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Making Mergers Work

Executives too often overlook the vital question of identity when seeking synergies from mergers and acquisitions.

BY HAMID BOUCHIKHI AND JOHN R. KIMBERLY

THE CEO OF a building products company based in Europe, which we'll call BPC, was seeking to expand the company's global footprint and believed that a significant presence in North America was essential. In the course of his search for acquisitions, he identified a large cement maker in the southern part of the United States and launched a takeover bid. The deal was completed after much maneuvering and arm-twisting, despite a negative recommendation from the target company's management to its board, and the acquiring CEO kept the initially hostile management team in place. One year later, he sent two executives from the European headquarters to occupy undefined jobs. As one of them recalled: "I was assigned ... to help with integration but I did not do much of that. Basically, I sold [BPC] to these guys. The CEO [of the acquired company] made all the decisions."

For a number of years, this and other acquisitions by BPC in North America consistently failed to meet performance expectations; the individual who succeeded the dealmaker as CEO finally asked us to see if we could figure out why. Following an analysis of performance data and a series of interviews with executives in the North American subsidiaries and in the European headquarters, it became clear that the anticipated economic synergies had not materialized because little attention had been paid to achieving psychological synergies. Executives in the North American subsidiaries felt both on the peripheries of the corporation as a whole

THE LEADING QUESTION

What can be done to increase the chances of a merger or acquisition working successfully?

FINDINGS

- The psychological factors and identity questions that are part of any merger are often overlooked. That's a huge mistake.
- Managers can follow four possible paths to achieve identity integration: assimilation, federation, confederation or metamorphosis.
- Each path addresses two crucial questions: What should be done with the parties' historical identities? How should a common identity for the future be built?

The fashion brand Louis Vuitton is one of numerous luxury brands under the overarching LVMH umbrella.

and out of the loop with respect to resource allocation decisions. There was a palpable lack of psychological engagement that manifested itself in some cases as open hostility toward the European headquarters. The gap between the parent and its subsidiaries was so wide that European managers were not allowed to visit a North American affiliate without the formal permission of its CEO.

The CFO of BPC North America had firsthand experience with the divide: "I went to [one of the acquired companies] for a meeting with their CFO. At the end of the meeting, he asked me to hand him back all the papers. He said that he was not authorized to let me take any documents. These people hated us."

This experience may appear extreme, but it will be familiar to those who have been through the M&A process. It illustrates why we need a new merger math. For one plus one to make more than two at the economic level, one plus one must make one at the psychological level. When M&As fail to deliver promised levels of performance, as frequently occurs, it is likely due at least in part to a lack of psychological synergies. Psychologically, the new entity is often a house divided.

Obviously, you don't want this to happen. The goal of a merger is to have the component parts add up to more than what they are worth individually. Our research and extensive work in this field have convinced us that this will only happen if you are able to merge the two companies into one on a psychological level. (See "About the Research.") The challenge lies in the implementation of a simple idea: People cannot achieve better results if they do not come together as one entity and pull in the same direction.

This may sound simple, but identity integration is often overlooked as the merger unfolds. Planning for post-merger integration typically focuses on operational issues such as harmonizing product lines and financial and human resource information systems, or determining which employees are retained and which ones are let go.

Attention is also paid to the identity of the merged enterprise in a superficial sense. The name of the acquirer may be retained, or a new logo may be created or a new name found. For the psychological synergy principle to operate, though, executives need to attend to a more complex, deeper set of identity issues, those that define the essence of the entity and give employees a clear answer to the question "Who are we?" and give external stakeholders a clear answer to the question "Who are they?" The first question refers to an organization's members' view of what makes that organization unique among all other organizations. The second question captures what external audiences believe is the essence of the organization. Left unattended, these deeper identity issues will diminish engagement and will inevitably affect the performance of the merged entity.

The point here is simple — but important. Operational integration post-merger is a necessary but not sufficient condition for successful performance. Careful attention to identity integration is also essential for success. Lack of attention to identity issues was largely responsible for the persistent performance problems encountered by BPC. It is amazing how much time and money companies spend on this problem after the fact, when they could have eliminated it with a little pre-merger planning.

