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SPECIAL FOCUS

# THE LEADERSHIP TESTING GROUND

**Mergers may be the truest test of great leaders.**

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NOBODY CAN EVER SAY THE MERGER world is boring. In recent weeks, government regulators frowned upon the marriage plans of British Airways and American Airlines. Last year saw the same thing happen when European commissioners ruled that General Electric could not acquire Honeywell. And just look at the amount of news ink spent describing the latest twists and turns in the Hewlett-Packard-Compaq merger saga.

But there's a more interesting story that is rarely told. While most people focus on the transaction itself—its sheer size, perhaps—the real drama is in the very human slog to create lasting value for

shareholders on both sides of the deal. The slog begins long before the deal is signed, and continues long after. There are many hearts and minds to win all along the way. And when the merger goes through, there are more customers to be dealt with, and many more employees, often with quite different cultural biases.

Talk about a leadership challenge.

Many fail that challenge, because the truly successful mergers are few and far between. Several well-structured studies calculate that 50% to 75% of acquisitions actually destroy shareholder value instead of achieving cost and/or revenue benefits. Those studies typically blame a deal's failure on poor strategic rationale, outright overpayment based on overestimated value, inadequate integration planning, voids in executive leadership and strategic communications, or an acute mismatch of company cultures.

So what distinguishes the great deals from the disasters? Bain & Company finds there are five distinct leadership characteristics at work (and we do mean *work*). In the course of more than 100 merger-integration assignments over the past decade, in industries ranging from wireless phone services to oil and gas, we have observed that the "merger masters" act as visionaries, spotting great deals, knowing why those deals are worth doing and articulating their promise to investors, customers, and employees. They are irrepressible cheerleaders for investors and other stakeholders, as well as for the teams that will face the hard task of integrating the two companies. They are maniacally focused on closing the deal. And as soon as the ink is dry, they start driving the actual integration. Lastly, they crusade constantly, reenergizing integration efforts when they flag, and maintaining morale and enthusiasm among all of the combined company's stakeholders.

Every leader, of course, is different. As is every deal. There is no "paint-by-numbers" approach. But leaders of successful deals tend to excel at one of the toughest challenges—playing multiple leadership roles and switching quickly from one role to another throughout the merger process. The roles employed—and hence the leadership time invested—vary dramatically with the type of deal.

## Differing Deal Foundations

We'll explore each role in more detail in a moment. First, though, it's important to look at how deal making is changing. In recent decades, mergers and acquisitions rarely changed the rules of competition even though the underlying intent has ranged far and wide. The 1960s and 1970s were the age of the conglomerates as businesses (and investors) saw value in diversification. Through the 1980s, leveraged buyouts were the order of the day, with high-risk, high-yield debt providing the fuel. "Asset-stripping" entered the nation's vocabulary as LBO transactions, such as Kohlberg Kravis Roberts' takeover of RJR Nabisco, worked to squeeze value out of poorly managed companies.

But the late 1990s saw both an increase in mergers and acquisitions and a fundamental shift in their motivation. None of the largest acquisitions was merely about swapping assets. Each had a stated strategic rationale. Some were conceived to improve competitive positioning; that was a key motivator for Pfizer's takeover of pharmaceuticals competitor Warner-Lambert, where Lipitor, the latter's powerful cholesterol drug, was the prize. Others let acquirers push into highly related businesses.

Cable powerhouse Viacom's acquisition of broadcast mainstay CBS has allowed Viacom to deploy CBS's assets to promote its cable offerings, and vice versa. Still other deals were geared to redefine a business model—for instance, new-media force AOL's deal with old-media empire Time Warner. The current crop of mergers harks back to the transactions of the early 1900s that boldly created the likes of DuPont and General Motors.

## Five Core Characteristics of Leadership

Each type of merger (see the sidebar on page 5 for a description of the most common types of transactions) calls for a customized approach. Yet the core characteristics of top-notch merger leaders remain the same. Here's what Bain has observed:

First, a leader must *establish and communicate the strategic vision* for the merger. He or she must answer successfully central questions—"why we are doing this" and "what we plan to achieve"—for both external audiences, such as industry analysts and government regulators, and internally, for all employees. It's critical that the answers are thorough, detailed, responsive, and timely.

