MAKING ACQUISITIONS WORK: PROBLEMS OF ORGANIZATIONAL INTEGRATION

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ABSTRACT

The United States is in the midst of the greatest merger and acquisition boom of all time. Despite the intense level of activity, the track record for mergers and acquisitions is poor. Recent research from the academic community suggests that the problems of integrating separate firms into a single entity may be responsible for this poor performance. The purpose of this article is to apply a conceptual framework of post-merger integration to a recent merger and to investigate the implications for improving the merger management process.

INTRODUCTION

Merger and acquisition activity in the United States is occurring at a phenomenal pace. According to the *Mergers and Acquisitions Almanac* (1986), 3,165 acquisitions were completed in 1985. The dollar volume of the 1,518 transactions for which prices were disclosed was a record \$139.1 billion.

However, this huge volume of merger activity has intensified doubts concerning the success of mergers in achieving synergies and increasing shareholder wealth. Conflicting research results and differing opinions of practitioners highlight the lack of consensus regarding the effectiveness of acquisitions, as well as the necessary criteria for merger success. This absence of agreement has been particularly prevalent in the areas of the role of organizational fit and corporate culture in making mergers work.

The purpose of this article is to apply a conceptual framework of post-merger integration to a recent merger and to investigate the implications for improving the merger management process. This framework is based upon recent research by Jemison and Sitkin

(1986) and Sales and Mirvis (1984).

THE ACQUISITION PROCESS

The vast majority of research into merger performance has been directed at the role of acquisition strategy in determining outcomes. Recent academic research indicates that how an acquisition is structured (the acquisition process) as well as the way corporate cultures are merged (acculturation) are important determinants of merger outcomes (Finkelstein, 1986; Jemison & Sitkin, 1986; Marks & Mirvis, 1985; Shrivastava, 1985). The most comprehensive framework of the acquisition process proposed to date was offered by Jemison and Sitkin. They suggested that four impediments (activity segmentation, escalating momentum, expectational ambiguity, and management system misapplication) are important factors which can influence merger success.

1. *Activity segmentation* refers to the separation and fragmentation of the various tasks required to initiate and complete an acquisition (such as financial analysis, competitor analysis, product line evaluation, etc.). Activity

segmentation generally occurs "because of the number of tasks to be accomplished, the technical complexity of acquisition analysis, and the traditional roles that different specialists play" (p. 148). The authors hypothesized that segmentation can result in two related problems: "(a) a poor integration of analyses which tends to result in (b) a disproportionate amount of time spent on analysis of strategic fit rather than organizational fit" (pp. 148-149).

2. *Escalating momentum* refers to the tendency of the acquisition process to take on "a life of its own" (p. 151) in which participants seem unable to control the process or their involvement. This momentum can cause premature closure of the deal, preventing more extensive or careful reviews of strategic and organizational fit issues.

3. *Expectational ambiguity* refers to the lack of a shared set of beliefs about the structure and implementation of an acquisition. It can result from the often beneficial use of ambiguity during premerger negotiation. Such ambiguity facilitates closure of the deal because it avoids problems arising from the attempt to iron out every detail. This same ambiguity can ultimately prove harmful and act as an impediment to success in the integration period of a merger. Disparate interpretations of the agreement may cause a breakdown of trust, leading to escalating conflict and polarization of preexisting attitudes.

4. *Management system misapplication* occurs when one merger partner inappropriately imposes its way of doing business on the other partner. It can stem from defensiveness or arrogance by either parent or subsidiary companies "to the detriment of their cooperative relationship" (p. 159). Parent firm arrogance can result from three types of "organizational chauvinism: interpersonal arrogance, cultural arrogance, and managerial arrogance" (p. 159). Misapplication usually occurs

through heavy-handed management by the parent and dismissal of the subsidiary's competencies and capabilities.

Though each of these impediments represents a possible pitfall to merger success, one cannot assume that all four will manifest themselves to the same degree in every merger case. Thus a key concern is to develop an understanding of the situational factors contributing to each impediment.

BLENDING OF CORPORATE CULTURES

Sales and Mirvis (1984) describe the barriers to acquisition success arising from the need for corporate culture integration. They argued that in culture collisions, there are three phases of cultural evolution.

Phase I: Threat to culture. An acquisition, even if it is friendly, causes transition and change, resulting in uncertainty, concerns over loss, and a sense of crisis.

