill sounded equally bullish, stating, "I think we can establish the most by sharing leadership. We can do that and accomplish much more than alone,"[4]

But neither man is naïve. They both realized that chemistry could change or philosophies diverge. That lesson was all too clearly highlighted in the 1998 departure of Jamie Dimon, the short-lived president of the new Citigroup. Dimon, who was once touted as being so close to Weill that he was considered like a son, was pushed out for not being a team player. Prior to the merger, Reed also had serious discussions with his board about their obligation to step in if the co-leadership experiment did not work out and to replace both him and Weill. In the words of a Traveler's director "I love this deal because we start off with such a big pile of chips…But I know that no stack of chips is high enough if these two guys can't work together".[42]

Another difficult governance issue that needed to be confronted early in the planning stages for this new enterprise was the composition of the board. Travelers had 16 members on their board and Citicorp had 12. Simply combining the two boards would not work. Weill and Reed settled on sixteen, eight from each side. That decision alone required that twelve existing directors be asked to step down, a process that Reed readily admits was painful.

2. <u>Corporate Culture and Style</u>

The style of the two leaders and their two corporations could not have been more different. Citicorp was a 190-year-old conservative bank with a fairly rigid culture led by John Reed, a 59-year-old professor-like executive. Travelers was a loose amalgamation of acquisitions led by the flamboyant and impulsive 64-year-old Sanford (Sandy) Weill. Reed

shuns the spotlight and claims he doesn't even own a television; Weill loves the give and take with the press and holds court regularly. Asked by *Fortune* magazine in a recent interview, "Now that you're allied with Sandy, are you going to have a more public profile?", Reed responded, "I hope not. My deal with Sandy was, I'd be happy to cooperate as necessary in the beginning. But I don't want all of a sudden to be a great public figure."[8]

Reed is candid about the inevitable culture clash that tying these two firms together was bound to create. In certain respects it was just that clash that made the linkage attractive to Reed. He had grown frustrated with the lack of entrepreneurial spirit at Citicorp and, despite years of trying, he was unsuccessful at instilling more of that spirit. While he knew the merger's effect would be traumatic, it was a trauma that in Reed's mind was overdue. *"I've been struggling for years to try to improve the management and energy levels within Citi... I think there is an intensity and a sales capability in Travelers that we don't have as well developed. This is going to improve our management DNA".*

3. Systems and Processes

Managing an enterprise as large as the new Citigroup requires sophisticated management reporting and control systems. Citicorp was well-networked prior to the merger; Travelers, as a conglomeration of prior acquisitions, was run largely as a set of independent companies. The CFO of the newly combined company faced the daunting task of delivering consolidated planning data to the new board with no planning infrastructure yet in place.

Also, this deal built so heavily on the notion of cross-selling financial products that some method was needed to first put the customer databases together.

4. Compensation

One of the most difficult elements of blending these two enterprises may prove to be their respective compensation schemes. Reed noted recently that if the Citigroup proxy was published tomorrow he would not be in it (i.e., he is not among the five highest paid individuals at the new firm). That individual case is easily correctable, but the lack of parity in pay scales goes deep into each organization. Citigroup cannot afford the rich benefit structure that Citicorp carried before the merger, and the new entity would go broke adopting the rich bonus scheme that Travelers had in place. Reed owns about $160 million of Citibank stock while Weill owns $950 million of Travelers.

5. Regulatory

The cross-industry nature of this deal runs contrary to the 1933 Glass Steagall Act, established to respond to widespread bank failures during and after the Great Depression. Provisions of the Act prohibit bank holding companies from owning insurance companies. However, a loophole in the law allows a deal to work in the other direction, that is, an insurance company can become a bank holding company. Under this provision, an insurance company that bought a bank would then become a bank holding company and have two years to comply with the Act. The Federal Reserve also has the authority to grant up to three one-year extensions to this two-year grace period.

The compliance people at Citigroup believe that the five-year window provided under the existing statute will be a sufficient timeframe in which to actually change the law. Legislation to open up these statutes passed the U.S. House of Representatives in 1998 only

to die in the Senate. Texas Senator Phil Graham, Chairman of the Senate Banking Committee, has put bank regulation reform high on the Senate priority list for 1999.

D. TRANSACTION OUTLOOK

The final verdict on whether this transaction will work as intended is several years away, but enough trouble spots have emerged to date to raise some legitimate doubts. The new enterprise has enormous potential and unparalleled capability, but unless it can forge a common vision those capabilities will be sub-optimized.

CHAPTER TEN

CASE STUDY NO. 5: IBM and Lotus

A. TRANSACTION RATIONALE

On June 5, 1995, Lou Gerstner, CEO of IBM, announced an offer to buy 100% of Lotus. The proposal met with strong opposition from upper management at Lotus, especially its CEO, Jim Manzi. Gerstner offered a $60 per share, all-cash offer for the software maker.[57]

To understand the dynamics of the acquisition that eventually took place, it is necessary to look back to 1993 when Gerstner was selected to become the first outsider ever to head IBM. He had a renowned talent for turning companies around and an equally renowned reputation as an intense, ambitious, driven executive. At the time of his selection, IBM was in the middle of a seven-year downward spiral. IBM's stock stood at roughly one-quarter of its historic high, and the workforce had been gutted from 406,000 in 1986 to 219,000 by 1994. After reviewing the company's product development process, Gerstner commented, "You don't launch products here. They escape."[49]

When Gerstner came to IBM in 1993 the company was hemorrhaging market capitalization profusely. In the previous seven years the company had lost $80 billion in market capitalization and the stock was trading at $47.50. From 1993 to 1995 Gerstner turned the 1993 loss of $8 billion into steadily growing profits and had recaptured $75 billion of market capitalization.

IBM was pursuing a strategy of disaggregating several businesses – a course which. Gerstner reversed after his 90-day review period. Gerstner's McKinsey-styled analysis of the business resulted in a wholly revamped IBM. He began cost-cutting measures, restructured the firm, and weeded out disbelievers. Even after his famous comment, "The last thing IBM needs is a vision", he brought one to the big company. He re-focused IBM by overhauling and reviving its mainframe business, reapplied its services business, and brought IBM back into the PC business. Furthermore, he plotted a course to make the corporation into corporate America's information technology company and to provide the architecture, systems, strategy, and services to connect entire industries. Andy Grove of Intel has said that Gerstner "...redefined IBM's sandbox and it is very big." Gerstner said that 1994 was the year IBM proved it could survive and 1995 was the year that it stabilized. [49]

Part of the stabilization came about with the acquisition of Lotus and its desktop software. Gerstner's vision of the future for IBM included a brand-name desktop software company, and he believed that should be Lotus. In February 1995, IBM had completed an extensive analysis of the market and identified Lotus as a good fit both strategically and operationally.

IBM built a team of 15 people to review, analyze, and plot each step of the transaction. With every detail of the financial, legal, and operational aspects already organized the plan was to move quickly. It was already anticipated that Manzi would not look favorably on the deal and that he would try to stop it at all costs. So the bid for the company had to be at a premium significant enough that it would discourage all "stalking horses". Finally, there was fear that once the news was out, either Oracle or AT&T would also enter the bidding. [49]

B. COMPETITIVE ENVIRONMENT

In the hardware and software worlds in which IBM and Lotus participate, the competitors are equally familiar household names: Intel, Sun Microsystems, Oracle, Digital Equipment, Cisco, Lucent, and the enemy of them all, Microsoft. The acquisition would give IBM the lead in groupware programs. There were never any indications that the government was concerned about the acquisition from an antitrust perspective. The government's focus was on Microsoft, which led to a suit against them for antitrust practices.

