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A phased approach to merger and acquisition integration: Tapping experiential learning.

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Abstract

A merger and acquisition (M&A) is not a strategy, but a means to pursue one. Although there are multiple reasons to pursue an acquisition, the primary challenge in doing so is that M&A consistently fails to improve firm performance.1 Poor integration between the acquiring and target firms provides and explanation for M&A performance falling short of expectations, because integration is pivotal in creating value from M&A. Without integration there is little justification for paying premiums for targets that average 40 percent.2 Integration, however, is difficult to execute, and existing frameworks describing M&A integration and its impact on performance have limited usefulness.

Disciplines

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Comments

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Chapter 3

A Phased Approach to Merger and Acquisition Integration: Tapping Experiential Learning

David R. King

A merger and acquisition (M&A) is not a strategy, but a means to pursue one. Although there are multiple reasons to pursue an acquisition, the primary challenge in doing so is that M&A consistently fails to improve firm performance.[1] Poor integration between the acquiring and target firms provides an explanation for M&A performance falling short of expectations, because integration is pivotal in creating value from M&A. Without integration there is little justification for paying premiums for targets that average 40 percent.[2] Integration, however, is difficult to execute, and existing frameworks describing M&A integration and its impact on performance have limited usefulness.

The shortage of definitive guidance on integration is consistent with the focus of M&A research in general. The variable most commonly examined in M&A research is relatedness, or the degree of similarity between an acquirer and target.[3] Despite expectations that a relationship exists, research has not found empirical evidence that relatedness between an acquirer and target influences M&A performance.[4] Although multiple explanations for this exist, two are most relevant to the current chapter. First, research generally examines simple relationships that fail to consider what relatedness means for the integration of an acquirer and a target's resources and operations. Emerging research suggests a complex relationship exists whereby related acquisitions perform well when there is enough difference between firms and resource combinations to create value, but performance of unrelated acquisitions falls when differences become too great.[5] Second, whereas different acquisitions may require unique integration approaches, research largely groups all M&A activity together. Specific types of acquisitions, such as those involving high-technology targets or those that involve diversification, may exhibit important differences.

Given lackluster M&A outcomes, a need for integration to improve performance, and limited available guidance on integration, improving M&A integration is an urgent and compelling management challenge.[6] A key to responding to this problem is to recognize that M&A is not an event but a process. One approach to viewing M&A in this light is to look at decisions made during each phase of an acquisition, and outlining practices that can be expected to improve results. This chapter applies this approach to the acquisition of smaller firms in related industries, an M&A scenario generally considered to have more potential for improved M&A performance. Integration is an important factor in related acquisitions as it is needed to transfer resources and skills. Similarly, relative size between an acquirer and target is a key variable, as research suggests that a target needs to be small enough to be easily integrated yet large enough to influence an acquirer's performance.[7] Using a phased approach in examining a specific type of acquisition can offer guidance that will help in identifying other circumstances where positive M&A outcomes can be achieved. It also offers acquirers the opportunity to unlock the power of experiential learning.

EXPERIENTIAL LEARNING

Instead of merely thinking about a problem, experiential learning involves a direct encounter with a problem and active attempts at finding a solution. Viewed this way, learning then involves reflecting on cumulative experience to guide behavior.[8] The implication is that ideas are not fixed and immutable, but are formed and reformed through experience where early decisions have implications for later performance. Tension between expected and actual experience is inherent in Kolb's iterative model of learning.[9] This model consists of four stages: (1) concrete experience, (2) reflective observation, (3) abstract conceptualization, and (4) active experimentation. Although experiential learning follows a continuous spiral that can be entered at any stage, learning generally begins with an actual experience where a particular action is taken and the effects of the action are observed. The next two stages relate to reflection on these effects, and the transformation of the experience into a sense of order using a set of guiding principles. Plans are then made to test developed models, leading to a continuing cycle of improvement as resulting observations are made.

Applied to M&A integration, experiential learning suggests that early consideration of issues leads to better results, as there will be a smaller gap between desired and actual results. Broadly speaking, the M&A process can be segmented into three phases: target selection and deal structuring, integration planning, and integration implementation. Prior experience and available knowledge guide target selection, whereas deal structuring relates to reflective observation. Integration planning involves the conceptualization of the desired combination of target and acquirer, and the development of blueprints for making it reality. As implementation of the developed M&A plans progresses, outcomes inconsistent with expectations help to refine actions, leading to active experimentation in pursuit of the M&A goals. In the next section, principles of M&A are integrated with those of experiential learning to develop suggestions for M&A integration across the phases of M&A.

