International Journal of Advanced Research and Development
ISSN: 2455-4030
Impact Factor: RJIF 5.24
www.advancedjournal.com
Volume 3; Issue 1; January 2018; Page No. 585-588

Challenges and critical issues faced in mergers and acquisition deals

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Introduction

There are several drivers which motivate the companies to enter into mergers. The classic reason for acquiring other businesses is being able to rapidly add scale and so achieve greater economies and market reach, gain access to new markets and distribution networks, capture new product technologies and innovations, wipe out competition and emerging competitive threats, provide long term ownership and control over value created. Technology and the need to achieve market dominance are two most important factors that drive most of the M&A deals. Once a company strikes a merger deal, it is very difficult to make it a success. Thus most companies prefer to enter into alliance or joint ventures before they progress towards merger activity. Making mergers work require outstanding leadership skills as well as good management skills to create an effective transition to new organization.

Reasons for Failure

1. Lack of Clear M&A Strategy

Lack of clear strategy and structured approach to M& As is one of the most common problem leading to the failure of mergers. Ideally, the management teams would typically approach M&A in the following manner:

(a) Assess our position
(b) Strategy
(c) Acquire, Merge or Build
(d) Acquisition/ Merger
(e) Realize the value

But in reality many management teams acquire or merge businesses without really having thought through the dynamics of their markets or the different market demands on acquisition. They are often tempted by the strength of equity market and the availability of capital. Usually, in excitement and without giving much thought to the aftermaths of the deals, important implementation issues may be missed. To avoid the dangers and the stages where implementation of operational changes and rationalization becomes very difficult, the SKF Swedish International Engineering company developed a clear acquisition process;

- Identify the target company.
- Scan the target company
- Develop project plan
- Evaluate target company
- Develop business plan
- Due diligence review
- Follow up

They considered acquisition as only the start of the process of realizing value. They prefer to leave nothing to chance and have a systematic approach to managing each phase of an acquisition. Strategy generally reflects the overall philosophy of the Acquirer. The real challenge is for the management to realize the scope for greater improvement and business growth. The management has to efficiently balance out between job losses on one hand and new business development on the other in order realize the scope of development of the business and success of merger. Therefore, a Clear strategy coupled with the correct acquisition is the way to lead to a successful merger and avoiding of expensive and disastrous mistakes.

2. Misunderstanding the nature of asset

Another major cause of failure of merger deals is faulty logic in valuing the asset to be acquired and then being unable to realise the value of asset. This is evident in the deal structures, based on inadequate information. In assessing the value of any asset the purchasers need to weigh whether the expected gains through the costs cuts and potential synergies (i.e the combined effect of the companies and not the sum of their individual effect), outweigh the costs of integrating the assets. There is the challenge of establishing the current and future value of the target company to the acquiring company's current strategic plans. In today's economy, there is a shift in focus from the tangibles in the balance sheet to the so called 'intangibles' which represent the real potential of future earnings. These intangibles include the quality of leadership, the speed of decision making the flow of ideas and the quality of talent. Another important intangible is the degree to which employees share a mindset which supports the firms strategic purpose. In a sense, the strength of the brand reflects the extent to which customers believe in and buy the brand and the extent to which the employees identify with and act in sync with the brand image. The due diligence process needs to be geared to identifying the state of these key assets, especially if they fit into the intangible category. So, if retaining the key people is critical to success of combined business, due diligence should look at the nature and location of talent and the issues such as the interests and intentions of the staff. Thus the major challenge in realizing the potential worth of an acquisition is managing the integration in a way that enhances the value rather than destroying it. The real challenge in mergers is being able to handle each and every aspect of the process so as to maximize the chances of strategic process. The problem for failure of mergers is that

once the merger process begins the high activity levels and sheer volume of decisions which have to be made cause the people to lose the sight of strategic purpose. In other words, every aspect of the way a merger is managed will contribute to making it success or failure.

3. Competitor and customer reactions

Many companies have learned to their cost that the customers are not much keen on mergers as the shareholders, if mergers mean disrupting or downgrading the quality of products or customer services, or leads to price rise. But the customers may give the company the benefit of doubt if they receive clear information as why the merger is happening and how will they be benefitted from it. However, this benefit of doubt does not last for long and the potential risk of competitors moving in is high. the danger at this time is that the organization becomes so internally focused that it stops paying attention to its customers. Similarly, the competitors view this as an opportunity to absorb the staff who have become destabilized by the merger, which may result in the transfer of vital information to the competitors.