The initial reaction from analyst and market watchers about the bid was varied. Some indicated that they thought the acquisition was being considered to boost slumping sales for IBM, but this theory didn't work given Lotus sales figures, which had seen declining profits for two years. In the first quarter of 1995 Lotus had reported a loss of $17.5 million. Microsoft had moved in with Microsoft Office and its presence began to systematically cut into Lotus's group products. Lotus was losing market share by the day. Lotus management was struggling to identify a successful strategy that would compete with and win against Microsoft. They simply could not find a way to circumvent the size and depth of Microsoft.

A more likely reason for the acquisition would be that IBM had long-term plans for incorporating Lotus's groupware products with IBM's systems to create a more vertical offering to corporate America. The acquisition also indicated IBM's concerns about the evolving marketplace in the Internet. It also signaled to the market that the stodgy dinosaur had come to life and was going to be a force in the market.

In contrast, after the telephone call from Gerstner, Manzi, the volatile, sharp-tongued chief of Lotus, spent three days trying to find adequate financing to thwart the IBM proposal. When his attempts failed and it was obvious he was going to become an IBM employee, he

insisted on reporting directly to Gerstner. This was accepted and he then attempted to take over all of IBM's software business from John Thompson, Senior Vice-President for Software Development. When this move was thwarted, Manzi left the company, having spent only 99 days as part of IBM.

IBM moved quickly to promote insiders at Lotus to fill vacant positions. It was important to demonstrate autonomy for Lotus and that conveyed the message that IBM was not going to invade and force the "Big Blue" culture on Lotus. Those who were selected to continue after Manzi (i.e., Michael Zisman and Jeff Papows) were familiar to IBM and to other key partners such as Sun, Oracle, and Intel. Papows and Zisman both quickly established that their motivation was not power or money but to make the acquisition work. After Manzi, an additional ten managers left, giving rise to provided opportunities for aspiring young managers to demonstrate their capabilities. One industry watcher exclaimed that "the brain trust of Lotus was leaving".

In fact, those who left were in staff positions that are typically tied to the CEO, namely, the CFO, human resources, marketing, etc. The real brain trust, those who generated and debugged code, never left . Within months of the transaction, employees realized they were going to survive, and with continuing investment from IBM they could actually accelerate many development plans and compete with Microsoft head-on.[57]

C. TRANSACTION EXECUTION

After Jim Manzi realized that he could not prevent the transaction, intense negotiation between the companies began the following week, resulting in an agreed price of $64 per share, and the entire $3.3 billion deal for Lotus was completed in one week. During the week

of negotiations, Lotus's board vested all outstanding stock options, driving up the cost of acquisition for IBM in a pseudo scorched-earth policy. The day of the announcement, the market price of IBM dropped by the amount of the premium paid for Lotus (~$1.5B), a clear indication of the market's perception of the value-creation capability of the acquisition. This number is the equivalent of 20 million boxes of Lotus Notes.

Within the first month after the transaction, the majority of Lotus staff personnel left and Manzi followed after 99 days. It is an interesting note that all Lotus individuals involved in the negotiations with IBM that first week were gone in three months. IBM's Thompson was prepared for such an eventuality, and within 24 hours of Manzi's departure Zisman and Papows were put in place as Chief Executive and COO, squelching any rumors that IBM was going to move in and take over.

In the first six months only one IBM employee moved to Lotus, and this was because of a vacancy in the CFO position. This decision, along with others that established Lotus as a wholly owned subsidiary, calmed fears and rumors among Lotus employees. Thompson understood the anxieties created by the acquisition, and he established a communication conduit with Lotus that ran specifically through his office only. Thompson said, "Frankly, I wanted some of our employees to behave more like Lotus employees." He further indicated that he did not want the new Lotus employees to be "kissed to death" by well-intentioned IBM employees. [57]

IBM left all of Lotus's personnel systems intact, such as stock options, compensation plans, and benefits. In fact, IBM eventually adopted some of the Lotus benefits plans. Now, three and a half years later, after high trust has been gained, the internal systems are being

reviewed for incorporation into IBM, specifically, the discount volume purchase, payroll, benefits, and compensation systems.

Prior to this many of the normal business exchanges between the firms were difficult. There was undoubtedly an additional cost burden due to loss of efficiency and effectiveness. Even personnel transfers were difficult. One Lotus employee was even told, upon transferring to IBM, "You're not really an IBM employee". Also going from IBM to Lotus encountered difficulties early on related to retirement and compensation systems that did not recognize employees as part of the same organization. Even so, these burdens were less expensive than the flight of knowledge capital.[57]

D. TRANSACTION APPROACH

This transaction was part of an overall strategy designed to expand IBM's opportunities in the new Information Age. The approach was one that was well thought out and impeccably executed. Thompson of IBM had performed a detailed assessment of the target and had contingency plans ready, such as a replacement for Manzi. With IBM's resources, Lotus was able to move to the forefront of the hottest segment of the software market.

The key to this transaction was speed. IBM knew that once initiated it had to move quickly to prevent other bidders and to retain and secure Lotus's intellectual capital. Within minutes of making the offer to Lotus, IBM had a special communications mechanism already in place on IBM's Web page to handle questions from Lotus employees. IBM went as far as possible to communicate with Lotus employees about the company's intentions within SEC regulations. IBM took care of personnel issues up front, recognizing that they were acquiring

people not hard assets. The week following the phone call and after the deal was closed, IBM bused all of Lotus's employees to the Wang Theater in downtown Boston where the new and the old had an open dialogue with leadership. IBM demonstrated its commitment to Lotus by replacing all of IBM's legacy software with Lotus Notes and by closing one of IBM's software research facilities in Texas and transferring all of the responsibility to Lotus.

E. RESULTS

At $3.3 billion, the hostile acquisition of Lotus was the most ever paid for a software company up to that time, and the deal cost IBM $1.5 billion in market capitalization. The acquisition has been characterized by many as less hostile and more like a bear hug. This acquisition is a successful one and can be characterized as a hostile, strategically integrated, vertical product-extension type of acquisition.

In the years since the acquisition, the attrition rate (a critical variable to Lotus) has dropped from 11% to 6%. Manpower has increased from 6,000 to 9,000 people. The installed base of their products has gone from 2 million users in 1995 to 34 million users in 1998. Under IBM, the bonus and compensation plans at Lotus have been very profitable for employees. IBM has indicated that for every dollar in sales of Lotus products, IBM receives $4-5 of hardware sales to go with it. This is the type of leveraging required to make an acquisition of this type work.

When questioned about the synergy of the transaction, Zisman told us that he never used the words *synergy* or *strategic* when talking about the acquisition. He indicated that it is imperative to be very clear about the reason for acquiring a company, and there are very different implementation techniques for integration depending on whether the transaction

involves an acquisition of assets or an acquisition of people. He feels that most companies engaging in acquisitions today do not have a clear business plan for how the acquired firm is to be folded into the operations of the acquiring firm. He further suggested that the executives who created the plan should be debriefed on the plan's progress every quarter and continually asked what they are doing to fix problems that have been encountered.

From the actions of and discussions with the participants in this acquisition, it became clear that it is necessary not be rigidly fixed on one particular strategy or one set of financial performance numbers. A critical eye toward the market and the needs of the customers should be at the forefront of business decisions about whether to acquire or divest, maintain core business or change toward evolving trends. There can be no sacred cows in the business. Every aspect of the business must be held in an open hand, with agility and flexibility as constant companions. In keeping with this sentiment Zisman noted that throughout the execution of the acquisition, it was necessary for the success of the business that executives check their egos at the door.