How can managers achieve the psychological synergies required to realize economic synergies from M&As? Our work in this field has convinced us that there is no "one best way" but rather four distinct paths that can be followed to achieve identity integration: assimilation, federation, confederation and metamorphosis. (See "Four Approaches to

ABOUT THE RESEARCH

This article is the result of an iterative process that alternated between collection of primary data, conceptual development, testing the ideas with executive groups, refinement of the conceptual framework and analysis of a number of cases of M&A.[i]

The conceptual framework is grounded in our consulting work with three companies: Building Products Company (a pseudonym), IT Company (a pseudonym), and SSL International, acquired by Reckitt Benckiser in 2010. The senior management of all three companies encountered challenges in post-merger integration and invited us in each instance to help them deal with those challenges. In our consulting roles, we were able to collect primary data from employees in all three companies.

Our thinking about the management of identity in M&As was further developed through numerous discussions with participants in executive education programs at ESSEC, INSEAD and the Wharton School. Participants in these programs came from French banking giant Groupe BPCE; Groupama Insurance; Macif, the French insurance company; biomedical device maker Medtronic; pharmaceutical giant Pfizer; Royal Philips Electronics; French aerospace expert SAFRAN (the result of the merger of aircraft and rocket engine maker Snecma and defense conglomerate Sagem); and Toyota.

To deepen our understanding of strategies for identity integration in M&As, we collected secondary data about several actual cases, gleaned from company documents, analysts' reports and the business press. We then used a subset of these cases to illustrate the four approaches to identity integration we had identified.

Identity Integration.") Each of these paths represents a particular combination of the answers to two questions that managers must confront in anticipation of a merger or acquisition: What should be done with the identities that the parties to the merger bring with them (in other words, their historical identities)? And how should a common identity for the future be built?

Specifically, managers must answer these questions:

- Can we or do we want to preserve the identities of each party to the merger, or do we need or want to delete some of them?
- Do we pursue a common future through the creation of a new organizational identity, or should we integrate through legacy identities?

Let's go through the options one at a time.

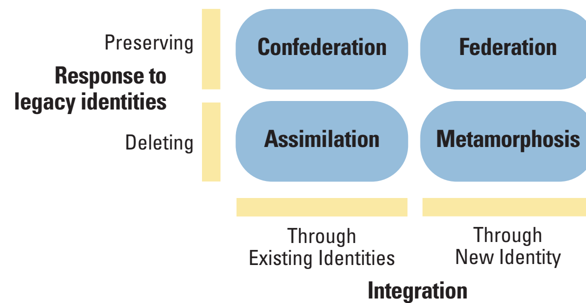
Assimilation

Assimilation occurs when the identity of an acquired company is deliberately dissolved into the identity of the new parent. The acquired company is stripped of its name and visual identity (logo, letterhead and so on) and adopts those of its new parent. The acquired company's management structure is dismantled, and employees who are not let go are distributed across the parent's organizational units. The process sends a clear signal to the members of the acquired company that they are expected to adjust and be loyal to their new employer. It also sends a clear signal to the company's external stakeholders that they will henceforth deal with a new organization.

Although this description of the process might sound brutal, the members and other stakeholders of the acquired company do not necessarily experience it that way. The reactions of employees and other stakeholders depend on the depth of their psychological commitment to the dissolved identity and on the perceived desirability and superiority of the identity of the new parent. For example, when a small technology company is bought by Cisco, its founders, employees, investors and customers are likely to see the acquisition as a positive event on the whole and not to see the trading of its identity for that of Cisco as a serious loss. Because becoming a Cisco employee has many benefits, members of the acquired organization have little reason to mourn their defunct identity.

FOUR APPROACHES TO IDENTITY INTEGRATION

There are four paths that managers can follow to achieve identity integration in a merger or acquisition: assimilation, federation, confederation and metamorphosis. Each path addresses two crucial questions: what should be done with the parties' historical identities, and how a common identity for the future should be built.