4. Inability to Maximize the potential synergies

Successful mergers are those that produce maximum synergy between the acquired business and the parent company. a major cause of merger failure is unrealistic synergies, based on inadequate information and checking in the due diligence process. Often the strategies are incomplete, focusing majorly on the needs of the purchaser, without integrating the different market demands on acquisition. most of the times the managers in the acquired organization are left powerless and unconsulted if the acquiring company is inexperienced at handling acquisitions, or is incompetent. In this scenario valuable knowledge is lost which makes a huge difference in the way acquisition is managed.

5. The Wrong Type and Level of Integration

When you merge cultures well, value is created. When you don't, value is destroyed. While some will suggest other factors – silly things like objectives and strategies and implementation – they are all derivative. The game is won or lost on the field of cultural integration. Get that wrong and nothing else matters. The fundamental premise of any merger is that the merging entities will be more valuable together than they are separately. It doesn't matter if you define value as shareholder equity, impact on the world or basic happiness. A merger is supposed to be an exercise in value creation. Yet, 83% of mergers fail. The vast majority of leaders get something very wrong along the way. [1] A key reason for the failure of mergers is the mismatch between the type and the level of integration required for specific purpose of merger or acquisition. There are three Levels of integration:

- Procedural integration
- Physical integration
- Managerial and sociocultural integration

Procedural is the easiest level of integration, including the integration of accounting systems and creating a single legal entity.

Physical integration involves integrating physical assets such as technologies and product lines as well as locations. In order to achieve synergies, resources have to be shared. Therefore, concerted efforts and long term strategies are required for exploiting synergies throughout the organization.

Managerial and Sociocultural integration is the hardest form integration to achieve. This includes selecting and transferring managers, changes in organization structure, the development of a compatible organization culture and a frame of reference to guide strategic decision making. This involves the systems and processes of people management as well bringing together different pay scales. It also involves gaining commitment and motivation from personnel and the establishment of new leadership. Its purpose is to merge cultures and managerial viewpoints. Integration involves people's differing beliefs and ways of working.

In most mergers integration of all three types takes place leading to job losses, changing of brand identity, new procedures, relocations etc. However, it is not necessary that sociocultural integration may take place but cultural differences need to be addressed.

Management of organizational cultures is very critical. An integration strategy has as its goal to create synergies or to establish a new third company. Therefore, integration has to be carefully handled.

Successful integration strategies focus on three or four key themes which reflect a shared image of how the organization would look after the change. The end game of a successful integration is that an organization is capable of achieving more ambitious business targets in the changing marketplace.

6. Mismanaging Organizational and Human Issues:

Typically, a strategy which is inconsistent with the culture of the new company is doomed to failure. So, if one fails to take into consideration difference in the organizational culture which can help or hinder the achievement of the strategy. Some management teas recognize the importance of getting people aspects of mergers right but then fail to think through as to how to achieve this. some signs of muddled thinking include failing to provide the people with adequate or relevant information, mishandling the appointment and redundancy processes, lack of visible leadership and frenzied workloads without a strategic overview or coordination. For employees, merger represent the biggest change that they experience in their workplace. Typically, managers and employees lack the support they need to survive and thrive during the mergers. Human resource professionals and line managers have a key role to play, as the HR professionals are responsible for designing appointments and exit processes, rationalizing terms and conditions and the other aspects of the employment contracts. Whereas the line managers are responsible for providing the support to others as well as keeping the business going while the members of their team are involved in the transition projects. [2]

Mismanagement of organizational and human issues include the following:

- **Poor governance** Lack of clarity as to who decides what, and no clear issue resolution process leads to poor governance. Integrating organizations brings up a myriad of issues that need fast resolution or else the project comes to a stand-still. Therefore, speed matters, but with a sound decision-making process.