The salient execution features of this transaction are:

- There can never be too little communication with employees of the acquired.
- Team creation (the right people in the right jobs doing the right things)
- Ensure autonomy, assist the company with finances, people (but do not overwhelm with help)
- Memorialize learning through some "lessons learned" processes
- Develop a clear and precise business plan and then grade the operating executive based on the plan and his ability to adjust it to the situation.
- Hire someone else to negotiate the sale of the business, otherwise the negotiations become too personal.
- Retain key personnel (without incentive programs, if possible)

- Do not adjust the stock options vestment schedule.
- Understand the real culture then grow beyond peaceful coexistence to cross-pollination.
- Build on the company's credibility with the customer and business partners.

CHAPTER 11

CASE STUDY NO. 6: Lockheed and Martin Marietta

In the nine years since the fall of the Berlin Wall and after fourteen years of continuous decline in the U.S. defense budget, current funding for defense is now at it lowest point since before the Second World War. During the 1960s the defense budget was roughly one-half of the federal budget; now it is about one-seventh. This dramatic shift did not come suddenly. In 1993 Defense Secretary Les Aspin conducted the now famous "Last Supper" with defense industry leaders where he presented the message of "Consolidate or Evaporate".

This set off a frenzy of activity among defense contractors. Several firms, such as General Dynamics, sold off much of their holdings in the defense arena. Others actively consolidated through acquisition. Both defense officials and industry analyst indicated that they believe future defense funding levels could only support as few as two but not more than four prime contractors. Lockheed and Martin Marietta both acquired firms during these years.

A. TRANSACTION RATIONALE

Lockheed was one of the leading firms in the defense technology sector, with expertise in special-mission/high-performance aircraft and missiles and guided weaponry. The company was based on the West Coast and in 1993 had revenues of $13.2 billion.

Martin Marietta was one of the early survivors and a chief competitor to Lockheed, and a leader in space, aviation, and communications equipment. In 1993, Martin Marietta generated revenues of $9.4 billion.

Without a doubt the major driver for the transaction was the drastic reduction of resources from the federal government. Defense spending had reduced nearly 50% in just a decade. Even so, officials at both Martin Marietta and Lockheed maintain that defense reduction was not the only motivation. The merger partners identified a forward-looking combination of complementary companies that would achieve critical mass sufficient to compete in the global market. They pointed to similar corporate strategies, overlapping businesses, excellent performance records, and a string of recent successful M&As as synergies they could leverage to enter into additional markets an attain double-digit growth.

In 1995, the merged company, known as Lockheed Martin, articulated its new vision through five corporate goals:

1. Enhance our position as one of the leaders in the aerospace/defense industry
2. Achieve significant cost reduction to increase margins and improve competitiveness
3. Generate substantial cash flow and deploy cash to enhance shareholder value
4. Produce double-digit earnings per share growth
5. Achieve superior shareholder returns

Just a few years before, the combined companies were 80% dependent on the defense budget. At the time of the merger, combined dependence was down to 60% and the new company has since reduced it further to the goal of 50-50, as seen in its recently reported data shown in Exhibit 11.1.

Exhibit 11. 1 Year-end 1998 Data

Sales:	$26.2 billion
Sales by Customer:	
- U.S. Federal Government	49%
- Commercial and civil government	24%
- International	21%
- NASA	6%
Net earnings:	$1.1 billion
Backlog:	$45.3 billion

Source: 1998 Lockheed Martin Annual Report

Lockheed Martin's top ten military programs in 1995 contributed 44% of their total revenue and many of their defense programs are pivotal to this country and to NATO allies. Programs such as the F-16, C-130, Apache Longbow helicopter, and F-22 have secure futures, but they do not represent significant growth opportunities for the company.

The 1995 merger produced a combined employment strength of nearly 300,000 nationwide. As a result of the merger, cost savings for the Pentagon were estimated at $2-3 billion per year for the next five. This seems credible since Martin Marietta, through its acquisitions of GE Aerospace and General Dynamic's Space Division had already closed 5 million square feet of facilities with a savings of over one billion dollars.[29,30]

As of late 1998, in pursuit of significant cost reductions, Lockheed Martin had closed 16 million square feet of factory space in 16 states, 3 major headquarters, and 4 major research centers; it had spun off 13 companies, and eliminated 125,000 jobs. Current projected savings per year are $2.6 billion. An accounting methodology had to be created to

track the savings in order to provide comfort to the markets and assure Department of Defense (DoD) officials that the merger would provide genuine savings to the government.

As a combined firm Lockheed Marietta now has 170,000 employees at 939 facilities in 457 cities and 45 states throughout the U.S., with 17 companies in four strategic business segments. In addition Lockheed Marietta has over 5,500 employees working internationally at locations in 56 nations and territories. At the time of the 1995 merger, revenues for the segments were $6.3 billion for Space and Missiles, $4.4 billion for Electronics, $7.4 billion for Aeronautics, and $4.7 billion for Information and Technology Services. The segments also had $43.6 billion in booked backlog.

B. COMPETITIVE ENVIRONMENT

The Lockheed Marietta merger created the largest armament manufacturer in the world. Norman Augustine, Martin Marietta's CEO, forecasted the drop in defense spending and the industry consolidation. Augustine echoed and amplified Les Aspin's original comment that companies had to liquidate, evaporate or consolidate. In pursuit of this directive, Augustine constructed the largest firm in a rapidly dwindling market where industry consolidation has eliminated more than 1.5 million jobs nationwide. Exhibit 11.2 illustrates the dynamics of the defense marketplace in the U.S. from 1993 to 1997.

Exhibit 11. 2 Pentagon Top Ten firms

	1993	1997
1	Boeing	Lockheed Martin
2	Lockheed Martin Marietta	Boeing
3	McDonnell Douglas	Northrop Grumman
4	United Technologies Corp	General Dynamics
5	GM Hughes	Raytheon
6	Northrop Grumman	General Motors
7	General Electric	United Technologies
8	Raytheon	General Electric
9	Rockwell	Litton Industries
10	Allied Signal	Textron Inc.

Source: Lopez, 1994

The wisdom of this strategy cannot be seen just by viewing the defense market alone. The American defense budget, or Lockheed's share of it, is not likely to grow. At best it will grow at 3-4%. Hence to meet Lockheed Martin's goal of double-digit growth, it must have substantial growth from other sources – specifically, the commercial ventures. So if half the business falls in the flat to low growth category, then the commercial side must produce growth in the 25-35 % range to capture corporate-wide double-digit growth.

This insight provides a better understanding of the previous attempt to acquire Grumman and later Northrop Grumman. Northrop provides over a billion dollars worth of parts to Boeing for its commercial fleet. Lockheed Martin does not want to compete with Boeing and Airbus for airliners but does wish to be a supplier. This is also consistent with its desire to become a 50-50 defense/commercial company.

Another source of growth for the company is in space vehicles. Lockheed Martin has won the competition to build the next-generation space shuttle. It also hopes to grow both its satellite business and its launcher business. With the dramatic growth in telecommunications and the need for global coverage and bandwidth, both of these services will be good opportunities for Lockheed Martin. The variety of launch services available through Lockheed Martin (i.e., Atlas, Titan, and Proton) also provides a one-stop shopping for their global clientele.