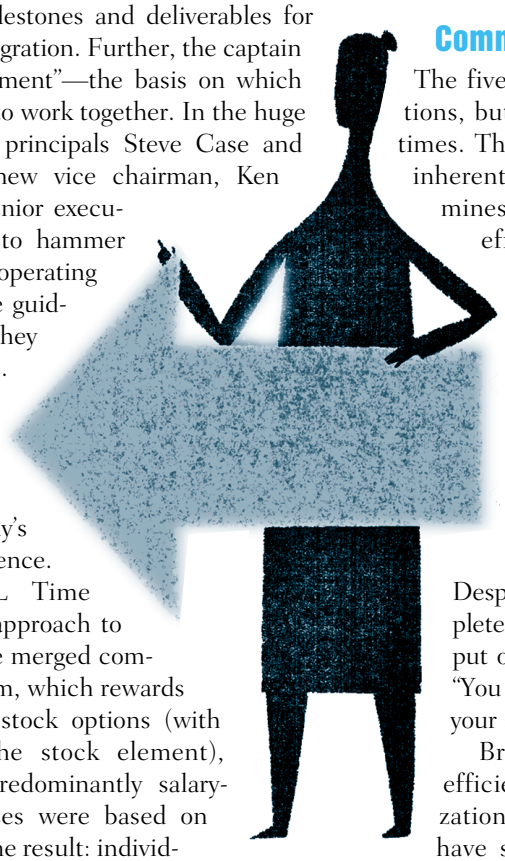
Typically, leaders need to explain the top four or five sources of value in the deal. Often, they must dispel potential antitrust concerns, both through the media and through legal channels. Additionally, the leader determines what the core values and culture of the new organization should be and communicates those values throughout the new organization. What are the golden rules that employees should live by? To bring the vision to life, the leader needs to explain and demonstrate these values from the outset.

The leader's second job is to *cheer on the troops*—initially his or her own and eventually those of both companies. The goal here is simple: it's to generate enthusiasm for the merger or acquisition, and to confront fear and uncertainty in its various forms. The challenges include combating investors' fears of stock-price falloff, regulators' concerns about unfair competition, executives' fears of losing status to counterparts from the merging company (often a former rival), employees' concerns over job losses, and customers' and suppliers' worries about potential disruptions in service.

Third, leaders must *close the deal*. That seems obvious, but it is not a given. One in five deals falls through after it is announced, sometimes because of regulatory issues,

other times because leaders fail to resolve outstanding disagreements. When Glaxo Wellcome and SmithKline Beecham first announced their intention to merge in 1998, the markets welcomed the news, sending the combined companies' value up 18% within two days. But prices fell a few weeks later when the companies announced that the merger was off—Glaxo's Sir Richard Sykes and SmithKline's Jan Leschly could not agree on who should get the top jobs. Glaxo and SmithKline resolved their differences only after Leschly retired. Jean-Pierre Garnier, formerly of SmithKline, became chief executive of the combined company when the merger closed in December 2000.

A leader's fourth task is to *captain change* by managing the integration of the two entities. He or she owns the action plan that outlines milestones and deliverables for the teams responsible for integration. Further, the captain defines the "rules of engagement"—the basis on which the two companies will start to work together. In the huge AOL/Time Warner merger, principals Steve Case and Gerald Levin asked their new vice chairman, Ken Novack, to bring together senior executives from both companies to hammer out a mission statement and operating principles that would provide guidance for all employees as they worked to implement change. Such guidelines for working together help free people from anxiety over power struggles, or arguments about which company's approach should take precedence.



In another step, AOL Time Warner created a common approach to employee compensation. The merged company adopted the AOL system, which rewards people through salary plus stock options (with significant emphasis on the stock element), replacing Time Warner's predominantly salary-based system, where bonuses were based on business-unit profitability. The result: individuals had an incentive to work together for the good of the *whole* company.

Of course, the integration task cannot be delegated to multiple people, so a leader has to stay engaged in the process. Case and Levin handled that problem by appointing experienced right-hand men, Bob Pittman and Dick Parsons, to captain implementation. Pittman and Parsons signed up to cut costs and improve efficiency across the organization and to make sure the divisions communicated with one another. In turn, the chief executives of each division pledged to meet their respective cost and revenue targets. Delegating in that way freed Case and Levin to continue running the two companies, and to focus on more strategic opportunities that fulfilled their vision.