Phase II: Cross-cultural contact. "Contact across cultures can affirm or challenge the integrity of a culture" (p. 111). Cross-cultural contacts can cause changes where the cultures meet, but also within the respective cultures themselves.

Phase III: Acculturation. The merging of cultures after an acquisition can take many forms. Sales and Mirvis have adapted a model of acculturation developed by Berry (1980) into the following four acculturation patterns. In practice, however, many organizations may develop elements of more than one form of acculturation, leading to a mixed model.

1. *Integration* is based on the desire for basic unity, along with the toleration of cultural diversity" (p. 124). The presence of more than one cultural group in a society or corporation is called **pluralism**. When this

cultural diversity is not only tolerated, but also valued by the organization, the society is **multicultural**.

2. "*Assimilation* assumes the desirability of maintaining the institutions and cultural patterns of the dominant group as standard" (p. 124). A **melting pot** environment implies that the acquired company moves freely toward the acquiring firm's culture. A **pressure cooker** environment implies a coerced move toward the dominant culture.

3. *Rejection* includes two distinct forms: withdrawal and segregation. "**Withdrawal** is self-segregation or flight, a basic form of adaptation to intergroup conflict; **segregation** means that group distinctiveness and separation are enforced by the dominant society" (p. 124).

4. "*Deculturation* means giving up the native culture, not taking on the culture of the dominant group, and remaining outcasts to both" (p. 124). This behavior typically occurs with individuals, rather than groups. **Marginality** occurs when people remain outside of both the acquired and acquiring firms' cultures by choice; **ethnocide** refers to the same situation occurring by force.

A CASE EXAMPLE

Although the above frameworks of the acquisition process and acculturation are extremely helpful, no systematic study has been done to apply these ideas to a real world situation. The remainder of this article applies these concepts to a horizontal merger between two capital leasing companies which occurred in September 1981. For 1981, the combined company had \$72 million in operating revenues and \$7.2 million in net income, including \$2 million in operating revenues and \$0.5 million in net income provided by the new subsidiary. The subsidiary was

operated as a separate entity until February, 1983, when the subsidiary's president was appointed president of the parent company. At this time, the operations of the parent and subsidiary were consolidated.

Two primary sources of data were utilized. First, a series of interviews was conducted with seven top executives of the company. Second, company literature, including annual reports and securities prospectuses, provided background information on the companies, as well as additional information on the management of the merger.

The interviews were conducted with the use of a questionnaire to provide structure and assure that all topics were addressed. The executives were categorized into two groups. The first group was made up of managers who were with the firm from the start of the acquisition process. The second group consisted of managers employed by the firm after the acquisition, but during the postmerger integration period. The executives interviewed included the CEO and the heads of most major organizational functions.

FINDINGS

Although there was unanimous agreement among the participants that the merger was highly successful, managers clearly identified the integration process as a significant obstacle to success. Several top executives regretted the lack of attention given to integration and organizational fit issues during premerger negotiations and the year following the acquisition. As predicted by the Jemison and Sitkin framework, the discussions during the negotiations focused on strategic fit and the purchase price. The majority of integration issues were left completely unresolved until after the acquisition had taken place.

The lack of attention given to postmerger integration may have also been

caused by the parent management's high degree of emotional involvement with the acquisition. This involvement was a result of a high perceived need for the merger. According to several officers, the acquirer was purchasing the growth and earnings of the target firm, in addition to complementary products. The parent was also somewhat concerned that a competitive bid for the target firm might occur during the negotiations.

In the year following the acquisition, the integration of the two firms continued to be largely ignored by the parent. Each company continued to operate in different market segments, and the sharing of products never occurred. The companies' respective computer and management reporting systems were incompatible with each other. Many conflicting or incompatible management systems were simply not addressed, while others were dealt with only superficially. This condition was not resolved until after the subsidiary president became the president of the parent company in February of 1983. Managers of the company still refer to the "acquisition" and "merger" of the subsidiary as two distinct events, occurring at different times.

A second cause of problems was the widely disparate corporate cultures of the two firms. The acquirer's culture was very decentralized, emphasizing stability and familial relationships. In contrast, the acquired firm was characterized by a centralized, high energy, growth-oriented culture which was typified and propagated by its president. The parent's management knew that it could not attempt to change the subsidiary's culture without a fight from top management.