M&A PHASES

Each phase of the M&A process has the potential to establish conditions for improving subsequent performance. However, there is no guarantee that they will; thus implementation may be unable to overcome errors committed earlier.[10] The implication is that achieving better M&A performance requires considering integration issues early in the process, beginning with having a clear strategic rationale for the M&A. What provides a good rationale is not specifically developed here. However, any rationale for M&A needs to incorporate the importance of acting quickly. Speed is the primary advantage of M&A compared to internal development since its results can be seen faster, and the need for speed can counter the potential limitations of an acquisition. Explicit recognition that a high hurdle exists in reaching M&A goals also requires that managers develop a clear strategic rationale for an acquisition. This must aid target selection, and carry through the stages of integration planning and implementation.

Target Selection

Improving M&A integration begins with a focus on target selection and deal structuring in order to minimize challenges during implementation. Target selection involves management of the acquiring firm identifying a target firm and setting deal characteristics, such as an offer price. Most deal characteristics are fixed after negotiations are complete and a deal is announced, so poor selection only increases the challenges of implementation. For example, the premium paid for a target firm is negatively related to M&A performance and paying too high a premium can preclude improved performance.[11] Still, there are a multitude of things that managers need to consider in selecting a target, and surprises from areas not considered will be inevitable. The focus here will be on a handful of observable attributes managers can influence in selecting a target and their expected impact on performance.

Resource Combinations

Acquisitions are a means of managing the resources available to firms, and improved M&A performance often depends on an interdependence between an acquirer's and a target firm's resources.[12] Research suggests acquisitions that enable acquirer and target strengths and weaknesses to offset each other are most likely to create value.[13] In the case of knowledge integration, positive outcomes can be expected for firms in related industries. For unrelated acquisitions, the negative impacts of dissimilarity increase as knowledge becomes more dissimilar.[14]

Acquisition strategies for resources either involve supplements, obtaining more of a resource, or complements, obtaining another resource that combines effectively with resources the acquirer already controls.[15] Although a strategy based on supplements results in adding to the resource base, a drawback of such a strategy is that resource redundancy following the combination of firms can lower performance.[16] In contrast, a strategy that pursues complements focuses on combining different but mutually supportive resources and can create new value.[17] For example, value can be added if an acquirer gains access to new customers and segments that complement existing product or service.[18] Complements can also provide a valuable source of asymmetry that can allow an acquirer to gain access to target resources at a price below their value to the acquirer. Although complementary resources are difficult to value, acquirers may pay a lower price compared to the potential value of a resource combination because the value of a given target varies for different acquirers with dissimilar resource profiles.[19]

The value that can be obtained from a target firm varies by bidder. The offer price of different acquirers should reflect the anticipated value of each expected combination with a target. However, to be accepted, the price of a winning bid need only exceed that of competing bids. Therefore, the price paid will exceed the value that could be created in the second-best combination, an outcome that should remain true even if a bid is not contested. Any surplus value for an acquirer over the price paid can be translated into higher performance. In contested acquisitions, competitors may attempt to bid a target's price above an acquirer's value in an attempt to sabotage a successful combination. If bids remain rational, winning bids can create value from the difference between the value estimated for the next best combination and the estimated value of the combination for the acquirer. The value achieved could be even higher for resources that complement one another because they often generate unanticipated benefits, such as easier collaboration.[20] This logic is consistent with early advice for acquisitions that suggested acquiring firms avoid unrelated acquisitions and select firms that complement them.[21]

Target Environment

Different environments place different demands on resource needs, so resources targeted through acquisition are those that are valuable in the environment where they will be used.[22] An implication that a target firm's environment makes a difference is that not all targets will be equally attractive. Still, acquirers do not consistently consider the impact of a target firm's environment during target selection. For example, acquirers often discount the role of a target firm's environment in assessing the performance of a target firm's management.[23]