- **Poor communication** Messages too frequently lack relevance to their audience and often hover at the strategic level when what employees want to know is why the organisation is merging, why a merger is the best course action it could take, in what way the company will be better after the merger, how it will "feel", how the merger will affect their work and what support they will receive if they are adversely impacted.
- **Poor programme management** Insufficiently detailed implementation plans and failure to identify key interdependencies between many workstreams brings the project to a halt, or requires costly rework, extends the integration timeline and causes frustration.
- **Lack of courage** Delaying some of the tough decisions that are required to integrate two organisations can only result in a disappointing outcome. Making those decisions will not please everyone, but it has the advantage of clarity and honesty, and allows those who do not find the journey and destination appealing to step off before the train gathers too much speed.
- **Weak leadership** Integration of two organisations requires a strong captaincy and leadership, someone whom everyone can trust to bring the ship to its destination, someone who projects energy, enthusiasm, clarity, and who communicates that energy to everyone. If senior managers do not walk the talk, if their behaviour and ways of working do not match the vision and values the company aspires to, all credibility is lost and the merger's mission is reduced to meaningless words. [3]

How to Prevent the Failure?

Several initiatives can be undertaken in order to prevent the failure of mergers and acquisitions. Following are those:

- Continuous communication is of utmost importance across all levels – employees, stakeholders, customers, suppliers and government leaders.
- Management and the managers have to be transparent and should always be truthful. By this way, they can win the trust of the employees and others and maintain a healthy environment.
- During the merger process, higher management professionals must be ready to greet a new or modified culture. They need to be very patient in hearing the concerns of other people and employees.
- Companies with access to reliable data can develop sound benchmarks for estimating realistic synergies and finding insights into the sources and patterns of error in estimating them.
- Management need to identify the talents in both the organizations who may play major roles in the restructuring of the organization. Management must retain those talents. [4]

Every organization be it big or small are likely to go through mergers at some stage. For this, they need to strengthen their ability to manage the future change and be better able to leverage a merger to achieve growth and work with new business paradigms. Once the deal is done, top managers have both structural roles (i.e. sponsoring work streams) and cultural roles (i.e. using their symbolic influence to reinforce new cultural practices which will underpin the business strategy) to play.

I spoke with Wolff Olins' strategy director Nick O'Flaherty about applying the findings from their recent leadership study to mergers and acquisitions. He started by asking if Verizon and AOL are merging and acquiring like it's 1999. He worries that they could be and suggests three key lessons from the "worst merger in history."

1. **Clearly define the specific value that will be created from the merger.** O'Flaherty told me that "AOL and Time Warner wanted something specific from each other – but the outcome of what that actually looked like for customers was never thought through, nor delivered." And he questions whether Verizon and AOL are "poised to make the same mistakes again." Specificity around how new value is created is key.
2. **Fully integrate the two businesses.** We've all seen organizations that acquire another organization and then run them as wholly owned, separate entities. You can't possibly realize synergies out of separate organizations. Synergies must be created together by teams looking beyond themselves to new problems they can solve for others.
3. **Ensure cultural compatibility.** O'Flaherty pointed out the cultural clash that occurred between AOL and Time Warner may happen again. Verizon is all about engineering while AOL is "more creative, more salesy." No way those two can come together well without some intensive therapy.

Wolff Olins' recent leadership study backs up these points. It indicated a shift from a concentration on outputs like sales to inputs like creating and building culture. This is in line with the power of building winners over trying to win. The CEOs surveyed talked about the need to hold their reins looser with the new generation, about the need to be more comfortable with ambiguity as they let their employees take greater leadership roles.

The study suggests we've moved from "command and control" in the late 19th century to "motivation and delegation" in the late 20th century to "focus and liberation" in this century. The study quotes Keurig Green Mountain's Brian Kelly's bias to "small teams and fast sprints with a tolerance for messy processes."

The key to a successful merger

The key to a successful merger is determining which culture to merge into which. Cocreating a brand new culture from scratch is a lot of hard work with a relatively low probability of success. The more straightforward and more likely to be successful approach is to pick one culture as the host culture and merge the other culture into it.

Vocus' acquisition of iContact is a case in point. Successfully merging in iContact was so important that they built an entire new headquarters for iContact in the spirit of the Vocus headquarters.

Contrast that with Philip Morris/General Foods' acquisition of Kraft. Even though Philip Morris/General Foods was doing the acquiring, they chose to merge the General Foods culture into Kraft.

Of course you have to define value creation and fully integrate the businesses. The point is that these are part of merging

cultures, not separate efforts. Corporate culture is the only truly sustainable competitive advantage and the root cause of any merger's failure or success. Make clear choices about the new, combined entity's behavior, relationships, attitudes, values and environment. Then insist on embracing those choices as a condition for staying on board.

Thus the top level managers have a key role to play in achieving merger success. They have to identify the risks that could lead to the failure of merger deals and try to resolve them effectively and efficiently.

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