The final area of growth for the firm is international expansion. This is a favorite of many larger firms but remains extremely elusive. Foreign firms tend to be wary of dealing with large American firms. Several inroads have been established as the result of foreign military sales of platforms like the F-16, C-130, and P-3. However, strategic alliances have been much more difficult to build. This leads to the point that even the largest of the world's defense and technology companies can no longer sell in major foreign markets without long-term commitments to significant local content.

The size of Lockheed Martin and its diversity also presents challenges in the way the company does business. For example, different internal segments of the business may have sensitive information regarding competitors which must be protected from other segments of Lockheed Martin. In today's marketplace a competitor may be one's ally in one business transaction and a competitor in another, which create a difficult bureaucracy to manage.

Simply stated, the overall vision and strategy of Dan Tellep and Norman Augustine is to be the world's leading technology and systems enterprise. Their ultimate vision for the company is not completely clear. They have bought companies at premium prices during the height of the golden years of the defense build-up, and bought or merged with others as the

drawdown occurred that produced today's mosaic of companies. Lockheed Martin is ranked 32nd on the *Fortune* 500 list of largest corporations.

C. TRANSACTION EXECUTION

In 1994, the year Lockheed/Martin Marietta merger dialogues began, there was $244 billion of mergers and acquisitions – and one of the largest was the $10 billion merger of Lockheed and Martin Marietta. The merger came on the heels of a failed bid by Martin Marietta to acquire Grumman. Northrop outbid Martin Marietta by two dollars a share and resulted in a $50 million breakup fee for Martin Marietta. This led directly to the initial negotiations between Lockheed and Martin Marietta.

From the outset the merger was identified as a "merger of equals". Dan Tellep of Lockheed and Norm Augustine of Martin Marietta were of like mind throughout the courting and closing of the merger. After five months of secret negotiations the merger was announced and subsequently approved by 98% of shareholders even though there was some contention over the $82.4 million in bonuses given out to the company's executives.

Prior to the merger the firms jointly spent over $750 million on R&D, $500 million on capital expenditures, and had 38 operating companies. The merger was consummated with a tax-free exchange of stock. Each Lockheed share converted to 1.63 shares of Lockheed Martin and each Martin Marietta share converted directly to one share of Lockheed Martin share.

The merger had to gain approval of the respective boards and shareholders, and the government. The Federal Trade Commission and the Department of Defense had to give their approvals. John Deutch, Deputy Defense Secretary, said he recognized that

consolidation could threaten competition but also weighed the potential benefits to the country and decided they weighed the concerns. The FTC and DoD went on to stipulate that firewalls be built between certain commercial and military segments of the new business, e.g., spy satellites.

It is interesting to note that the debt load created for the new corporation meant that it would have to provide $4 million per day to service the interest on the debt and find one million dollars of new business every three minutes to sustain the firm. It required 47 different banks to build a consortium big enough to finance the acquisition. Goldman Sachs stated that "this is the largest high-grade unsecured debt financing for a U. S. corporation ever. Only federal agencies or countries have had larger debt issues."[12]

Through a career of more than forty years that culminated in building the largest aerospace/defense firm in the world, Norm Augustine identified the following hard-earned lessons in his recent book[12]:

- Make a list of your objectives and prioritize them
- Write down *in advance* your walk-away position.
- Understand your counterpart's emotional issues.
- Understand you counterpart's *real* objectives.
- Never bluff!
- Be patient.
- If things are going badly, try to involve a neutral third party -- preferably one that is respected by both sides
- Never permit debate and disagreement to become personal.
- Try to find items to trade that are more important to the other side than to you.

- Don't be constrained by the specific scope of what's being negotiated – bring in peripheral items that could be traded to bring about a solution.
- Never give up
- Negotiate only with individuals who have at least as much authority to make an agreement as you have (to avoid bait and switch tactics). (p.114)

D. RESULTS

In the three years following the merger Lockheed Martin outperformed its peers with a 28% compound annual shareholder return, compared to a 25% return for its aerospace/ defense peers. Critical to maintaining growth of this magnitude is the generation of cash flow. To this end Lockheed Martin has initiated programs to enhance cash flow. These programs include:

- Supplier management efforts to enhance the company's leverage through its procurement activities;
- Move to reduce its receivables (this is expected to generate an additional $200M);
- Improve the inventory management system (this is expected to increase cash flow by $150M);
- Broaden "Lean Manufacturing" to "Lean Thinking" with the elimination of non-productive assets, improving quality, and promoting just-in-time manufacturing; and
- Greater investment in employee development.

Since the merger and through 1997 the company achieved record operating margins and record win rates on competitive programs. In 1996, the corporation recorded a win rate

of 63% and more than 67% in 1997. Its earnings before interest and taxes were 10% for 1996 and 10.4% for 1997. By the end of 1997 and the beginning of the first quarter of 1998 by all available measures the merger was very successful. The stock price had risen over 120%, but at the end of the second quarter missed earnings tipped the market's favorable attention and a downward spiral began. At the end of 1998 the gains for the corporation since the merger have shrunk to only 40%, well below the S&P 500.

Lockheed Martin characterizes its corporate mechanization as that of a "merchant supplier" and "merchant buyer". This means that they produce what they do best, and purchase what they do not produce from firms that produce those products the best, thereby creating a "virtual company".[41] It is difficult to see how a colossus the size of Lockheed Martin can effectively function as a piece-parts supplier. Agility to get to market and agility in the market become amplified success criteria.

A further implication of this mechanization as a systems integrator is that Lockheed Martin must build a consortium of stratified companies for each major systems integration project -- a new "virtual company" for each new project. The advantage of this approach is reduction of technical risk by utilizing specialists in each field. The downside is that it takes many more programs to support the firm and secure double-digit growth projections. The success rate through the bid and proposal stage must be very high.

The salient execution features of this transaction are:

- Communicate, Communicate, Communicate
- Re-engineering is not a profit center
- Have a road map, even when there is not a road
- Always have contingency plans

- Do it fast
- Build one company, one culture
- Honor the past, honor the legacy of the integrated companies
- Capture the lessons learned.