The integration of Cerent, a company bought in 1999 for $6.9 billion, illustrates how Cisco practices assimilation. "On the morning that Cisco took over the company, employees arrived at work to discover they already had new titles, business cards, bosses, bonus plans and health plans, plus access to Cisco's computer system," according to U.S. News & World Report.[1] Only four of the 400 employees left the company in the first six months. In terms of converting employees from an acquired organization into employees of the acquiring company, "it's hard to name a better-run company in the world [than Cisco]," said analyst Michael Howard.[2]

Not all companies that integrate through assimilation do so rapidly. The approach to assimilation used by Wells Fargo in its acquisition of Wachovia, for example, was intentionally slow. The deal closed on December 31, 2008, but it was not until October 2011 that the last region, North Carolina, became fully integrated. As Wells Fargo CEO John Stumpf said at the outset, "Blending cultures, combining businesses, products and systems and changing names will take time — two to three years — because we want to do it right."

Assimilation is less effective when the merged organizations are perceived as equals or when the identity of the buyer is less valued than that of the acquired firm. When the new parent and its acquisition target are comparable in size, profitability or reputation, members and stakeholders of the acquired company may feel that their organization's identity is at least as valuable as that of the new parent and may bristle at losing it. The problem is

compounded when the acquired company has doubts about its new parent. For example, European and Japanese companies have had difficulty with the integration of their acquired subsidiaries in the United States when the U.S. managers did not think highly of the management skills and effectiveness of their European or Japanese "owners" and resented dissolution of the identity of their company into that of a foreign-based company.[3] A similar challenge is now faced by multinational companies from emerging markets such as China and India as they are making acquisitions abroad.

Confederation

Confederation is the extreme opposite of assimilation. Here, the merged organizations preserve their historical identities and are not expected to meld in order to create a new one. Each organization keeps its name, legal independence, management structure and autonomous decision making. Coordination in this setting is kept at the minimum level necessary to achieve synergies in particular and limited areas.

The Renault/Nissan and Air France/KLM combinations are good illustrations of the confederate approach to integration. Instead of pursuing a full-fledged merger with Nissan, which some might argue would have maximized economic synergies, Carlos Ghosn consistently emphasized that he was trying to fix Nissan's strategic and operational ills and preserve its core Japanese identity at the same time. He did, however create a purchasing organization jointly owned by Renault and Nissan and create ad hoc task forces to encourage new product managers and engineers at Renault and Nissan to use common parts and platforms.

The Renault/Nissan design served as a template for the implementation of the Air France/KLM combination. Although Air France formally acquired the Dutch airline in 2004, the deal explicitly specified that KLM would keep its name, management structure and operational autonomy for eight years. Jean-Cyril Spinetta, the former chairman and CEO of the Air France/KLM Group who led the acquisition, explained: "With KLM, we want to remain very pragmatic. Our group is made of two companies unified by a common share ownership and a tied economic performance and led by the chairman and CEO of Air France. Our agenda thus is coordination. But in areas such as freight, where branding is less important, we are ready to move toward more integration. [In the passenger market], things are more complicated. Rushed integration in this area could lead to disaster."[4]

Confederate integration should be considered when a satisfactory level of synergies, on the revenue or on the cost side, can be achieved without tying the organizations closely together in day-to-day operations. In this case, broad strategic guidelines and a few coordination mechanisms are enough to ensure that the merged organizations pull in the same direction while maintaining their autonomy and respective identities.

But these economic calculations should be supplemented by serious consideration of the psychological distance between the merged organizations. It might have been optimal in purely economic terms to pursue a higher degree of organizational integration of Renault and Nissan, but the organizations were, and still are, very different. While both make cars, the two companies have unique identities established through several decades and have grown in countries with very different cultures. Their people do not know one another, do not speak the same language and deal with different suppliers and business partners.

Furthermore, although Nissan was in deep trouble when Renault took over, the stakeholders of the Japanese company were not prepared to let Nissan's identity be dissolved into that of a French automaker. In hindsight, Ghosn's approach looks to have been the best possible trade-off between the benefits of tighter integration and the cost of ignoring the psychic distance between the two companies.

Similarly, the psychological and cultural divide between Air France and KLM was and is still wide, even though both organizations are European. Pursuing a confederate approach — the CEOs of both companies were careful to use the French word *rapprochement*, meaning "gradually bringing together" — gave people on both sides time to get to know each other and to begin informally to forge a common identity. In a recent interview,[5] the CEO of Air France-KLM announced that the time is ripe for deeper integration of the two airlines, eight years after the merger. The plan outlined in the interview suggests that integration is shifting to a federalist configuration with a stronger common corporate center.