Finally, the most challenging call is to *crusade for the new entity*. Crusading roots itself in the second task—building enthusiasm in both companies—and develops momentum as the deal closes and integration progresses. Generating momentum means dispelling inertia and encouraging people into actions consistent with the overall strategic vision. The crusader needs to give guidance on how to behave and to set both hard and soft targets for performance. And, when crusading for changes in behavior, he or she needs to lead by example. A hallmark of great leadership: sitting down to listen to the concerns and comments of employees, suppliers, customers, and other stakeholders.

## Communicating a Vision

The five leadership "hats" are essential to all transactions, but leaders need to put on each hat at different times. The strategic rationale behind the deal, and the inherent risks and opportunities that it presents, determines which hat is worn, and when. For example, in efficiency-driven deals, the communications challenge tends to center on managing employee, supplier, and distributor fears surrounding initiatives to lower cost and raise productivity.

British American Tobacco (BAT) is a powerful example of the forceful efficiency-driven deal. BAT acquired Rothmans International in January 1999. Merging the two involved weathering three major antitrust enquiries and combining operations in more than 70 countries. Despite that complexity, integration was largely completed within a year. "The worst thing you can do is put off decisions," says chairman Martin Broughton. "You need absolute clarity … and you must stick to your strategy or you'll lose the troops."

Broughton aimed to lower a key source of risk in efficiency-driven mergers—fears within the organization that threaten productivity. Some companies have seen productivity drop more than 50% from the merger's announcement to the day when each employee knows whether he or she still has a role in the merged company. Those distractions leave the organization vulnerable to competitive attack, and the fears spur employee defections. Broughton's openness with stakeholders not only set the transaction's strategic vision, but it made him an effective captain of change, and a believable cheerleader.

The theme is similar at BP. Between mid-1998 and the spring of 2000, Sir John Browne, chief executive of BP, closed a series of multibillion-dollar transactions that brought together BP, Amoco, Arco, and Burmah Castrol

into a single company with a market capitalization of around $200 billion.

Browne explained the logic and vision behind the mergers and acquisitions. "In different ways, each of the steps we took helped us to fill a strategic gap that we had identified in the mid-1990s. These steps took us into natural gas and into the Far East, where we were traditionally weak, and into some of the best retail markets in the world. Our goal is to be a global player—we want giant fields that we can develop at low cost," says Browne.

When a company announces a merger to grow scale, investors look for a clear message on where savings will come from and when, as well as what savings initiatives will cost. To gain the confidence of external audiences, a leader needs a strong track record, clarity, certainty of purpose, and a credible plan. Browne's actions proved his mettle as captain of the integration—and crusader for a common culture in the new organization.

"Of course the benefit from transactions comes partly through cutting costs—and we've done that by taking 20% out of the combined cost base. But it is also about the economies of scale in terms of intellectual capacity, technology, and learning. To do that you have to create a single organization—with common processes and standards, common values and a way of working that encourage people to look forward rather than to dwell in the past."

Browne moved swiftly to achieve this goal. Within 100 days of closing the Amoco deal, he had filled all the top management jobs and completed most of the cuts—including some 10,000 layoffs. During that period, BP-Amoco's stock price rose by nearly 11%. Browne startled some Amoco executives by imposing BP's structure and management style on the new company, an approach that ultimately resulted in the resignation of some senior figures at Amoco.

The result? BP achieved the projected $2 billion in cost savings within the first year, a full 12 months ahead of schedule.

In a merger primarily meant to enhance revenue, the approach relies heavily on communication. The leader needs to spend much more time in face-to-face contact with people than he would in a simple scale transaction. He or she needs to listen to employees' concerns and to explain the individual roles required to make the new company successful.

In short, the leader needs to cheer on each move and crusade for more. Such contact serves to reinforce changes in culture and values. Maintaining a high profile in the early days is critical, as is remaining involved in integration. In the early days after the deal has been signed, the leader needs to set up task forces that will drive the necessary changes. It should be his role to run those that are most difficult or critical to corporate strategy.

As integration progresses, the leader must also ensure that both entities continue with day-to-day business. It helps to make a clear distinction between those leading the integration task forces and those managing operations. And leaders of deals that presume a company will grow market share by transforming or broadening its offering need to keep a close eye on customer retention throughout the merger process.