CHAPTER TWELVE

LESSONS LEARNED

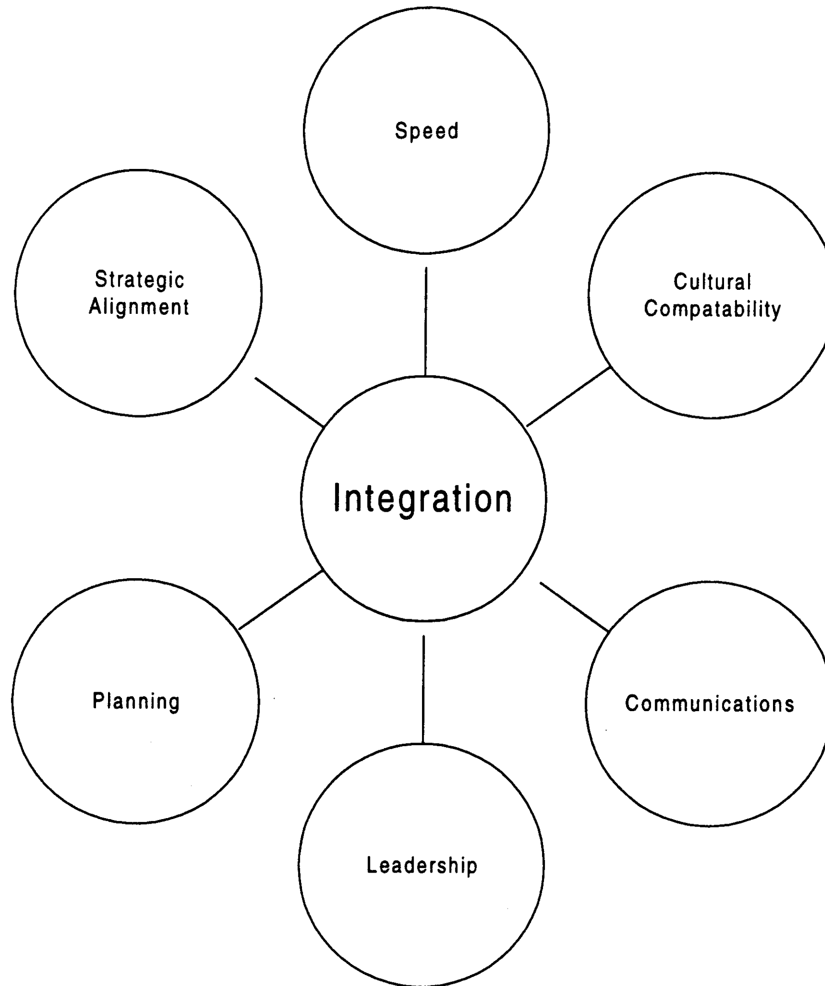
As the previous six cases illustrate, each merger or acquisition is unique. Each is driven by a strategic rationale developed by an individual(s) in the context of the current competitive environment. Because these transactions are so inexorably linked to the perspectives, egos, and passions of the individuals involved, their progress and outcome are unpredictable. They defy rigid rules and frameworks. Some poorly conceived deals thrive because of the drive and focus of an enlightened leader; other more brilliantly constructed strategies trip over the egos and hubris of principles and fail.

The deals move at a pace dictated by the industry and its particular stage and cycle time. Certain deals move from concept to fruition in a matter of days, while others take years to develop. The Citicorp transaction, which at the time was the largest merger in history, was conceptualized in ten days and completed in less than a year.

Timetables, however, are often misleading, as is the term *completed*, for as these cases clearly illustrate, the work involved in truly integrating two firms can stretch on for years. Lockheed Martin is still knitting together some of the elements of its 1995 acquisitions spree almost four years later, and IBM has only recently begun transitioning to a common set of benefits with its 1995 acquisition, Lotus.

With so many critical variables impacting integration, it is impossible to define a set of "silver bullets" that will guarantee the success of a transaction. Near-perfect execution in the integration stage of the acquisition is necessary for, but not sufficient to, making such a

Exhibit 12.1 Determinants of Success or Failure



Source: Authors

guarantee. We have, however, noted in our research six specific dimensions that appear to be the principle determinants of whether an integration succeeds or fails. Those six dimensions, shown in Exhibit 12.1 above, are experience, a focus on value drivers, leadership and leadership alignment, speed, people and cultural, and communications. We will look

carefully at these six dimensions and identify those best practices that help capture enhanced shareholder value. We will also discuss the particular challenges of cross-border transactions.

A. Experience: Integration as a Core Competency

The probability of success in acquiring and integrating companies is materially enhanced in companies that do it often, that is, they leverage their past experience. Those corporations that have earned a reputation for integrating acquisitions in a particularly effective way attack integration as a critical process, a core competency. Their process "template" reduces the period of ambiguity that is often characteristic of these transactions They develop what Jack Welsh of General Electric terms "a rhythm for deals". Companies like Johnson & Johnson, Emerson Electric and General Electric are regarded as benchmark performers in this area. GE averages 80-120 deals a year and conducts rigorous post-mortems after each to distill from the transaction learning that can be transferred to other deals.

This closed loop system is most visible in GE's financial sector, GE Capital. In a *Harvard Business Review* article, Ashkenas, *et al.* point out:

> Most acquisitions and mergers are one-time events that companies manage with heroic effort; few companies go through the process enough to develop a pattern. Thus it tends to be seen not as a process -- as something replicable -- but only as something to get finished, so everyone can get back to business.... Improving the acquisition integration process, however, may be one of the most urgent and compelling challenges facing business today.[11]

Our analysis of companies like Lockheed Martin and Boeing also reflects a learning-curve effect in integrating acquisitions. They build a cadre of deal-seasoned individuals that the company can call upon for each new deal.

Jerry King, former President of Boeing's Space and Defense Business, had planned to retire shortly after he led the successful integration of their $3 billion acquisition of Rockwell International. He was Boeing's most knowledgeable and credible executive in the area of integration. Shortly after Boeing announced plans to merge with rival McDonnell Douglas, company president Phil Condit asked King to postpone his departure and run this second major acquisition in a year. King and his new team started deal number two six days after the completion of the Rockwell acquisition

Martin Marietta (one half of the future Lockheed Martin) struggled with its first major acquisition, General Electric's defense business. According to CFO Phil Dukes, *"GE had cherry-picked key employees prior to turning the unit over and left Martin with some significant gaps to close. In subsequent deals, we knew what to look for and consequently they went more smoothly."*

Using Third-Party Consultants

General Dynamics recognized its limited number of experienced integrators and instead chose to engage Booz Allen to help them integrate Bath Iron Works. Booz consultants, working with teams from the parent and the newly acquired subsidiary, used the integration opportunity to reengineer important processes. Mike Mancuso, General Dynamic's CFO, was so pleased with the speed and quality of the integration effort that he

turned to Booz Allen again in August 1998 to help integrate their newest acquisition, NASCO.

The use of third-party consultants in integration efforts is controversial. Many regard their involvement as a concession, an admission that "I can't get the job done." Jerry King (Boeing's transition leader) recalls that *"Consultants would line up outside my door each morning offering their assistance and I would listen politely, mainly out of fear that I was missing something... but I didn't see anything we couldn't handle ourselves."* Other companies use consultants more surgically for specific tasks or a bundle of tasks in the overall integration process.

Our study shows that professional assistance can play a valuable role in integration efforts in certain circumstances. Third parties, if selected carefully, can compensate for skill gaps in the parent firm. They can provide assistance in structuring the integration process and preparing the integration team for what to expect. In addition, consultants also can play the role of third-party mediator when the stress of marrying two distinct cultures creates friction. Pete Teets, Lockheed Martin's COO, recalls that the consultant that they engaged to help in the integration became the common enemy of both sides. *"He led us through a painful but necessary process of alignment and became a foil for our frustrations. At the end of the process the consultant left and we still liked each other."* Such mediation and affirmation can be well worth the up-front consulting costs if it results in a more unified team and better relations with the new teammates.

One area that appears to be lacking in many of the companies we looked at was in the way integration experiences are memorialized. Few of the companies we examined had well-developed playbooks that captured the learnings from prior deals. Lois Hedgepeth, the

integration manager for the AT&T/TCG transaction, learned what she could by interviewing those involved in prior deals. She recalls one executive saying, *"Whatever we did on the McCaw deal, don't do that"*. Such informal documentation leaves transition managers scrambling to reinvent the process each time critical process improvements painfully learned in prior transactions are missed and mistakes repeated.