Industry environment relates to three factors: munificence, dynamism, and complexity. Munificence relates to the degree that the environment supports growth for firms within the industry.[24] Growing industries are expected to positively impact firm performance, but this may simply be an enabling and not a direct cause of firm performance.[25] Although high munificence will not guarantee a better target, target firms operating in environments with low munificence may focus internal resources on competitive defensive moves that offer less upside potential than resources developed by firms in munificent environments.[26] Dynamism corresponds to the level of unpredictability within an industry and relates to the difficulty of discerning patterns from environmental change.[27] Environmental uncertainty may lower the frequency of acquisitions by contributing to doubt about the value of other firm's resources. However, the advantage of speed, or quickly gaining resources in acquisitions, may make resources that are needed and owned by a target firm in a changing environment more attractive.[28] For example, Walgreen paid more than twice the prior closing price for drugstore.com, but the acquisition enabled them to access vendor relationships and achieve a 50 percent increase in customers that would have required significant time to accomplish separately.[29] Complexity relates to the number of organizations a firm contends with in an industry.[30] Although complexity can arise from different sources, the factor salient in M&A relates to concentration, or the extent to which monopoly power exists within an industry.[31] Monopoly power tends to increase with industry concentration and decrease with industry fragmentation. Fragmented industries are more complex as resources are widely distributed across multiple firms.[32] Although the resources of firms in concentrated industries will likely generate interest from potential acquirers, it is less likely that these firms can be purchased without a paying high premium or other complications.[33] Early acquirers when consolidation has begun in an industry are able to pick the better targets and leave behind a smaller and less competitive pool of firms.[34] It is also possible that early acquirers are better-managed firms that are responding proactively to industry contraction by improving efficiency.[35]

Successful acquirers not only consider the target, but also its industry environment. Selecting targets early in the consolidation of a target's industry or around times of rapid change may provide more favorable starting points for performance. Targets in growing industries also provide a more forgiving environment for successful integration. The implication is that target selection needs to consider more than internal characteristics of potential target firms.

Friendly Fit

In a friendly acquisition, there is an increased chance that the combined firm will achieve easy and fast synergistic resource combinations that lead to higher performance. Challenges associated with hostile acquisitions include paying a higher premium to overcome resistance and greater difficulty in carrying out due diligence.[36] However, the primary reason that hostile acquisitions are less desired is that they involve high management turnover that reduces the ability to integrate a target firm's resources.[37] Managers represent a valuable resource in the combined firm, and successfully moving into new markets may depend on retaining target managers with relevant market knowledge. Although there may be positive elements of management turnover such as target firm managers becoming redundant in a combined firm or the elimination of managers who contributed to poor performance, the loss of knowledge often outweighs any benefits from target manager turnover.[38]

Although managers of firms in related industries can be expected to have common perceptions, there are no guarantees, and the question of whether to integrate management of the target must be addressed. Three methods are suggested for evaluating this issue. First, acquirers need to consider the ability of the acquirer and the target management to work together, something that will be easier in friendly deals. However, during negotiations, people are likely to put their best face forward. One option is to role play a target decision to assess compatibility, as improved fit will likely result when an acquirer finds that they would make a similar decision under similar circumstances.[39] This concept corresponds to two of Cisco's rules for target selection, which require that a target have a similar vision and a compatible culture to help ensure that it has a complementary philosophy.[40] The challenge of combining companies is likely to be proportional to any cultural gap and can be lessened by picking firms with similar cultures.

Second, successful acquirers are likely to include a termination fee to align interests when completing an announced acquisition. Including a termination fee provides some protection for the acquirer when facilitating integration planning by enabling the acquirer to reveal private information to a target firm.[41] The buying and selling of a home offers an analogy in that when the buyer makes a security deposit the seller provides property disclosures. In the context of an acquisition, the target firm agrees to termination fees that serve as an enabler for the acquiring firm to disclose the strategy for combining the firms and the role of target firm employees following the acquisition.

Third, successful acquirers avoid targets with golden parachutes or comparable takeover defenses. If stock options vest when a takeover occurs, it makes integration more challenging because an acquirer needs time to transfer skills, something made difficult when key people in a target stand to benefit financially as a result of a takeover.[42] Even if they stay, target employees who experience significant financial windfalls from an acquisition will likely focus more on their newfound wealth than the on interests of the continued success of a combined firm. As a result, successful acquisitions generally avoid conditions that hinder an alignment of interests and knowledge transfer.

Method of Payment

Firms can pay for an acquisition using either cash, a combination of cash and stock, or with stock alone. Research suggests that managers finance acquisitions in the manner perceived to be the most profitable. Managers who believe their stock is undervalued will thus pay for an acquisition using cash, and pay with stock when they think their firm's stock is overvalued.[43] However, the choice of payment may also consider the type of acquisition. Related acquisitions are often paid for with stock because this shares the risk inherent in the acquisition with the target firm.[44] Additionally, paying with stock can help align a target firm's interests with improving performance in a combined firm. For example, stock payment may provide a means for coping with information asymmetries between an acquirer and its target.[45] The use of stock to align target firm interests with a successful outcome is similar to how stock options are used to align executives' interests with those of shareholders. Another way to align target executive interests is with an earnout, or an arrangement where the final price paid depends on meeting performance targets.[46]