## Captaining Change

It's not easy to establish a precise integration plan when the rationale behind a merger or acquisition involves radical change in the way a company does business. Rolf Börjesson, chief executive of U.K. packaging company Rexam, needed to have his mind in two places at once as he worked recently to bolster his company's core packaging operations. On one hand, he launched a series of acquisitions to build scale and grow revenue internationally, at the same time selling off businesses that no longer fit the model. On the other hand, he pursued a long-term vision that will transform his company and perhaps change the nature of competition in the packaging industry. Börjesson's leadership mantra for the task: "Communication, communication, communication."

In 1999, Rexam first acquired PLM, a Swedish beverage packaging company, and the following year, it bought U.S.-based packager American National Can. Each buy brought economic benefits. PLM opened up opportunities for cost reduction through shared European manufacturing facilities, while American National Can brought further cost savings in Europe and opened up the U.S. market for Rexam.

Meanwhile, the additions contributed to Börjesson's longer-term vision. He plans to create a packaging conglomerate of sufficient scale to attract investors' attention (at the time, no company in the sector was listed in the S&P 500). Börjesson and his team are building a position from which Rexam can trade business units with other parent companies in pursuit of the most efficient global configuration of packaging businesses, both in costs and revenue. That bold strategy aims to transform Rexam into an international leader in the packaging industry.

Börjesson's tactics are smart. Rather than trumpeting his long-term strategy to the market, he focuses on making a success of each individual acquisition. He believes in winning shareholders' support through results,

# SIX REASONS WHY

All merger transactions, large and small, unions of equals and outright takeovers, can be clustered into these six strategic categories:

***1. Active investing.*** Leveraged buyout companies and private equity firms acquire a company and run it more efficiently and profitably as a stand-alone firm. Typically, these transactions improve performance through financial engineering, incentive compensation, management changes, and stripping out costs.

The purchase and restructuring of GartnerGroup by private equity player Bain Capital (a company independent of Bain & Co.) illustrates the power of active investing or "squeezing the lemon." By narrowing its scope from an array of media and consulting services to a tight focus on valuable technology data, Gartner became a premier broker of computer information, its margins expanding to 30% from 10%. However, active investing is truly the domain of leveraged buyout and private equity firms. Corporations need a more strategic rationale.

***2. Growing scale.*** Mergers most often aim to grow scale, which doesn't mean simply getting larger. Rather, success requires gaining scale in specific elements of a business and using those elements to become more competitive. For instance, if the cost of materials drives profit, then the scale of purchasing activities will be key. If customer acquisition is more important, then channel scale will be critical. Getting scale-based initiatives right requires the correct business definition and the correct market definition. That is rarely easy because, over time, the definition of scale in an industry can change dramatically, especially during recessionary times when demand shrinks.

In acquisitions seeking to gain scale, pre-merger planning can be done "by the numbers." One can, in advance, calculate goals for combined market share and cost reduction, plan steps to achieve them, and create measures of performance. That type of merger places great demands on a chief executive's ability to cope with complexity. The task may not be easy, but at least the leader can craft a plan before the transaction and execute it after the merger.

***3. Building adjacencies.*** The next most common impetus for mergers and acquisitions is to expand into highly related or adjacent businesses, as Viacom did by buying broadcaster CBS. That can mean expanding business to new locations, or into new products, higher growth markets, or new customers. But most important, the additions should be closely related to a company's existing business. Chris Zook, in *Profit from the Core*, provides empirical evidence that expanding into closely related businesses through acquisitions drove some of the most dramatic stories of sustained, profitable growth in the 1990s: GE, Charles Schwab, and Reuters, to name a few.

***4. Broadening scope.*** In mergers geared to broaden the scope of products or technologies, a "serial acquirer" systematically buys expertise to accelerate or substitute for a traditional new-business development or technology R&D function. That acquisition model—successive deals to broaden scope—has been used successfully in industries such as financial services (for example, by GE, whose new chief executive, Jeff Immelt, recently reaffirmed his desire to make acquisitions in Europe), and in Internet hardware, where equipment maker Cisco Systems made 18 purchases in 1999, and 22 in 2000. At those firms, growth strategies include major ongoing investment to scan for new product concepts or technologies. For most, organic development would be too expensive, too slow, and/or would diffuse the focus on their existing businesses.