B. A Value Driven Approach

The market, like the Lord, helps those who help themselves. But, unlike the Lord, the market does not forgive those who know not what they do.[21] A successfully managed integration can capture the value implicit in a transaction. It cannot, however, always compensate for a poorly conceived or badly valued acquisition. Three elements -- strategy, valuation and integration -- must be tightly integrated in order for a deal's full potential to be realized. Too often exorbitant premiums paid for a target set up unrealistic integration objectives and drive managers to either draconian cost-cutting or other poorly thought-out actions. Successful companies begin planning for integration from the moment the deal is conceptualized. Like a farmer who has the harvest in mind long before the crop is sown, value-driven companies "begin with the end in mind".[28]

How that integration plan will be staffed is also something that should be thought through early in the process. We have noted in these and other mergers that the integration manager begins his/her involvement during the candidate screening stage. They build an intimate understanding of the deal and the reasons why it was initiated. Boeing's Jerry King sat in on the original exploratory meetings between the two companies. This practice of involving the integration leaders early sets up a critical continuity. AT&T's Lois Hedgepeth

pointed out that it is impossible to adequately brief a new player on all that has transpired in a transaction after it is signed. *"A lot doesn't get written down, and what does, does not always capture the true sentiments of the principles"*.

A merger compresses years of critical decisions into a short period. It is a dynamic process full of complexity. Without the proper focus, getting lost in the details and missing critical issues and opportunities is easy. In order to avoid such overloads a value-based framework is imperative.

The starting point for such an integration approach is a carefully articulated statement which can then be used as the framework for another deal. Why did the transaction occur? What was the benefit envisioned when it was launched and how does the valuation (price) reflect those benefits? This linkage between strategy, price, and integration objectives provides a roadmap between perceived value and realized value. It is perhaps the most dependable indicator of whether a deal will succeed or fail. Rather than lock the valuation spreadsheets away in the controller's safe, they should be shared with the people who now must "make it happen".

Team members must be given tools to effectively triage the thousands of issues that need to be handled during the transition. Targeted synergies must be specifically mapped and disaggregated so the transition teams can understand their role in delivering benefits. Ambiguity is the enemy.

C. Leadership and Aligning the Leadership Team

Integration tests the energy, creativity, and vision of the leadership team. The team must shepherd the organization through a time of high anxiety and low productivity while

keeping stakeholders happy. Decisions must be made quickly and decisively in order to support the fast-paced changes required. They must be more visible to the organization and model the new culture both formally and informally.

Nothing can sink a promising merger faster than mixed signals from the leadership team. Given the heightened anxiety level so common in these types of transactions, employees study every word, gesture, and expression of top leaders searching for inconsistencies or contradictions. Often the paths of leaders can diverge unintentionally by one or the other making a decision without realizing the implications to their leadership partners.

Style becomes an issue. The merger of Citicorp and Travelers illustrates this point dramatically: John Reed, the quiet introvert who contrasts dramatically with Sandy Weill, the flamboyant showman. These two individuals quickly built their common vision for Citigroup over a number of lengthy conversations and letters while the deal was proceeding. The level of decisions needed to actually govern the enterprise requires much more detail and time. For example, as a separate entity prior to merger, Travelers routinely brought hundreds of compensation issues to the board for approval; Citicorp took only a handful that far. Which approach would be utilized going forward? Reed preferred a rolling six-quarter planning process while Weill used a standard annual plan. Again, which would survive?

The delicate balance lies somewhere between being frozen in indecision while each decision is tested for its hidden implications and the "Damn the torpedoes, full speed ahead" approach. As with so many other elements of integration the key lies in communication, clarity, and patience.

D. Speed and Critical First Steps

> Mergers create a built-in crisis that provides management with a unique opportunity: employees are waiting and expecting change to happen. Rather than allow things to slow down, management must maintain the momentum and capitalize on the opportunity to make change happen.[16]

Of all the characteristics mentioned by executives involved in successful M&A transactions, speed is often the first. Speed in the integration of two companies has at least three benefits:

1. it shortens the payback period on the investment;
2. it minimizes the productivity lost due to confusion and anxiety; and
3. it takes advantage of the window for change created by workers expectations.

The first obvious benefit of speed is the time-value-of-money function. Acquisitions are up-front investments, the checks are written and the debt incurred on Day One. The ultimate return on those investments will be governed by the net (positive and negative) synergies produced and the timeframe necessary to produce them. Any delay caused by poor planning or slow execution either lowers the return on the investment or raises the savings that must be generated. Executives must build a sense of urgency and an understanding that the clock is ticking.

The second reason for speed is lost productivity. Transitions in some large companies become spectator sports. While management wrestles with the optimum approach to integration, the workforce spends its time speculating, worrying, or telephoning headhunters. The search for perfect solutions and organizations delays re-engaging the workforce. Jack

Welch said it best: *"The key is to get everyone in the game"*. Multiplying a couple of lost hours a day times a population of 10-20 or 100,000 people puts the need for speed in context.

The third reason for speed is more subtle. Merger announcements create a window of time in which the associates anticipate change. They prepare themselves for it and are generally receptive to it. That window of opportunity closes quickly. Failure to act signals the organization that business as usual has returned and the excitement and energy for meaningful change diminishes. Trying to restart that momentum is difficult and resistance grows.

E. People and Culture

Mergers or acquisitions are intensely personal events. They change the game for everyone involved. Some careers will accelerate, some will stall, others will end, and for a while, at least, few know into which category they will fall. Employees lose the mental map of how the company really works. The workforce becomes frozen and personally centered. This period of ambiguity can stretch on for months while organizational structures and leadership assessments are made.

Mergers have also become synonymous with layoffs. In a recent article, Joan Harrison reports that mergers accounted for 10.4% of all layoffs in the first three-quarters of 1998.[35] Fewer people, greater efficiency, and consolidation of facilities are phrases that excite Wall Street but cause enormous anxiety on Main Street. As the anxiety builds, the need to communicate to the workforce becomes key. A recent study by the human resources consulting firm, Hewitt Associates, stated, "Fifty seven percent of HR directors identified employee communications as a critical contributing factor to the success of the transaction".

It goes on, "Effective communications from day one plays an important role in reducing employee resistance."[32]

In addition to communications, cultural differences must also be acknowledged and dealt with. Peter Sanborn, a member of Hewitt's global M&A team says, "Up-front, mutual understanding of the way two companies operate helps make for a successful transaction. Defining unspoken rules of the road for the combined organization is crucial to the integration process and to achieving the anticipated synergies." [32]

Corporations must be careful to honor the heritage and heroes of the two firms. GE Capital holds "Hero" sessions with acquired companies at which representative from both companies share the legends and the lore upon which the companies were built. Trademarks, logos, and other visible reflections of prior cultures must be handled delicately to avoid inadvertent insult.

Success lies in building a new culture that borrows the best from the past and focuses the workforce on the future. To instill this new culture, role models should be used extensively. By placing selected individuals in highly visible positions that personify the desired attributes of the new culture (i.e., teamwork, positive attitudes, and openness to change), the organization reinforces those characteristics. Likewise, a company undermines the new culture by refusing to move out of important roles people who refuse to embrace the new culture. Jamie Dimon, number three man in the Travelers Group, was asked to leave for just such a reason.

F. Communications

There are multiple dimensions to the communications challenge in transactions. Different audiences need different information. All are important and all must be reconcilable to each other. The merger of Lockheed and Martin Marietta was designed to leverage scale and deliver savings. But whose savings? What savings? The Pentagon was interested in savings to its cost base and overhead rates; Wall Street was interested in savings that translated into profit. Press releases and the speeches of corporate executives had to be very specific since the numbers were hugely different. Phil Dukes, CFO of Lockheed, had to regularly reconcile the two, for both the generals in the Pentagon and analysts on Wall Street.