The use of stock as a form of payment should also help an acquirer to avoid the negative effects associated with taking on too much debt when paying for an acquisition with cash. Debt can lower an acquiring firm's financial performance. The stock price of a firm with higher debt will be discounted in comparison to that of a firm with less debt (assuming everything else is equal) to reflect the higher risk of investing in the firm. This discount results from equity investors having a lower priority than bondholders when making claims against the assets of bankrupt firms. Accounting measures of financial performance will also be poorer when levels of debt increase as a greater share of a firm's earnings are allocated to servicing debt payments. As a result, high debt levels raise the bar for the performance needed to improve performance and can lead to strict controls that negatively impact the adaptation needed to improve performance following an acquisition.[47] In summary, there is reason to believe that successful acquirers take steps to align target interests by paying for their acquisitions with stock or using an earnout.

Integration Planning

The time between an M&A announcement and its completion is typically called due diligence, and represents the start of integration planning. There is a growing chorus of voices from institutional and other investors calling for more rigorous due diligence. Greater justification is needed from managers for their rationale in pursuing an acquisition to overcome resistance attributable to there being managerial incentives from M&A yet low average M&A performance. Though the purpose of due diligence is not to identify reasons to abandon an acquisition, it is the last chance for avoiding an acquisition that does not make sense. Conditions where deals should be terminated include distrust between acquirer and target management, a combination that threatens important customer relationships, or expectations that key employees will leave a combined firm.[48] Necessity often dictates involving only a few key people in acquisition planning. However, it is better to err on the side of including more people to ensure that as many potential problems are identified and potential solutions considered.

Most firms do not efficiently use the time between announcement and completion as optimism from successful negotiations delays planning for implementation. Indeed, a sense of accomplishment from bringing negotiations to a close when a deal is announced tends to shorten due diligence. However, taking more time for due diligence can improve success and avoid problems that hinder improved performance.[49] One positive result of taking additional time for planning is that unexpected information uncovered during due diligence will usually be negative, which in turn requires more time to evaluate its implications.[50] Focusing on the right things can also help firms make better use of the time available. This can be facilitated by establishing and communicating clear goals that can be used in making decisions, something that can make a difference in developing an executable plan. Integration planning typically focuses on the depth and speed of integration, but developing an integration plan begins with considering M&A goals.

The goals for an M&A should have already been established; thus integration planning relates to the experiential learning stage of applying theories or models in relation to what has been observed. Stakeholder analysis represents an existing tool that applies to M&A integration, and the interests of stakeholders in achieving M&A goals can first be addressed during integration planning.[51] A stakeholder is any group that can affect or is affected by a firm's objectives.[52] Managers can be caught by surprise and have initiatives derailed by an unanticipated negative reaction from a stakeholder group. With effective stakeholder analysis, urgent concerns can be identified and addressed. A stakeholder group that should have already been considered when making a public bid is important target shareholders such as institutions or family holdings. By performing an analysis of additional stakeholder interests, an integration plan can balance the interests of different groups in pursuing M&A goals. Obvious additional stakeholders in an acquisition involve government regulators, customers, employees, and competitors. However, additional stakeholders, such as vendors or other business partners exist and need to be considered. Once identified, it helps to prioritize stakeholders to better manage how to approach them. One method is to build a matrix for prioritizing stakeholders along dimensions of stakeholder power and interest.[53] Resulting stakeholder groups are shown in Table 3.1 and each is discussed in the following sections.

Government Regulators

Regulators have a high level of power over the completion of any deal, but likely have low interest in all but a minority of announced combinations. One way to strengthen regulatory resistance is to announce a deal as a fait accompli before or during the regulatory review process. The focus for this stakeholder group thus involves meeting conditions established by policy makers. Because regulatory requirements vary across the

Table 3.1
Prioritizing M&A Stakeholders

	High Interest	Low Interest
High Power	Manage closely (regulators)	Keep satisfied (customers)
Low Power	Keep informed (employees)	Monitor (competitors)

nations comprising the European Union,[54] the discussion here is limited to the review under the Hart-Scott-Rodino (HSR) Antitrust Improvements Act of 1976. This U.S. law requires that before most M&A transactions can complete, filings describing the proposed transaction and the firms involved must be submitted to the Federal Trade Commission and the Department of Justice. The rules, filing requirements, and associated fees are fairly complicated and interested readers can learn more at the Federal Trade Commission's Website.[55] After filing for HSR review, there is generally a 30-day waiting period to allow regulators to review information and consider anticompetitive implications. During the waiting period, there are limits on data sharing and joint decision making between firms that are part of the acquisition. The regulatory review may be shortened or extended, but it must be satisfied before a transaction can close. Although most firms wait until the review is complete, firms can begin planning for integration sooner. One option is to use third parties, such as consulting firms, to perform needed analysis of joint data and provide relevant summaries.[56] In doing so, companies need to ensure that incentives paid to advisors do not lead to higher costs.[57]

