M&A For Staffing Services:
The Inherent Challenges with Mergers & Acquisitions

By Steve Sorrentino, Principal, MergeQuest

The merging of two companies into one is not a recent idea - there were “waves” of corporate mergers back in the 1920s, the 1960s and the 1980s - but the enormous scale on which companies have swallowed each other up over the past decade far exceeds what has gone before. The total worldwide value of mergers and acquisitions in 1998 alone was $2.4 trillion, up by 50% from the previous year. However, research suggests that a large proportion of mergers and acquisitions do more harm than good to companies and their shareholders: Mercer Management Consulting concluded that “an alarming 48% of mergers underperform their industry after three years” , and *Business Week* recently reported that in 61% of acquisitions “buyers destroyed their own shareholders’ wealth”.

Why do so many firms choose to participate in mergers and acquisitions, and why do so many of these subsequently go wrong? In this article, I will attempt to answer these questions, and examine what steps companies can take in order to prevent acquisitions from ending in failure.

The reasons for mergers and acquisitions

One of the most common arguments for mergers and acquisitions is the belief that “synergies” exist, allowing the two companies to work more efficiently together than either would separately. Such synergies may result from the firms’ combined ability to exploit economies of scale, eliminate duplicated functions, share managerial expertise, and raise larger amounts of capital.

In some cases, firms may derive tax advantages from a merger or acquisition. Corporations may pursue mergers as part of a deliberate strategy of diversification, allowing the company to exploit new markets and spread its risks. AOL’s merger with media giant Time Warner, for example, saved it from being affected quite so disastrously as many of AOL’s Internet competitors by the ‘dot com crash’.

A company may seek an acquisition because it believes its target to be undervalued, and thus a “bargain” - a good investment capable of generating a high return for the parent company's shareholders. Often, such acquisitions are also motivated by the “empire-building desire” of the parent company’s managers.

Why mergers and acquisitions fail

Sometimes, the failure of an acquisition to generate good returns for the parent company may be explained by the simple fact that they paid too much for it. Having bid over-enthusiastically, the buyer may find that the premium they paid for the acquired company’s shares (the so-called “winner’s curse”) wipes out any gains made from the acquisition.

However, even a deal that is financially sound may ultimately prove to be a disaster, if it is implemented in a way that does not deal sensitively with the companies’ human capital (its people) and their different corporate cultures. There may be acute contrasts between the

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attitudes and values of the two companies (especially between the respective CEO's), and especially if the new partnership crosses national boundaries (in which case there may be language and other cultural barriers to contend with).

A merger is an extremely stressful process for those employees involved: job losses, restructuring, and the imposition of a new corporate culture and identity can create uncertainty, anxiety and resentment among a company's employees. Research shows that a firm's productivity can drop by between 25 and 50 percent while undergoing such a large-scale change; demoralization of the workforce is a major reason for this. Companies often pay undue attention to the short-term legal and financial considerations involved in a merger or acquisition, and neglect the implications for corporate identity and communication, factors that may prove equally important in the long run because of their impact on workers' morale and productivity.

Managers, suddenly deprived of authority and promotion opportunities, can be particularly bitter: one survey found that "nearly 50% of executives in acquired firms seek other jobs within one year". Sometimes there may be specific personality clashes between executives in the two companies.

Strategies for a successful merger or acquisition

Why are so many organizations apparently unable to overcome such difficulties? A merger is often a unique, one-off event in the lifetime of a firm; companies therefore have no opportunity to learn from their experience and develop tried-and-tested methods to ensure that the process is carried out smoothly. One notable exception to this is the financial-services conglomerate GE Capital Services, which has made over 100 acquisitions during a five-year period. Through this extensive experience, GE Capital has learnt four basic lessons:

1. The integration of acquired companies is an ongoing process that should be initiated before the deal is actually closed. During the period in which the merger is being negotiated and subjected to regulatory review, the management of the two companies can liaise with each other and draw up a clear integration strategy. Starting earlier not only allows the integration to proceed faster and more efficiently, but also gave GE Capital the opportunity to identify potential problems (such as drastic differences in management style and culture) at a stage when it is not too late to abandon the deal if the difficulties encountered seem so severe that the acquisition is likely to fail. Unfortunately, however, even if a very thorough investigation is done prior to the acquisition, there are often potential problems that will not manifest themselves until long after the deal has been done. It is also impossible to take early steps towards integration in the case of a hostile takeover bid (where the managers of the company being acquired refuse to co-operate with their potential buyers).