Communication strategy is a vital part of the integration process. The need to communicate in real time to various constituencies challenges even the most experienced communication teams. A CEO anxious to impress the street with aggressive cost cuts can create an instantaneous labor crisis with just a few comments. Timing, content, and consistency are all critical. Customers want to be kept in the loop as do regulators, bankers, politicians, and most importantly, employees. In their zeal to say something leaders must be careful to avoid "content free communications".[31]

Despite these many challenges, communication must be frequent, accurate, and clear. It is the principle tool by which executives can relieve anxiety and gain alignment. The form of those communications are important as well. Executives must be visible and accessible. They need to carve out time to meet with employees, give out information, and spend time receiving it. IBM, in its hostile takeover of Lotus, had an employee Web site full of information available for Lotus employees right from Day One. IBM executives like Lou

Gerstner (the Chairman) met with employees and welcomed them to the organization, not two or three weeks after but on the first day.

Technology has greatly improved this aspect of integration. Video teleconferencing, e-mail, Web sites, and other technologies enable the leadership team to keep everyone in the loop as never before. These channels must be used to both give and receive information. Questions and issues raised by employees can be valuable sources of integration know-how.

Content is also vitally important. Frequent communications that merely repeat prior knowledge or broad generalities will do little to facilitate a successful venture. The communication philosophy should err on the side of too much rather than too little. The leadership team must not only communicate freely but take affirmative steps to ensure that those communications make it all the way down the organizational chart. Like a football team driving down the field, everyone must know the play.

G. The Special Challenges of Cross-Border Transactions

> *While there will always be room for small highly creative firms, there will be giants that rule the earth ... we haven't begun to understand their potential size and scope.*
>
> --Paul H Oniell, Chairman Alcoa

The era of the global firm is underway, and as the world moves to a more global market, the number of cross-border mergers or acquisitions is on the rise. The value of cross-border deals reached a new record in 1998: $544.3 billion, a 60% increase over the prior year.[59] That same survey reported foreign investment in the U.S. tripled in 1998 to a level just over $200 billion. The recent mergers of Deutsche Bank with Bankers Trust, Vodafone with Air Touch, and Daimler Benz with Chrysler, illustrate just how common this

phenomenon is becoming. Even transactions that, on their surface, appear to be purely domestic, often involve significant foreign operations. These transactions introduce a layer of complexity to the already formidable challenges associated with domestic deals.

Incremental complexity varies tremendously depending on the similarities or differences in the home country of the two firms. Differences can be either readily apparent or extremely subtle. Those obvious dimensions include:

- legal and regulatory systems,
- the involvement of governments and government agencies,
- the strength of labor unions,
- the prevalence of crime and corruption, and
- environmental laws etc.

Some of the more subtle but equally important factors include:

- the strength of the capital markets (profit motive and how patient capital is),
- culture,
- ethnic mix,
- work ethic, and
- the strength of the family unit.

These elements often prove to be the most difficult aspects of a transaction. Due diligence rarely accounts for the culture and style of the target, yet those elements can be two of the largest risks that cross-border acquirers will face. Spending the afternoon with a 50-page country guide will not prepare a company to thrive in a foreign market. Daimler-Chrysler is currently struggling with just such issues in their integration. Another, more

location-specific issue, is executive compensation schemes and how they are perceived by workers.

In Europe, wealthy families have a tremendous influence on the course of events in a particular area, and their presence behind the scenes can be significant. The Agnelli family in Italy controls Fiat; the powerful Italian bank, Mediobanca, presides over what *Business Week* terms the "*salotto buono* (genteel drawing room) … [where] if companies changed hands, it was done through gentlemanly swaps of shares, far from the prying eyes of minority shareholders"[1]

In Japan and Germany, a subtle but significant influence is exerted by universal banks like Deutsche Bank which has historically not only financed but also held friendly shares in numerous related corporations. France's *noyaux dur* system is similar. Regardless of the source these relationships must be carefully mapped by acquirers hoping to achieve success in a cross-border transaction.

The 1984 acquisition of the Italian appliance maker Zanussi, by the Swedish firm Electrolux, illustrates the role these dominant European families play. The Agnelli-Wallenberg connection helped engineer the union through their influence on Mediobanca on the Italian side and through the Electrolux influence on the Swedish side.

The deal also reflects the effect that experience plays in the integration process. Powered by the investment capital of the Wallenberg family Electrolux had built a Pan-European powerhouse through 200 acquisitions over a twenty-year period. Beyond merely the acquisition capital, the Wallenberg influence shaped the corporate culture and the corporate business model. It featured lean corporate staffs, clean reporting lines, and dense information flows. That corporate model and culture became the template used to integrate

acquisitions. Some of those acquired companies took to the model easily while others struggled.

The Zanussi transaction was well-planned and orchestrated. It featured some of the hallmark characteristics of a successful integration, including; speed, detailed planning and the use of focused, fast-paced transition teams. Electrolux injected needed investment and added volume to their load-starved factories. In addition, Electrolux leveraged their in-country expertise by tapping their highest-ranking Italian general manager to become the new Chairman of Zanussi, which helped neutralize the "invaders from the north" mindset.

Despite these well-planned steps, the transition was not without its problems. Electrolux was accustomed to imposing a management template on new acquisitions that was radically different from the existing culture at Zanussi. The Italian system was much more hierarchical than the Wallenberg model. Titles and formality collided with open doors and first-name cordiality. Further, the team being rescued from economic disaster was not convinced that such a rescue was necessary. They believed the problem left when Electrolux replaced the existing senior team.

This fundamental difference in style and culture is all too common in transitions. Associates lose the mental map of how the company really works – a map that has been built over years -- and a period of ambiguity sets in. Any synergistic benefits can be swiftly swamped by lost productivity and efficiency.

However, Electrolux again moved quickly to unfreeze the workforce. Like GE, Hewlett Packard, and other successful integrators, the new management of Zanussi focused the workforce on designing a new culture that they could all own collectively. They developed a Mission, Values and set of Guiding Principles to focus and unify the team in a

forward-looking direction. They did the hard work of team building and training necessary to get the train moving again. But, as the case illustrates the culture-melding process take years and both the conqueror and the conquest must give ground.

The Zanussi transaction illustrates the importance of developing strategies that consider all the firms' stakeholders, both formal and informal. The support of the Agnellis and Mediobanca proved crucial in this transaction. Government support might be the key in others. Companies must build an intimate knowledge and capability to deal effectively in the environment of the target. They must know what they don't know and avoid any presumption that what worked at home will necessarily work in a foreign country.

Core competencies must be built not only for doing deals but more specifically for doing deals in the target's home area. Firms can compensate for any shortfall with the help of local experts. Picking up a subtle nuance in the early planning rather than as the transaction occurs can generate savings that well justify incremental resources utilized going into the transaction. False confidence about firm capabilities can prove disastrous.

H. Best Practices

Beyond the six dimensions outlined above certain best practices and procedures emerge from the companies that do transactions often. They include:

1) Use small empowered transition teams
2) Use the best people to work on the integration
3) Limit the team's life
4) Tie incentives to achieving synergies
5) Getting the unpleasant decisions done early

6) Provide for adequate transition resources

7) Avoid horse trading with people and positions

8) Treat displaced workers generously

9) Set up the integration infrastructure early (e-mail, phones, etc)

10) Appoint full-time transition managers

11) Avoid getting frozen while looking for perfect solutions

12) Celebrate early victories

Transition teams are the engines that drive high-velocity change. They should be empowered to act as well as be sufficiently seasoned to know when not to act. Their results will be highly dependent on the caliber of people used and the resources available. Preference should be given to highly networked individuals who can move quickly within the informal structure of the firm. Boundaries should be established early and the decision-making architecture clarified so those teams can stay moving and not get bogged down. The life span of teams should be kept intentionally short to force them to focus on important things.