Regulatory reviews by other government bodies may also be required before an acquisition can complete. For example, the European Union can impact acquisitions of U.S. companies as illustrated by Intel having to make concessions to gain regulatory approval of its McAfee acquisition.[58] The potential for additional regulatory reviews reinforces the need to consider regulatory issues and remedies as part of target selection, as any accommodations to gain regulatory approval will influence integration implementation. By anticipating regulatory reviews, firms can minimize planning delays. Firms with active acquisition programs or strategically important deals may want to establish a team dedicated to government relations or liaison with regulatory agencies. For example, AT&T has announced it will make concessions to regulators to complete an acquisition of T-Mobile. AT&T has a skilled team of 93 lobbyists in Washington, DC, and has spent $46 million in campaign contributions to both major U.S. political parties.[59] The primary focus of successful acquirers during regulatory review is continuing integration planning while keeping government representatives informed and regulatory requirements satisfied.

Customers

A sometimes overlooked group that likely has high power and interest in an acquisition is customers of both acquirer and target firms; thus the concerns of customers need to be managed carefully. Acquirers often focus on internal issues during integration at the expense of external market issues.[60] Having a short-term focus on integration planning can sacrifice long-term results that depend on serving customers. For example, customer service quality often declines during the turmoil surrounding an acquisition, and results in two-thirds of businesses losing market share following a merger.[61] In contrast, an emphasis on creating value for the customer as part of an acquisition facilitates the building of trust between the customer and the new firm, reduces customer uncertainty, and lowers dissatisfaction and defection.[62]

In planning for integration, retaining customers may be more important to acquisition performance than reducing costs.[63] Research suggests that acquisition performance suffers significantly from negative customer reactions.[64] A lack of communication with customers to allay concerns can be expected to have consequences. For example, IBM cut its orders in half following the combination of two high-technology firms because no one communicated what the acquisition meant to this customer.[65] Acquirers that remain committed to serving their customers and improving customer value as part of the integration will be more successful

Employees

Just as a deal needs to be sold to customers it also needs to be sold to employees.[66] The best strategy will fail if it does not consider the people needed to execute it. Employees represent a challenging group to deal with in that they have high interest yet low power on an individual basis. Employees need to be kept informed about an acquisition and its implications. When employees learn of a merger, they expect and are prepared for dramatic changes.[67] Most employees anticipate that when an acquisition is announced there is already a plan for integration; thus the need exists to educate employees about the M&A process.[68] M&A announcement simply begins the regulatory review and planning needed to answer employee concerns.

Employees will have little tolerance for delays that fail to set a clear direction for a firm and communicate their place in it. Successful acquirers recognize that silence is not an option even if there is a lack of definitive answers.[69] Employees will be hungry for information to help deal with the uncertainty created by the acquisition, and will be looking for the strategic rationale for the acquisition. Employees want to know that a plan for creating a better organization exists, that it signals that people matter, and that it addresses what the acquisition means for individual employees.[70] A lack of information shared with employees about plans or their development will only lead to employee speculation and the resulting anxiety that complicates integration efforts. An integration plan needs to use frequent and effective communication to gain momentum with small wins that increase employee buy-in.

Achieving M&A goals depends on ensuring that key people do not leave soon after an acquisition is announced. Further, reestablishing leadership continuity with a target is critical.[71] Under the best of circumstances, employees experience uncertainty following an acquisition announcement and employee commitment will be lowest during the planning prior to acquisition completion. Acquisitions are often motivated by gaining tacit, socially constructed knowledge in a target, but that knowledge may not survive attempts to integrate it, leading to employee turnover becoming a primary suspect in poor M&A performance.[72] The first employees to leave are generally the best and brightest because they have the most options. The primary causes of departures include decreased employee perceptions of control, and discounted past contributions. Typically 12 to 25 percent of personnel are viewed as redundant.[73] The combined effect of layoffs, employee defections, and the need for growth to meet M&A goals often drives resumed hiring. Care is required to avoid the need to recruit old employees back at a higher salary.[74] Achieving M&A goals depends on ensuring that key people do not leave soon after an acquisition is announced. As a result, the focus of employee retention begins with top and middle managers, or the people most likely to influence employees.