For the confederate model to work, people on both sides must understand how far down the integration path top management is willing to go. In the Renault/Nissan case, it was important that Renault managers, at all levels, refrained from adopting a "conqueror" attitude toward their Japanese counterparts when Nissan was struggling to recover from near death. Now that Nissan has recovered and is reconnecting with its glorious past, it is equally important for Japanese managers to avoid arrogance toward their French counterparts. Much of the burden for maintaining mutual respect falls on the shoulders of the senior managers who bridge the two organizations.

Federation

The key difference between federalist and confederate integration lies in preserving the identities of merged organizations while at the same time developing an umbrella, or overarching, identity that each member organization can relate to, identify with and thrive within. The image that comes closest to the federalist model is Russian nesting dolls: Each has its own existence and face and, at the same time, contains dolls with their own faces and beings.

The federalist approach seeks to develop a new layer of identity and identification on top of the existing layer. In the political world, an example of federalist identity integration on a large scale is the European Union. Instead of asking, or expecting, the French, German or Italian people to give up their national identities, political leaders are gradually shaping a European identity that can be laid over national identities. (The economic problems that individual member countries like Greece are causing for the European Union show the inherent risks in laying one identity over another.) The federalist project will have succeeded when people naturally think of themselves as "French and European" or "German and European" or "Italian and European."

In the business world, federalist integration has been successfully and consistently implemented by U.S.-based giant Johnson & Johnson and by the Paris-based luxury brands conglomerate LVMH.

Johnson & Johnson is a household name and is recognized as a global leader in the health care industry. It operates through a family of over 250 widely autonomous companies with about 128,000 employees in 60 countries.[6] The management structure of J&J enables operating companies to have their own management structure and local identity. J&J's recent problems with quality control in its McNeil Consumer Healthcare division, including its production facilities in Fort Washington, Pennsylvania and Puerto Rico, however, are a reminder of the managerial challenges in maintaining consistency across operating units in a highly decentralized system.

Bernard Arnault, current chairman and CEO of LVMH, has consistently reinforced the federalist model as a way to balance two contradictory imperatives: preserving the uniqueness of the organizations supporting luxury brands while achieving economies of scale and scope in selected areas. The federalist model has enabled Arnault to maintain the identities of a galaxy of highly autonomous organizations supporting high-end companies and brands including Louis Vuitton, Moët & Chandon, Hennessy, Parfums Christian Dior, TAG Heuer, Céline and Sephora. At the same time, the LVMH Group identity has enabled Arnault to put a recognizable face on this diverse portfolio of organizations and brands, enabling LVMH to achieve economies of scale and scope in distribution, advertising, human resources management and efficient access to financial markets.

Metamorphosis

Metamorphosis is the process by which the identities of merged companies are dissolved and fused into a completely new identity. The key benefit of this approach is the avoidance of uncertainty and anxiety among people on all sides about who are the winners and losers of the merger. Efforts by top management to establish a new identity for the combined organization is intended to create a neutral terrain. The process enables members to "forget" the identity of their original organization. This, in turn, permits the development of a common, shared identity, in which all parties ideally feel they have voice and contribution.

An example of metamorphosis is the creation of SSL International. This resulted from the merger between Seton (maker of tubular bandages and pharmaceuticals) and Scholl (maker of orthopedic

footwear) in 1998, followed by the merger of that company in 1999 with London International (maker of Durex condoms and disposable products used in hospitals). Instead of using the identity of one of the companies to integrate the others or keeping the merged companies at arm's length within a confederate or a federal structure, the chief executive sought to create a new organizational identity for the merged company.

To build the new identity, he set up an integrated corporate strategy and organizational structure, picked a leadership team from the three merged companies and contracted with a business school to design an executive training program, where we were asked to facilitate the identity part. Interestingly, SSL International was acquired in 2010 by Reckitt Benckiser, which has followed the assimilation approach — and dismantled the SSL organizational structure and identity.

Symbolic and Substantive Levers of Identity Integration

Managers can shape and reinforce an organization's identity through effective use of two different and complementary levers: symbolic and substantive. Symbolic identity management levers consist of discourse about what the merged organization stands for or should stand for. It includes crafting a mission or identity statement, defining organizational values and developing corporate branding (name, logo, slogan and visual identity). It can also include creation of an organizational saga to celebrate the defining moments in the company's history or strategic use of a sponsoring budget to express the identity of the organization through identification with an area of human activity, such as a humanitarian cause, a sports discipline or a cultural movement.