Incentives can make an enormous difference in a transition effort, but only if structured effectively. They can stem the exodus of key talent while the environment is being stabilized. They should be structured to align and support the value drivers of the deal. They should apply to individuals with critical skills as well as essential leadership talent. Care needs to be exercised in structuring the programs to avoid disincentives to non-covered employees and departure bonuses at the end of the integration period for those who are covered.

Getting unpleasant decision done quickly enables the organization to grieve, recover, and move on. Long-drawn-out rationalization exercises or manpower reviews merely extend the period of lost productivity and delay the realization of consolidation savings. Pre-closing planning sessions should focus on these critical first steps and identify actions to be taken in the first 100 days.

Provide adequate transition resources. Transitions are expensive, they consume thousands of man-hours as well as incremental travel, computer resources, and consultants. The investment in transition resources, however, must be measured in the context of the overall transaction. Teams must be provided with the resources necessary to succeed. Short-changing the process risks squandering the value inherent in the deal.

Avoid horse trading with people and positions. Mergers, by their very nature, create redundancies. Often these redundancies involve people close to the leader of one organization or the other. In an effort to avoid the tough decision involved in picking the best candidate, horse trading often takes place (such as "my guy as President, then yours as CFO" and so on). This momentary avoidance of conflict is often at the expense of selecting the best man. Even worse than horse-trading is the failure of leaders to make any decisions, by appointing co-leaders. This current trend of appointing co-leaders makes it difficult for associates to understand the decision-making architecture of the firm.

Treat displaced workers generously for the benefit of those who remain behind. It speaks loudly to the new team about the kind of organization to which they now belong. Any attempt to build a new culture and *esprit de corps* while friends and colleagues are poorly treated will fail.

Set up the transition infrastructure early. Telecommunications, local area networks, and other basic infrastructure items are often overlooked in the planning for a transition, but they play a crucial role in facilitating knowledge transfer. Time zones, software issues, and incompatible e-mail systems can delay important first steps. Again, pre-closing planning should clear any such obstacles prior to day one.

Select a full-time transition manager. The transition manager is the quarterback of the process. He/she must orchestrate the transition teams and keep them focused. He/she allows other managers to focus on running the business while the integration proceeds. These leaders should be high-potential individuals who know the organization well. They should have strong networks and be excellent communicators. Ideally, these individuals should gain their expertise on the deal by participating in prior phases of the process.

Avoid being frozen searching for perfect solutions. Given the number of decisions required to make a merger work, mistakes are inevitable. Managers need to be prepared for as the need for quick decisions accelerates as well as the inherent risk that speed creates. A balance between speed and risk must be maintained. Trying to accommodate the volume of decisions with a normal deliberate process will create a backlog of issues and grind the process to a halt. Likewise, too much speed can lead to poorly thought-out decisions that will ultimately need reconsideration. This kind of judgment underscores the need to involve the best available talent in the process.

Celebrate early victories. Momentum is important in getting the new organization focused. Celebrating early victories helps to break down anxiety-driven organizational paralysis and build a new sense of teamwork.

CHAPTER THIRTEEN

CONCLUSIONS

This thesis began with the premise that integration can be the key to unlocking the value of a merger or acquisition, that integration skills and experience can become a source of competitive advantage. Through the numerous examples included in this thesis we believe we have validated that premise We have distilled from our research and then outlined those dimensions and best practices that appear to differentiate successful deals from those that fail.

However, we are quick to point out that no silver bullet exists. The six case studies and countless others underscore the fact that these projects are hard work that challenges corporate managers in deeply personal ways. We explored how pride, ego, ambition, and hubris all can interfere with the process and keep transactions from realizing their potential and how, at their core, these transactions become a question of people.

We also illustrated how many of today's management bestsellers work in the integration process. Leadership, change management, teamwork, stress reduction, and others all are part of the integration toolbox. We discussed how companies like GE, Hewlett Packard, and others treat integration as a core competency and train their workers accordingly.

All of these challenges must be placed in context, however. Integration is a tremendous opportunity for those teams willing to take up the challenge and exploit the opportunity for change.

Transitions force organizations to re-examine in a detailed and fundamental way their strategies, processes, cultures, and people. Although disruptive, this tremendous effort and focus can represent a giant step forward for organizations willing to run with the opportunity. It can be the re-engineering opportunity of a lifetime if the creative energy and efforts of an aligned group focus on creating a new organization rather than replicating an old one. "Breaking worn-out habits and fighting bureaucratic practices are empty acts if you don't offer employees something better."[55]

Every organization has a collection of legacy practices which are utilized not because of any conscious choice to but rather because they have never risen to the level of importance necessary to gain management's attention. The efficiency lost because of reliance on these hundreds or thousands of practices that may in fact be severely outdated is never accurately measured. Individually they are not significant; collectively they may represent a real millstone. If integration requires these systems and processes to be re-examined, and that examination confirms the need for new ones, then teams should be encouraged not to replicate them but to blow them up and to start anew. A careful balance must be struck between bogging the process down and missing an opportunity. Break-through thinking can and will occur if the right environment is set from the beginning.

Senior managers engaged in the process of mergers and acquisitions should use integration to re-think top-heavy organizations, inefficient facilities, or poorly designed processes. They should strive to build an environment in which innovation and creativity flourish. It is only by seizing the integration challenge that companies can fully unlock the value of the deal.

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APPENDIX

Questions used as a baseline for interviews:

- How did the transaction come about; who initiated it?
- How much time was spent deciding to go? What was the transactions time line? (6, 12, 24, 36, 48 months)
- What was the transaction's strategic intent? Was it well understood or did people have different perspectives?
- How many others were in the hunt?
- Was there a firm walk-away point if the deal got too pricey?
- What was the board told and when? Were any of the directors involved?
- Did you know the other parties personally?
- What role did intermediaries play?
- What level of integration did you foresee originally?
- How much of the deal's payoff was provided by synergy?
- How do you measure success?
- Who led the negotiations and why?
- Did they have a continuing role in running the acquired company?
- Who else was on the negotiating team? Why?
- Who ran the due diligence? Who was on the team? Why?
- Who ran /runs the transition team? Why?
- How much did the three teams overlap?
- How did you balance confidentiality and thoroughness? (who to include)

- Did you have a standing M&A team? What was the experience level of the members?
- How was the transition process structured, i.e., steering committees, timing, empowerment to make changes, ground rules, playbook?
- Was management of talent a problem? How did you evaluate /retain and incentivise people? How much employee turnover was there?
- How were governance issues resolved and when?
- How involved was the board in the transition?
- How were communications coordinated; what were the critical ones? How often did you have town meetings to inform employees?
- How were redundancies handled? How quickly were winners and losers identified?
- Were large headcount reductions required?
- What were the biggest surprises?
- How were customers taken care of during the process, communicated with, commitments executed, issues resolved?
- How did you protect productivity/bottom line?
- How much of a factor was geography?
- Tell me about the two cultures, how did you blend them?
- How did you handle policies, procedures, quality programs, auditors, and monthly closing etc.
- What was the biggest challenge in the integration?
- What would you have changed?
- How about the transition's cost and schedule? How close to planned levels did you get?
- If you were teaching an M&A course on the post-merger process, what would you stress?