Top Managers

Reestablishing leadership continuity with a target is critical as the conditions created by an M&A are stressful in that they require employees to update their organizational identity.[75] Limiting political behavior will also require aligning actions and words, and top managers in both firms need to communicate commitment to an acquisition before it is completed. Successful acquirers likely avoid statements that "best practices" from each firm will be implemented, as they recognize that this is unrealistic. Making comments that an acquisition will take the "best practices" from each firm also leads people to justify their processes at a time when new processes are often required.[76] The need to retain and motivate people to work together makes it imperative to include top managers from a target firm in integration planning. The importance of this goes beyond what was discussed in considerations about selecting targets with a friendly fit.

An obvious decision needing input from the target firm relates to the assigning of top jobs in a combined firm where multiple people in the acquirer and target firms perform similar duties. The management of the acquiring firm will typically need to make these decisions, but they will have less knowledge about employees of the target firm than of their own. Meanwhile, a majority of M&A integration issues are political or emotional in nature. Instability and insecurity over power bases can contribute to feelings of gain or loss that increase political activity to preserve self-interests.[77] How top jobs are assigned during integration planning can mitigate political activity and enable faster implementation.[78] Cisco again provides an example of how this is done well. They announce new roles and titles immediately upon completion of an acquisition, and as a result, Cisco enjoys lower turnover of acquired employees than overall levels of corporate turnover.[79]

Middle Managers

The management of acquiring firms need to keep in mind that there are consequences of filling managerial positions following the acquisition mostly from within their own ranks. A blended top management team that retains a target's top management can help to motivate middle managers.[80] Middle managers require special consideration as they represent the primary means of translating strategic objectives to workers and implementing M&A objectives. When excluded from decisions surrounding an acquisition, middle managers can feel left out and foolish as employees come to them for answers they don't have.[81]

Middle managers who see top managers being treated fairly in a combined firm can be expected to have a more positive attitude, which can be important in reducing employee anxiety.[82] Cisco has established a reputation as a "good" acquirer because no target firm employees lose their jobs unless both CEOs assent.[83] An example of where this did not happen is Oracle's $7.4 billion acquisition of Sun Microsystems. Oracle's CEO, Larry Ellison, expressed a low opinion of Sun's top management[84] and placed Oracle managers in positions of responsibility, contributing to a "brain drain" of Sun employees.[85] By comparison, working to reduce middle managers' uncertainty allows them to better understand M&A goals and more quickly begin the task of achieving them. A potential exception would be when there are inefficiencies or poor management in a target firm. Regardless, top management assignments should pull from both the acquiring and target firm, and be followed by communication to educate and explicitly enlist the support of middle managers.

Competitors

Acquirers need to remember that competitive pressures that drove the selection of M&A as a strategy to meet goals do not end once an acquisition is announced, and that competitor reactions need to be monitored. Although M&A announcements are public and create uncertainty for customers and employees of combining firms, they clarify what competitors can expect. Competitors often treat the distraction caused by integrating firms as an opportunity. When not bound by restrictions of regulatory review, competitors can immediately plant seeds of doubt in the minds of employees and customers. For example, quality disruptions frequently occur during M&A due to the downsizing of manufacturing capacity and transferring of work to facilities with people unfamiliar with the products or the processes used to produce them.

Employees will typically not know what a merger means for them, let alone be able to answer questions from customers. As a result, competitors will be actively recruiting employees and customers of firms involved with an M&A at the same time that those firms are least prepared to answer external challenges. Informal industry networks that make employees valuable to an acquirer can work against acquirer interests as competitors actively solicit employees experiencing uncertainty. Many employees will get job offers from competitors within five days of an acquisition announcement.[86] To the extent that competitors can leverage the uncertainties faced by firms involved in M&A to their advantage, the task of implementation only becomes harder. This challenge can be minimized by carefully monitoring competitor actions following an acquisition's announcement.

Prudent Planning

The amount of time that managers spend after an acquisition announcement to evaluate a target firm and plan for its integration varies. However, with an average time between announcement and completion of approximately 60 days for U.S. firms, the prevailing length of integration planning is probably not adequate.[87] Given that regulatory review of announced transactions can take up half of that time, it seems lamentable that coordination is limited to only one month of planning for multimillion dollar combinations. This is even more so when related firms require greater coordination of activities, or when there are particular challenges during integration planning to examine how acquirer and target firms fit together.[88] Additional time may also be needed to address any nonpublic information uncovered after the acquisition announcement because any new information is likely to be negative.[89] Successful acquirers recognize that prudent planning lays the foundation for the integration implementation needed to create value. A study of the appropriate time frame, based on an examination of the average time to complete acquisitions, suggests that acquirers should wait at least 120 days after an announcement before closing a transaction.[90]