Our experience suggests that there is a tendency for senior managers to think of identity management largely in terms of symbolic initiatives. They seem to believe that identity is about an organization's "skin" — its name and visual appearance. While attention to the skin is undoubtedly important, the senior managers' work is hardly done when an attractive layer of makeup has been applied to the new entity. It requires more than a call to the corporate beauticians. Cosmetic work on the surface of the organization has to be connected to substantive actions that embody and give meaning to the cosmetic symbols.

Substantive levers of identity management refer to acts and decisions about the organization, not just discourse. They include decisions regarding ownership, governance structure and leadership team composition. They also include recruiting people who can embody and promote the new organizational identity; letting go of people who are not in line with the new identity; changing organizational structures and management systems; and perhaps ensuring consistency between the company's business strategy and the new identity.

When a merger involves the creation of a new identity, swift symbolic initiatives (mission statement, name or logo) enable managers to communicate the new projected identity fairly quickly. For these efforts to be fruitful, however, they need to be followed by substantive decisions regarding people, business strategies and operations that are aligned with the symbolic initiatives. Problems arise when managers fail to realize the importance of supplementing symbolic initiatives with consistent, and often more difficult, substantive decisions regarding people, business strategies or operations or undertake divergent symbolic initiatives and substantive decisions. The skin and the soul need to be aligned.

Recommendations for Successful Identity Integration

The four paths to identity integration described here offer alternative approaches to making one organization out of many. Each model represents particular trade-offs regarding how to deal with legacy identities in building a common future. The cases used to illustrate each model show that all four can be successful when they are a good fit with the context and objectives of a merger.

Our experience with and observation of how some large and well-known companies have practiced identity integration lead us to the following conclusions.

First, there needs to be recognition that in order to have an effective merger, executives must recognize both the economic *and* the psychological synergies that need to occur. Too often, the psychological issues tend to be either overlooked entirely

or underappreciated as mergers are contemplated and consummated. In no way do we minimize the importance of financial architecture in influencing the success of M&A; we only emphasize that it is not the whole story.

Second, there should be some assessment in the pre-merger phase of the extent to which identity issues might preclude successful fusion. By including an identity audit in the due diligence process, managers might in extreme cases decide that, despite potential economic synergies, a merger should not be pursued because psychological synergies would be very difficult to achieve. (See "The Identity Audit.") In less extreme cases, the identity audit would enable managers to identify the issues and obstacles that would need to be addressed in order to achieve successful identity integration.

Third, it is dangerous to use language from one model while pursuing integration through a different model. Although it may be tempting to use language from the metamorphosis or federalist model to disguise what is really assimilation — especially when the architects believe that open admission of assimilation might derail the transaction or increase the price tag — the longer-run credibility price is steep. For example, by joining the two companies' names in DaimlerChrysler and using the "mergers of equals" phrase, Jürgen Schrempp, the man who drove the ill-fated merger, raised the expectation among Chrysler people of a federalist design in which the U.S. automaker would retain its autonomy, U.S.-born leadership and identity. Two years later, he admitted that he had never taken seriously the "merger of equals."[7]

Such an open admission is rare. But discrepancies between espoused and actual integration practices are a common fact of business life and can cause senior executives of acquired companies to feel they have been lied to in order to secure their agreement to a merger. The long-term effects are likely to be highly toxic.

Fourth, managers should be pragmatic with regard to the four integration models and not fall into a "one-size-fits-all" trap. The approaches followed by Unilever with regard to its acquisition of ice cream maker Ben & Jerry's and by Coca-Cola with its acquisition of Honest Tea suggest that the uniqueness of an acquired organization can justify an exception to a standardized post-merger integration template. Unilever, a successful practitioner of assimilation, acquired Ben & Jerry's in 2000 and has made a set of formal commitments to maintain the ice cream maker's independence and unique identity. References to Unilever aren't plentiful on Ben & Jerry's website. Similarly, Honest Tea was fully acquired by Coca- Cola in 2011 but is still operating as an independent company.