2. Integration management needs to be recognized as a "distinct business function", with an experienced manager appointed specifically to oversee the process. The 'integration managers' that GE Capital selects to oversee its acquisitions can come from a wide variety of backgrounds, but all must have the interpersonal skills and cultural sensitivity necessary to foster good relationships between the management and staff of the parent company and its new subsidiary.

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3. If uncomfortable changes (such as layoffs and restructuring) have to be made at the acquired company, it is important that these are announced and implemented as soon as possible - ideally within days of the acquisition. This helps to avoid the uncertainties and anxieties that can demoralize the workforce of a newly-acquired company, allowing employees to move on and to focus on the future.

4. Perhaps the most important lesson is that it is important to integrate not just the practical aspects of the business, but also the firms' workforces and their cultures. A good way to achieve this is to create groups comprising people from both companies, and get them to work together at solving problems.

Other M&A researchers, however, question whether aiming for total integration of two contrasting company cultures is necessarily the best approach. There are, in fact, four different options for reconciling cultural differences: complete integration of the two cultures, assimilation of one culture by another, separation of the two cultures (so that they are maintained side by side), or de-culturalization (eventual loss of both cultures). The optimal strategy may depend upon the degree of cultural difference that exists between the organizations, and the extent to which each values its own culture and identity.

Research suggests an alternative set of "seven key practices" to assist with a successful merger or acquisition:

1. Close involvement of Human Resources manager(s) in the merger process – especially as it relates to reconciling differences in compensation plans and pay structure, as well reconciling differences between the merged company's employee benefit plans and structures. You don't want the merged firm's employees to experience a step-down (dilution) in compensation or benefits – as this will immediately, dramatically and negatively affect the merged employees' attitude about the merger from the get-go.

2. "Building organizational capacity" by ensuring that close attention is paid to the retention and recruitment of employees during the merger.

3. Ensuring that the integration is focused on achieving the desired effect (for example, cost savings), while at the same time ensuring that the core strengths and competences of the two companies are not damaged by the transition.

4. Carefully managing the integration of the organizations' cultures.

5. Completing the acquisition process quickly, since productivity is harmed by the disorganization and demoralization that inevitably occur while the change is underway.

6. Communicating effectively with everyone who will be affected by the change. Other authors agree that "being truthful, open and forthright" during an acquisition is vital in helping employees to cope with the transition.

7. Developing a clear, standardized integration plan.

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Conclusions

Although there are many different opinions on precisely what causes so many mergers and acquisitions to fail, and on how these problems can be avoided, there are certain points that most analysts appear to agree on. It is widely accepted, for instance, that the 'human factor' is a major cause of difficulty in making the integration between two companies work successfully. If the transition is carried out without sensitivity towards the employees who may suffer as a result of it, and without awareness of the vast differences that may exist between corporate cultures, the result is a stressed, unhappy and uncooperative workforce - and consequently a drop in employee productivity.

With this in mind, it is important that a clear 'integration plan' is in place, and that it is overseen by a dedicated manager with the experience and interpersonal skills to calm employees' anxieties and reconcile cultural differences. Preparation for the transition should begin as soon as possible, preferably before the deal has been signed, and any necessary changes should be implemented as quickly as possible to avoid stressful uncertainties that can damage morale. Open and honest communication throughout the process is vital in retaining the trust of employees.

Even when following these principles, there may be situations in which a tie-up between two companies could never be made to work effectively, because there are irreconcilable differences in corporate culture or because the drawbacks of a merger would outweigh any potential benefits. Although it is obviously impossible to predict with certainty the outcome of a merger or acquisition before it takes place, thorough preparation can definitely help, and companies should not be afraid to abandon plans for a tie-up if there is evidence that it is unlikely to be a success.

Most importantly, any decision to carry out a merger or acquisition should consider not only the legal and financial implications, but also the human consequences - the effect of the deal upon the two companies' managers and employees. It is upon them, ultimately, that the fate of the newly-merged company will depend.

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Steve Sorrentino is the founder and Principal of MergeQuest, a trusted and experienced M&A Advisory Services firm serving the Staffing Services industry. Steve specializes in helping sellers and buyers with their M&A goals, in addition to offering Business Valuations for Staffing Industry businesses. Steve can be reached at (781) 334-7184, or by email at sjsorrentino@mergequest.com, (website: www.mergequest.com)

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