Implementation

Although actions taken prior to completion of the acquisition will influence success, implementation is the true test of strategy. Making M&A work is one of the hardest business tasks, and implementation requires active experimentation to ensure that goals are met. When an acquisition is completed, two firms legally become one, yet internal barriers remain and complete integration may be spread out over several years.[91] Although initial performance will decline as integration disrupts normal work processes, achieving higher levels of performance depends on the regular review of progress toward meeting desired performance and organizational goals. This requires executives to take the concepts that drove a deal and make them operational realities by shifting from prudent planning to fast execution. Implementation will be facilitated by two tasks: the assigning of clear responsibility for integration management and continuing adaptation.

Integration Management

M&A increase people's workloads, but there is often a failure to prioritize work and thus the right thing gets done only by chance. After the initial excitement surrounding deal announcement, acquiring firm managers typically turn their attention back to prior tasks.[92] However, issues arising from implementation will need immediate attention. Managing integration thus needs to be kept separate from the day-to-day demands of firm operations.[93] This means it is necessary to make integration implementation a manager's only responsibility. In many successful acquirers, this person is called an integration manager.

An integration manager with full-time responsibility and accountability for making integration work can help avoid the problem of having managers who participated in integration planning simply returning to the demands of their regular jobs. Used effectively, integration managers perform the task of keeping others focused on creating value, and maintaining the momentum from integration planning.[94] Successful acquirers select this person from the integration planning team, empower them, and then track progress toward achieving integration goals through reviews that help identify needed changes. These reviews focus on making business units respond to the integration manager, and, by extension, help the combined firm be successful. They can keep uncertainty from stalling integration by maintaining a focus on implementation and by providing a mechanism for addressing issues and making decisions.

Integration managers require good project management skills, but more importantly, they need to be general managers. Assigning an executive from the acquiring firm that has been made redundant due to the blending of the top management team gives the new top management team an integration manager they trust. If the team is announced early, the person selected can also be ready to start integration the moment the acquisition completes. However, attracting the right talent to this role requires acknowledging that the position has limited duration (about one year) and is part of a leadership pipeline. The reward to the integration manager is increased visibility with the promise of a promotion. Meanwhile, the reward to the organization is better integration, and managerial talent with firsthand knowledge of M&A difficulties, as experienced managers form part of the firm's acquisition capability.[95] Another alternative would be to select someone close to retirement so as to leverage their experience and provide them with a transition event that is meaningful for both the individual and the organization.[96]

Continuing Adaptation

The plan that begins any successful endeavor is not the same path that is ultimately followed, and any single acquisition will be only part of a larger corporate strategy. As an acquisition is planned and integrated, new information becomes available, setbacks occur, and competitive dynamics change, all circumstances that require adaptation. Feedback mechanisms to maximize learning and performance guide dynamic adjustment by firms in order to reach aspiration levels.[97]

Despite managers' best efforts, it is unlikely that targets will be optimally integrated the first time, and restructuring will need to be repeatedly applied to unlock as much value as possible. Managers confront messy problems through a process of considering alternatives then assess results that follow experiential learning. As experience with integration and restructuring is gained, managers will be able to make better decisions when recombining units.[98] This process, however, takes time, and it can take years after an acquisition before changes in firm performance are observed. Though each context will be different, different researchers have suggested three years may be needed before positive results can be achieved from an acquisition.[99]

Successful implementation also requires recognition that there is more than one way to achieve a goal, so implementation should focus more on the desired end and remain flexible on how goals are accomplished. Restructuring may require creating new divisions from existing resources or new acquisitions, dividing divisions into different groups, eliminating divisions by reallocating resources or divesting assets, or additional options. However, successful acquirers capitalize on each success, while recognizing that continued improvement requires additional restructuring. Two gauges of success to monitor during implementation are how well talent and customers are retained. These will provide early indications of whether improved performance is being achieved or additional changes are required.

DISCUSSION

Aspects of successful M&A have been explored to show how early decisions impact integration success. Evidence from successful acquirers

Table 3.2
M&A Phases and Integration Decisions

Target Selection	Integration Planning	Integration Implementation
• Related target	• Focus on stakeholders	• Integration manager
• Consider environment	• Announce executives	• Continue restructuring
• Friendly fit	• Enlist middle managers	
• Partial stock payment	• Prudent planning	

across M&A phases suggest that early decisions are likely to have consequences during integration implementation. Bringing together established concepts may not necessarily have yielded new individual insights. However, the application of experiential learning to M&A phases offers an improved framework for understanding M&A integration decisions. A summary of decisions related to M&A integration is presented in Table 3.2 and illustrates that more decisions that impact integration are made before implementation begins than during it. The ideas presented also suggest implications for both management theory and practice.