Differences in the two corporate cultures came to the forefront in November, 1982 when the subsidiary president presented a new business plan to the parent of the acquiring firm. One of the plan's elements was the transfer

of corporate headquarters from the Midwest to the West Coast. The parent approved the business plan with two strict conditions: (1) Each member of the management team must be given a six month trial period, regardless of past performance; and (2) All 115 home office personnel must be given the option to relocate, regardless of position. This type of corporate altruism was contrary to the subsidiary's culture. Although the president strongly objected to these conditions as being too costly, they were eventually adopted as part of the plan.

Relative Importance of Factors

Of the four impediments identified by Jemison and Sitkin, only escalating momentum and expectational ambiguity appeared to have important effects upon the acquisition outcome. As described below, these factors follow closely the pattern described by Jemison and Sitkin.

Escalating momentum was apparent in the premerger negotiation phase of the acquisition. The negotiations for the deal took approximately three months. Several circumstances contributed to the acquirer's desire to complete the acquisition as quickly as possible. First, management was under pressure to improve the parent's performance. The company's chairman had given management one year to turn the company around, or he would change the management. The target firm had the products, growth, and earnings to enhance the acquirer's performance to a significant degree. As a result, the parent's management wanted the target firm very much, and was quite emotionally involved in the acquisition.

In addition, a public announcement concerning the abortion of merger plans between the target firm and another company served notice that the firm was looking for a buyer. This publicity encouraged the acquirer to move quickly before other competitive bids were

made.

The fact that the parent's top management knew the target firm's president, may have hastened the acquisition to a certain extent. This familiarity could explain the paucity of analyses prior to the merger, potentially leading to the lack of resolution regarding the details of postmerger integration issues.

The absence of restraining forces may have also contributed to the rapid pace of the acquisition process. The acquirer's board of directors exercised only moderate involvement, primarily providing general oversight and evaluation of strategic fit issues. The necessary regulatory approvals were obtained easily during the three month negotiation period.

Expectational ambiguity also appeared to be important in the acquisition process. A high level of uncertainty existed despite the complete willingness of the acquired firm to share information with the acquirer.

During the negotiation period, little information regarding integration issues was discussed. As a result, few disagreements concerning integration were discovered. It is possible that the familiarity of the parties with one another partially accounted for the deferral of these issues. The implicit assumption made by the firms was that these details would be worked out incrementally after the acquisition date. However, the lack of shared understanding of how these details would be resolved later proved to be a source of conflict.

The differing corporate cultures of the two companies was a reason for both the deferral of integration issues and the conflict which occurred regarding those issues subsequent to the acquisition. The parent's management avoided integration issues because of concern for the survival of its culture in the face of the subsidiary and its

strong president.

As a result of this inactive stance by the parent's management, a high degree of turmoil pervaded the companies in the year following the acquisition. Neither firm knew what to expect from the other, causing distrust and increasing polarization of attitudes concerning the other company.

The two most influential process impediments affecting the degree of merger success were escalating momentum and expectational ambiguity. Activity segmentation and management system misapplication appeared to have a negligible effect upon the outcome of the acquisition. Although momentum and ambiguity were significant hurdles to merger success, the managers involved in the acquisition did not realize this until much later and consequently, these problems were not explicitly managed. As a result, considerable management attention was required to resolve the difficulties created by the process impediments.

ACCULTURATION AT THE COMBINED ORGANIZATION

This acquisition led to different forms of acculturation over time. The forms of acculturation changed dramatically after the top management change in March of 1983. Several elements of cultural integration were apparent during the first year following the acquisition. Both the parent and subsidiary maintained their native cultures to a high degree, and the differences in culture were largely tolerated. The subsidiary had come to accept its status, but was proud of its distinctiveness. However, the companies' tolerance for each others' culture did not develop into the encouragement of diversity which occurs in multicultural organizations. Therefore, pluralism never advanced to become multiculturalism.

At the same time, both the parent

and subsidiary displayed elements of cultural rejection. In the year following the acquisition, cross-company contact was minimal. To a significant extent, the companies chose to ignore one another. The subsidiary president reported directly to the chairman of the parent company, rather than to the president, as would be the usual case. Little consolidation of functional areas was attempted, with the exception of finance departments. This separation was voluntary on the part of both firms, which is characteristic of the withdrawal form of acculturation.

