Merger Failures, Value Destruction and Cultural Conflicts - And How to Avoid Them!

By Stephen Warrilow, Associate Director – Change Management, Antony Consulting Pte Ltd, August 2012

To fully understand merger failures we need to understand the motivation behind M&A activity - which is primarily about the creation of value by exploiting [what is euphemistically referred to as] synergies.

Technically speaking, "synergy" is defined as the increase in the merging firms' competitive strengths and resulting cash flows beyond which the two companies are expected to accomplish independently. The word "synergy" entered merger vocabulary during the 1960s merger wave, and was used to describe gains from conglomerate mergers that could not be readily identified, but were presumed to be present to explain why the mergers occurred.

If it were not for the catastrophic failure rate of most mergers and the destruction of shareholder value and, most importantly, the human cost, then this could be amusing. But to my mind it isn't, it is an appalling indictment of the business world and their advisors that [just as in the world of change management] 70% of all M&A activity fail to realise the intended benefits.

There have been endless studies over the past 30 years to explore the reason for merger successes and merger failures. The overwhelming evidence is that over 70% of the time, mergers do not create synergies and shareholders of both companies involved do not see gains in shareholder value.

According to a survey published by KPMG in 2008, the proportion of M&A deals that have reduced value has increased by 50 percent in the two years since their previous survey. Culture remains one of the top post deal challenges with companies continuing to link post deal HR challenges with cultural complexity.

Greatest risks to merger success are all people related.

A survey conducted by A.T. Kearney in 2004 to identify the most critical phase to merger success or merger failures, revealed that whilst the majority of 53% stressed that the actual implementation phase - often referred to as the "post-merger integration" phase - bears the greatest risk - this post-acquisition phase is the most ignored.

In a study of 40 British companies, Cartright and Cooper [1995] reported that all 40 conducted a detailed financial and legal audit of the company they intended to acquire, but that not even one of these same companies made any attempt to carry out an audit of the company's human resources and culture to assess the challenges concerning integration of the organization they were acquiring.

A brief review of many business and academic studies into the factors impacting merger failures reveals the greatest risk of merger failure existed in the area of people issues, and proposes the value of a "soft" due diligence audit focusing on human resources to identify cultural difference and issues to be faced and impacts on those people who are critical to the success of the merger.

Dominic Fong of Curtin Business School said: "One critical factor that befalls a merger is cultural conflicts....". T.J Tetenhaum describes culture "as the heart of a merger integration". Another writer Richard S. Bibler suggests that cultural incompatibility is the single largest cause of merger failures. According to Bibler the difficulty of blending two organisations lies in the fact that each group tends to see the world through its own biased cultural filters, which he refers to as "familiarity blindness" or "cultural trance", and this cannot be overemphasised as a cause of merger failures.

A very personal perspective...

What really bothers me is the way the system currently works for remunerating all of the professional advisors who provide services to the corporate world. I would welcome the day when professional advisors and senior executives have a significant part of their large remuneration linked to the medium term [i.e.3-5 years] shareholder value they created - cos I somehow feel that might go a long way to redefining the whole concept of "synergy" and reducing the percentage of merger failures.

Excuse the lateral thinking for a moment - but can you imagine civil engineers or construction companies or the people who build nuclear power stations - working on the same basis - where a 70% failure rate was accepted? Can you? So why on earth should the world of business be any different?

Why does this bother me? Quite simply, because of the very considerable, unnecessary, and totally avoidable human cost.

So how to avoid these risks of merger failures...

The best way to avoid these merger failure reasons is to conduct a "soft" due diligence audit, focusing on the human resources aspects of the merger to identify (1) cultural difference and issues to be faced, and (2) the impacts on those people who are going to be most affected, and those people who are critical to the success of the merger.

And as my contribution to all this, I have developed a diagnostic process that allows a company to test the impact of a proposed business initiative or venture on those people most affected by it, to identify why it may fail and to establish precisely what has got to be done to make it a success.

This tool can be applied to a proposed merger as part of the HR due diligence process, to identify and assess the cultural issues that will be encountered. The tool is sufficiently flexible and scalable to be adapted, modified or enhanced to meet a specific requirement.

It is low tech and simple to understand and apply, it involves staff at any or all levels and enables them to articulate difficult issues in a non-confrontational way, and it can be undertaken quickly and before large sums of money are irrevocably committed to the proposed merger.

The output of this process forms the input for the creation of a programme management based approach to managing the change management and HR related aspects of post merger integration aspects.