While Cisco was, and still is, known for elevating the dissolution of acquired identities to an art form, the company has likewise made a series of exceptions, starting with the 2003 acquisition of LinkSys and continuing with the acquisition of Scientific-Atlanta, IronPort and WebEx.[8] Cisco has developed a hybrid identity integration model, with assimilation applied to targets operating in the company's historical core business and federation applied to firms operating in new areas of diversification.

Fifth, we stress that, although they have access to powerful symbolic and substantive levers by which

THE IDENTITY AUDIT

An identity audit reveals what makes an organization unique in the eyes of its employees and stakeholders.[ii] It also reveals the degree of alignment among different constituencies regarding what the organization stands for. For example, a business may be commonly viewed as a high-technology company, while a good deal of its identity may be anchored in its nationality or ownership structure.

An identity audit consists of three steps, beginning with a careful study of available data — current, historical and internal (such as company documents and white papers) and external (everything from annual reports to news coverage). This step enables the auditors to capture how managers, employees, shareholders, customers, competitors and the media portray the organization. The result of this step is a list of possible identity anchors to be validated and refined in the next two steps of the process.

The second step consists of a series of in-depth interviews of representative members of key stakeholder groups. The interviewees are invited to reveal their understanding of the organization's identity anchors through a discussion of a list of past actions, strategic decisions, and, when applicable, controversial episodes.

The final step in the audit consists of large-scale validation of the identity anchors that surfaced in the first two steps. Auditors create a questionnaire, to be completed by a large sample of key internal and external stakeholders, that asks respondents to express their degree of agreement with a series of statements, each corresponding to an identity anchor.

Analysis of data from the survey yields a reduced list of identity anchors that make the organization unique in the eyes of its key stakeholders and an assessment of the degree of alignment between various perceptions of the organization's identity. When the audit is conducted in conjunction with a merger or acquisition, either of two extreme outcomes should raise a red flag: strong consensus among the target's stakeholders around an identity that could hinder the realization of synergies, or a high level of divergence among stakeholders about the target's identity.

they can shape identity, defining the identity of an organization is not the province of senior managers alone. Identity is shaped, owned and reinforced by the organization's key stakeholders. It lies in the eyes of the beholders. Failure to acknowledge this can lead managers to promote definitions of their organization that are disconnected from, and sometime at odds with, how other stakeholders perceive them. To avoid divergence and contradictory claims about what the merged company stands for, managers should include an initiative designed to monitor how employees, customers, shareholders and other relevant stakeholders perceive the merged company in the post-merger plan.

Finally, we underline the importance of the time dimension in identity integration. With the goal of maximizing psychological synergy as a priority, managers should remember that, in contrast to strategic and operational alignment, identity alignment is not a "one-off" task but a process that can take several years. The Renault/Nissan case provides a good example of what we mean by gradual identity integration. Given the globalization of the car industry and the size of potential synergies and economies of scale, full-fledged integration of the two automakers would have probably been the most optimal economic solution. However, neither Nissan nor Renault was prepared for assimilation (of Nissan by Renault) or for metamorphosis (full integration of the two automakers into a new identity). The wide geographical and psychic distances would not have allowed a federalist scenario, which would have meant the creation of a new identity and common management structure above the historical identities of Renault and Nissan. Therefore, the confederate model provided a good starting point for the two companies, but it is clearly not the end of the story. As with KLM and Air France, the next step may be a move toward a federalist management structure, where a central authority makes major decisions for the two automakers (phasing of new product launches, more shared parts and more cross-assembly platforms, for example) while the two organizations keep their own management structures and operating autonomy. After the federalist phase has allowed for the creation of enough bonds and sense of common purpose, the time could be ripe for a full-fledged metamorphosis, in which Renault and Nissan would cease to exist as separate organizations and would be promoted as mere brands.

Integration is a long-term process. The returns from combining the resources of more than one organization under a common ownership structure will be enhanced only when the importance of identity integration is fully recognized — and when the same careful planning and execution that tend to accompany the economic aspects of a deal simultaneously accompany the psychological dimensions.

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i. A previous version of this article is available online: http://knowledge.wharton.upenn.edu/papers/download/022012_New_Merger_Math_June_15_2011.pdf.

ii. A more detailed discussion of the identity audit is available in Chapter 10 of Bouchikhi and Kimberly, "The Soul of the Corporation."

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