When the subsidiary president became the president of the parent company in March of 1983, the forms of acculturation changed significantly. He immediately began the assimilation of the parent company into the subsidiary's culture. The swift consolidation of the two companies produced extensive conflict. The subsidiary's culture was championed by the president, yet several of the subsidiary's departments were subsumed by parent company functions. A "We versus They" mentality soon developed. The ensuing culture shock resulted in high turnover of parent company employees, especially in marketing. This involuntary assimilation is characterized by Sales and Mirvis as the pressure cooker form of acculturation.

The forms of acculturation which developed during the first year after the acquisition appear to have been affected to some extent by the acquisition process. The significant degree of escalating momentum and expectational ambiguity apparently contributed to the severe lack of attention given to integration issues. The resulting uncertainty appeared to lead to the polarization of attitudes, which hindered the development of pluralism and encouraged the extent of withdrawal within both companies.

In summary, the acquisition process had a considerable effect upon the

initial forms of acculturation adopted within the firms. The factors identified by Jemison and Sitkin and Sales and Mirvis seemed applicable to understanding the outcome of this particular merger. This carries some important implications for managing the merger process.

IMPLICATIONS FOR MERGER MANAGEMENT

Five major implications of this study are important for managers involved in mergers. First, management attention should be focused on the *sources of acquisition problems* rather than the symptoms of these problems. This requires a proactive view of the acquisition process, rather than a defensive, reactive approach. Such a mentality would enable managers to think in terms of addressing the sources of acquisition process impediments rather than dealing with the resulting problems *ex post facto*. The first step is for management to be made aware of the potential problems arising from mismanagement of the acquisition process. If involved executives are not aware of process factors, they can do nothing to minimize these pitfalls and their subsequent effects.

Second, postmerger integration issues should be *addressed fully during pre-merger negotiations*. In addition, these specifics should be fully communicated, to whatever extent possible, to both organizations. Although the use of ambiguity may be helpful in reaching agreement in acquisition negotiations, integration issues should be clarified due to their importance in long-term merger success. Furthermore, vagueness regarding integration concerns may have severe dysfunctional results. Possible consequences of this ambiguity include a cycle of escalating conflict leading to attitude polarization and distrust (Jemison & Sitkin), and manifestations of the merger syndrome (Marks & Mirvis, 1985). Therefore, every effort should be made to ascer-

tain the specifics of relevant postmerger integration issues, and communicate these specifics as openly as possible.

Third, line management should be *actively involved in the acquisition process*. As with all other strategic decisions, line managers have the responsibility of successfully implementing specific elements of the acquisition plan. In premerger negotiations, the inclusion of line managers can provide a diversity of perspectives which may increase the attention given to organizational fit and counteract the escalating momentum to complete the deal (Jemison & Sitkin). Before the merger, broader input can also lessen anxiety and provide a "reality test" for top management's scenarios (Mirvis & Marks, 1986). During the postmerger integration process, consultation of line managers can prevent the imposition of inappropriate management systems onto the subsidiary.

One method of involving line managers in the acquisition process is to create a merger task force with several transition committees to deal with specific areas of integration (Mirvis & Marks, 1985). However, to be effective, this type of transition structure presumes the cooperation of both organizations.

Fourth, in making an acquisition, *corporate culture issues should be taken into account*. A company must be aware that it is not simply purchasing products or earnings. Management should recognize that the firm being acquired has a distinctive corporate culture which may be extremely difficult to change. Indeed, the presence of completely disparate cultures held by potential merger partners should signal the need to management to develop a strategy for dealing with the differences, or abort the acquisition altogether.

Fifth, managers involved in acquisitions should be *aware of the effects of process factors upon acculturation*

forms. Much of an acquisition's success may depend on the careful management of the acculturation process. In a given case, some forms of acculturation may be better suited than others to creating merger success. Due to the relationship between the acquisition and acculturation processes, the management of acculturation must begin early in the merger process. Otherwise, the acculturation forms which develop within the firm may diminish the potential for long-range merger success.

SUMMARY

The current pace of acquisition activity is likely to lessen. However, many firms will be left with the ongoing management challenge of making their acquisitions work. A solid acquisition strategy is not enough to ensure success. Attention to the integration of new subsidiaries into the parent organization is crucial. Recent academic research has proposed critical areas of concern for managing an acquisition program. This article has illustrated the implications for improving the quality of acquisition management.

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