IMPLICATIONS FOR MANAGEMENT THEORY AND PRACTICE

An insight with a theoretical implication provides a possible explanation for why M&A continues to be used as a strategic tool when evidence suggests acquisitions fall short of expectations. Cultural differences are a common explanation for M&A failure, but this explanation may serve simply as a scapegoat for poor decisions that amplify differences between acquirer and target firms, or for failing to account for stakeholder reactions to an acquisition announcement.[100] Further, the consequences of decisions made in target selection before an acquisition is announced have implications for integration and performance. It is possible that decisions made when negotiating a deal, such as offer price, could preclude improved results regardless of the effectiveness of integration.

Other insights also have implications for both managers and researchers. First, a single acquisition will likely be part of a larger strategic goal or initiative. This means that additional restructuring that may include further acquisitions or divestment of assets may be required to achieve firm goals. For researchers, this means that the treatment of M&A as an isolated event is likely to be inappropriate. This also raises the importance of managers recognizing how the strategic rationale for an acquisition may guide later decision making. Second, explicit recognition and handling of stakeholder issues during integration planning will be of interest to researchers and managers. For researchers, insights gained about stakeholder interests and power may help to explain observed decisions in M&A. For managers, consideration of stakeholders will enable an acquirer to move quickly from careful deliberation to fast execution. Specifically, reflecting on relationships and then actively experimenting to improve them during implementation, can enable an acquirer to start from a better position and more quickly move to capture value. Third, a case has been made for a greater role of middle managers as facilitators of integration and meeting M&A goals. Extending research beyond the impact of firm characteristics or top management teams (e.g., CEO) to consider middle managers may help to explain the variance in M&A performance. For managers, improved employee assimilation may also result from a strategy that includes publicly recognizing middle manager role models.

Another implication for management practice that is drawn from the research presented here involves the need for managers to consider integration issues across the phases of M&A beginning with target selection. The reasons for considering integration early in the M&A process include bringing up issues when they can be best addressed, and improving prospects for experiential learning or well-informed decision making. By considering a target firm's environment and pursuing related acquisitions with a friendly fit, an acquirer may be able to negotiate a price below the value of its anticipated combination with the target by benchmarking the value of potential competitors. To the extent that complementary resource combinations exist and contribute to information asymmetry, an acquirer has the opportunity to access resources at prices below their value, while offering the potential to unlock value through effective integration planning and implementation. Once a deal is announced, the engagement of management in negotiations needs to be extended in time and scope to include additional people. To the extent that regulatory review hinders coordination, third-party consultants can provide information for making decisions. Decisions made between the announcement of the acquisition and its completion will define responses from customers, employees, and other stakeholder groups whose support is needed to meet established goals. Following completion, steps need to be taken to avoid management attention shifting back to day-to-day issues, and to keep integration and strategic goals in clear focus. Strategic goals motivating acquisitions need to be pursued by multiple means to find the ones that work.

Three cautions related to the application of the advice contained in this chapter are worth mentioning. First, the suggestions offered here are not considered to be definitive. In other words, the relationships described represent possible ways to improve M&A integration and performance, and are not considered to be either inevitable or the only paths to improved M&A performance. For example, the role of middle managers in determining M&A performance, and how to effectively enlist this group to translate strategy into results, will likely vary. A second related limitation is that the suggestions focus on the acquisition of smaller, related targets or conditions viewed as conducive to good M&A performance. Conditions conducive to the success of M&A with different starting characteristics (e.g., diversifying acquisitions, mergers of equals) will likely diverge from the relationships developed here. Further, there are likely specific circumstances where an acquirer may elect to not integrate a target firm. Third, the need for a strategic rationale for M&A is mentioned consistently throughout, but examples of rationale that can lead to high performance are limited. Although the motivation to act fast and pursue complementary resources is mentioned, clarifying the actual motivations for M&A and likely performance outcomes represents an ongoing challenge.

In conclusion, the primary contribution of the chapter is a pragmatic recognition of the fact that the failure of most M&A to meet expectations raises the importance of early consideration of the prospects for effective and successful integration. Addressing integration issues during each phase of the M&A process will improve integration planning and implementation. To the extent that implementation clarity is achieved and there is a clear strategy for selecting a target, a foundation for active experimentation can provide a less elusive path to improved M&A performance by leveraging experiential learning.

NOTES

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