SOME COMPANIES ARE MORE EQUAL THAN OTHERS: WHY MERGERS OFTEN FAIL

Professor Michael Gibbs
University of Chicago Booth School of Business
“Merger of Equals & Unequals”
co-authors: Kathryn Ierulli & Valerie Smeets

- Why do 50+% of mergers fail?

- Difficulty of integration?
  - prior research focused on finance, accounting, strategy
    - or was based on field interviews, small sample size
  - we take “Personnel Economics” approach
    - blending economic & social factors
    - large sample, statistical
Predictions from Prior Research

- Cutting generous pay in Target firm
  - wages higher at Target firms
  - turnover of highest paid Target employees
  - no effect on Acquiring empl. or workforce mixing

- Scale/scope; Implementing best practices
  - more or less turnover?
  - less new hiring if merge for scale
  - how much mixing of workforces?
  - Target employees should fare well, esp. if minority
New Focus: Organizational Integration

- Reconciling formal structures is difficult
  - titles, hierarchies
  - evaluation & compensation
  - tools, methods, etc.

- Reconciling informal structures may be harder
  - firm specific human capital
  - cultures
  - social networks
  - implicit contracts

- What dynamics might arise between the groups?
“Ethnic Conflict” or Assimilation?

- Conflict more likely with groups of similar size

- Minority groups tend to assimilate
  - ex.: Chewas & Tumbukas
    - in Zambia, allies
    - in Malawi, adversaries
  - why?
    - in Z, each was a minority
    - in M, each was a large % of population
Examples

- EADS
  - “split management was created to avoid tipping the balance of power toward France or Germany”
  - “board, on both sides, lost confidence in Streiff”
  - “wasn’t diplomatic enough to handle politically sensitive task of restructuring – shifting work from one country to another”

- Then there’s Daimler-Chrysler ...
Predictions: Organizational Integration

- “Dominance” – relative workforce size
  - relative power / incentives for conflict
  - extent one group must mix with the other

- Could go either way: the less Dominant my group,
  - the more we might assimilate
  - the less valued are our skills, culture, etc.

- Merger more of equals → greater conflict
Data

- All Danish mergers, 1980-2006 (... Denmark?)
  - private sector, 5 or more employees
  - 595 mergers, 100,000+ employee-years
  - who works in each “establishment”
  - employee demographics, pay & turnover
  - firm industry, size, # of establishments, etc.
Findings

- Mergers not motivated by desire to cut pay
  - Target employees were paid less
  - lower turnover of best paid
  - higher turnover of most skilled

- Inconsistent with implementing best practices
  - Target turnover would fall; not depend on dominance

- Few mergers of equals (similar size firms)

- Most changes occur in first year or two
Turnover

- High turnover for both workforces
  - especially for Target workers

- Workforce Dominance reduces turnover
  - put another way: the minority workforce shrinks
  - Dominance 25% lower → turnover 10% higher
Mixing & Hiring

- Little workforce mixing

- Who mixes?
  - Target employees
  - less Dominant firms
  - high skilled
  - R&D, managers
  - new (post-merger) establishments

- New hiring, despite high turnover
Interpretations

- Integrating workforces is difficult & costly
  - lost specific human capital, culture, networks, etc.
  - conflict / favoritism → Target workers lose out

- Firms appear to *avoid* integration
  - new hires easier to integrate than Target
  - use key employees to implement “integration”
    - *managers* broker across functions & organizations
    - *R&D* implement knowledge sharing
Implications: Due Diligence

- Assume integration won’t work (well)
  - harder to do, the more equal the firms
  - it will be messy & take a long time

- Consider ways to avoid integration
  - purchase customer lists, assets, technology
  - joint ventures
  - merge, but keep separate divisions

- M&A analysts may give lip service to cultural fit. Don’t – unless not planning to integrate
Implementation

- Don’t say it’s a Merger of Equals if it isn’t

- Make expectations of assimilation explicit
  - both sides
  - don’t tolerate factionalism, favoritism
  - centralize cultural integration
  - include in evaluation criteria

- Use role models & brokers
  - high potential people from both sides
  - recognize & reward integrators
  - managers, R&D
Example

- Explicitly avoids mergers of equals
- “HR screen” of Targets before merger
  - HR people on the M&A team
  - assess fit of management style, organization, & culture
  - acquisition is cancelled if fit is poor
Setting expectations

- “This is an acquisition, not a merger of equals”
- “We don’t say, ‘We’ll leave you alone.’ We change everything”
- “The more flexible & positive you are, the better it will be”
Integrate as quickly as possible

- Target must be embraced by at least 1 Cisco group
- both structural & cultural integration plans
- look for short-term successes as well as long-term
- immediate training in “Cisco Way”
- new employees assigned “Cisco Buddy”
- past mergers reduce factionalism in workforce
Conclusion

- Integration = biggest barrier to merger success
  - mergers of equals are hardest to implement
    - economic & social factors

- Look for synergies from other sources
  - clients, technology, geography, sharing best practices

- Do organizational due diligence, skeptically

- Leadership must be forceful, skilled & tireless at integration & workforce management