***5. Redefining the business.*** Deployed strategically, mergers and acquisitions can redefine a business. That's an appropriate strategic rationale when an organization's capabilities and resources grow stale very suddenly due to, for example, a major technological change. In such cases, a firm cannot quickly refresh its technology or knowledge by making internal investments and incremental adjustments.

When telecom equipment provider Nortel Networks embarked on a strategic shift toward Internet-based infrastructure, it relied on a series of acquisitions to make it happen. Nortel made a string of purchases from the late 1990s onward, migrating from supplying switches for traditional voice networks to supplying technology for the Internet. John Roth, then Nortel's chief executive, called it the company's "right-angle turn." Despite being hit hard in 2001 by the downturn in the telecom sector, Nortel has become a contender in Internet equipment sectors.

***6. Redefining an industry.*** Sometimes a bold, strategic acquisition can redefine an entire industry, changing the boundaries of competition and forcing rivals to reevaluate their business models. (The AOL Time Warner mega-merger was set up to do that.) But in those bold mergers, the numbers may not be as precise. The companies involved will have a post-merger model for operations. However, the model will change as industry rules change and as competitors react. In such a profoundly uncertain environment, vision is critical and must come from the top of the organization. A strong leader must cope with flux by confidently and effectively communicating the strategy and vision. The post-merger integration plan will have to be much less detailed and much more flexible than that of a scale transaction, leaving room for leadership to adapt its message to a rapidly evolving competitive environment.

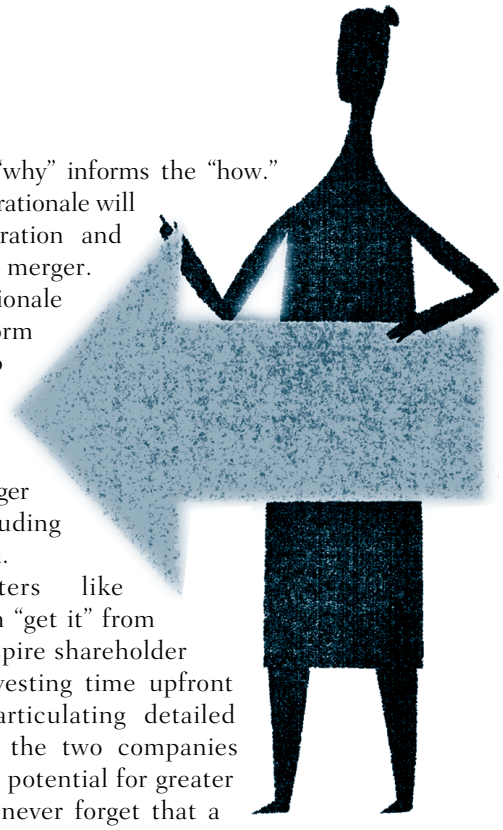
stating: "Give them some detail before the deal, and lots after." He has picked acquisitions where he believes he can show results quickly. His question when a potential purchase comes up: "Can we have all the savings on the bottom line in three years?"

To help achieve rapid results, Börjesson invests heavily in building goodwill and enthusiasm for change by cheering and crusading. He communicates directly with employees, customers, and suppliers, and identifies quick wins to stoke momentum. Following Rexam's purchase of American National Can, Börjesson chartered a plane so he could visit every site personally and host question-and-answer sessions. During the integration process, Börjesson guided his team toward the easiest cost-reduction opportunities first. He recalls, "We used these early results to show the benefits of the merger—that really worked for us."

Börjesson is part way through his quest to change the industry he competes in. His long-term vision guides his choice of acquisition and priorities for his integration teams. Day to day, the short-term goals—reducing costs and growing revenues in a new market—determine the way he spends his time.

## When Strategy Alone Is Not Enough

A clear strategic rationale for an acquisition is critical, but it's not enough to guarantee a successful deal and merger integration. The rationale helps to identify the right target and set boundaries for negotiations, but the hard work remains of bringing two companies together effectively. Nonetheless, the "why" informs the "how." The right strategic rationale will inform the preparation and valuation of the merger. The strategic rationale should also inform what leadership and communication style to adopt and how to plan for post-merger integration, including cultural integration.



Merger masters like Rexam's Börjesson "get it" from the start. They inspire shareholder confidence by investing time upfront developing and articulating detailed examples of how the two companies can combine their potential for greater reward. But they never forget that a transaction's strategic rationale is only the first step on a long journey to capture the full value of their vision. ◆

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