Growth through mergers and acquisitions: how it won't be a loser's game

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Despite managerial over-optimism, research evidence consistently shows that 50-75 percent of mergers and acquisitions (M&As) fail to live up to expectations. This article, drawing from both academic evidence and accumulated experience of companies, offers managers an understandable and practical set of tips on what to do and what to avoid. In the zero-tolerance environment that was created in the post Sarbanes-Oxley world, we expect companies to be much more careful in planning and implementing mergers. Therefore, M&As needn't be a loser's game any more.

The 1990s saw an unprecedented wave of mergers and acquisitions (M&As or simply ''mergers'' hereafter), mainly fuelled by the stock market boom. Analysts estimate the deal volume during the period 1995-2000 to exceed $12 trillion. Corporate aspirations around this increasingly popular strategy converge around themes including global presence, diversification, and economies of scale.

Despite managerial over-optimism, research by both academics and consulting firms consistently showed that 50-75 percent of M&As fail to live up to expectations (e.g. Swerdlow *et al.*, 2001; Papadakis, 2005; Sirower, 1997). Striking examples of past failures include the combination of Time Warner and AOL, Daimler Benz and Chrysler and many others.

What should be of interest to the business community is that we now see a new wave of mega-mergers (e.g. Procter and Gamble and Gillette, Bank of America and MBNA, Telefonica and O2, Sears and Kmart). These recent deals have rocketed the global value of M&As to $2 billion in the first ten months of 2005 alone, producing a new record for the new millennium.

Several questions arise. Have companies learned anything from past failures? Are we going to see the same mistakes repeated again? Does growth through M&As have to be a loser's game? How can companies entering a merger improve the likelihood of success?

We will respond to these questions drawing from both academic evidence (e.g. Kay and Shelton, 2000; Sirower, 1997; Papadakis, 2005) and accumulated experience of companies that seem to have mastered the game of M&As (e.g. Cisco Systems, GE). The article aims to offer managers an understandable and practical set of tips on what to do and what to avoid.

What usually goes wrong in M&As?

Although there is no ''one size fits all'' solution to the effective management of M&As, past research has offered us an extensive body of knowledge. Drawing on this body of evidence we can spot a large list of possible reasons for failure, including poor communication, cultural clashes, changing external environmental conditions, integration difficulties, inability to achieve synergy, poor planning, talent lost or mismanaged and others (e.g. Schuler and Jackson, 2001; Bryson, 2003; Cartwright and Cooper, 1996; Griffith, 2000).

It's worth noting that while the majority of research pays significant attention to mistakes that take place *after the merger*, we would like to draw managerial attention to the mistakes that usually take place *before the merger*. It seems that in many cases the seeds of an unsuccessful merger are sown well before the deal is signed.

Among the main mistakes that usually take place before the merger are:

- the managerial hubris problem;
- the lack of thorough due diligence;
- improper selection of the target;
- the exceedingly high premiums paid;

- the lack of a clear vision and a strategy; and
- the lack of a plan of what to do the day after the deal.

Among the main reasons why M&As fail after the deal is signed are:

- lack of leadership;
- neglect of opportunities to grow;
- poor internal communication;
- the inability to create and celebrate early wins;
- lack of involvement of middle managers;
- cultural clashes; and
- the inability to serve customers seamlessly.

Things to do before the deal

Conduct a thorough ''due diligence'' analysis and identify synergies

For most companies in the past, the term ''due diligence'' was mistakenly taken to mean a study of the P&L and balance sheet of the acquired company, some aspects of its market presence, as well as legal issues. Of these three categories, financial due diligence is the easiest to conduct. That is why many executives relied on just financial reports to make their decisions without taking into account other factors.

Even in cases where companies do their homework, they may still miss significant information. It is interesting to note that in the classic case of Hewlett-Packard's acquisition of Compaq in 2001, the acquiring company had not conducted any research prior to the deal on how consumers rated Compaq products. When they did it, several months after the merger, they were astonished to reveal that consumers considered Compaq products to be inferior. However, it was too late to do anything about the merger itself.

In many cases, inadequate due diligence has proved disastrous. In our study about half of the participants admitted that their due diligence processes failed to uncover major problems in the target companies (Papadakis, 2005). Moreover, some of them blamed the target companies of ''dressing up'' to look better for the deal.

In the zero-tolerance environment that was created in the post Sarbanes-Oxley, world the term ''due diligence'' has gained new significance. It now includes not only data analysis but also analysis of every aspect of the value chain of the acquired company. Furthermore, ''due diligence'' should also mean examining such subtle issues as cultural fit, minimizing the reputation risk, as well as communication with employees at the target company.

Summing up, it is not adequate just to conduct a financial due diligence. Executives should also ask for a thorough strategic, cultural, legal and reputation risk due diligence (see Table I for a list of questions to ask).

Is it the right target?

After finishing a thorough due diligence analysis, top managers are in a position to decide whether this is the right target. Managers should not hesitate to kill a deal if it seems to have some strategic or other flaws. In our own research, about a quarter of managers admitted that they stayed with deals they had serious doubts about.

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