

Hearts and Minds

The Key to Successful
Mergers



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Mergers and acquisitions (M&A) continue to be a critical strategic tool for Australian corporations looking to drive tangible bottom line improvements. M&A offers the promise of rapid growth and bottom line benefits in a world where CEOs are under increasing pressure to drive short term improvements and where shareholders are becoming more and more impatient with below average share-market performance. The challenge is that few organisations actually deliver on this promise – in fact over half of all mergers fail to deliver the anticipated benefits.

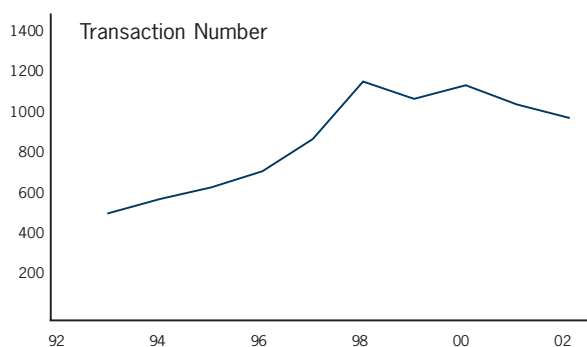
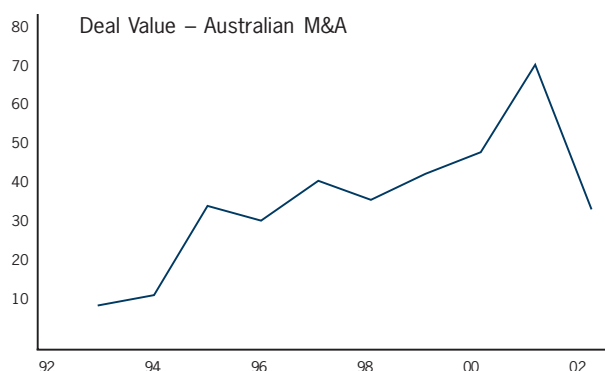
Why is it that the merger or acquisition option looks so good on paper but success is rarely achieved in reality? Part of the answer lies in the fact that most companies

have a natural tendency to focus on the more tangible aspects of the merger – identifying improvement opportunities, rationalising sites, designing the new organisation chart, developing product migration plans, etc. However, in doing this they often ignore or over look the critical but less tangible people and cultural issues. While every merger is unique, all too often we find that the inability to effectively integrate people and culture is at the heart of most merger failures.

Smart Mergers and Acquisitions are Here to Stay

In the past decade the value of merger and acquisition activity in Australia has increased 5-8 times – a growth rate that is almost twice the global growth rate. Despite a recent downturn in the value of deals, Australian M&A activity remains strong with approximately 1,000 transactions each year completed by Australian companies (see Exhibit 1).

Exhibit 1 Recent Trends in Australian M&A Activity ¹



Source: Thomson Financial, 29/9/03

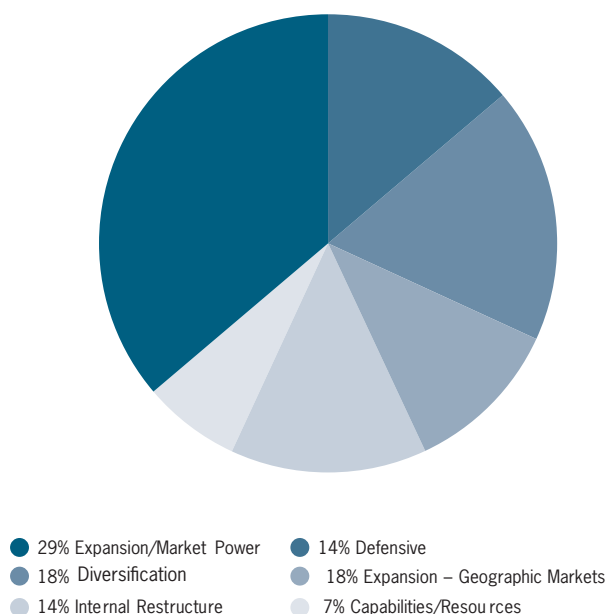
1. The sharp decline in the value of Australian merger and acquisitions during 2002 is partially offset by a few major deals in 2001 including BHP's acquisition of Billiton, SingTel's takeover of Cable & Wireless Optus and Brambles acquisition of GKN.

Why do Companies Pursue Mergers and Acquisitions?

Companies typically pursue M&As to achieve one of six primary objectives:

Objective	Description
Expansion/Market Power	To increase market share and power within an industry (e.g. buying power, cost leadership)
Diversification	To expand into a new industry sector
Defensive	To fend off a potential acquisition or to increase barriers to entry within an industry
Internal Restructure	For internal strategic and/or financial corporate objectives
Geographic Expansion	To access new geographic markets
Capabilities/Innovation	To access capabilities/Innovation (e.g. technology, intellectual capital) or resources (e.g. minerals, natural resources, metals)

Exhibit 2 Examples of Drivers of Recent M&A Activity in Australia



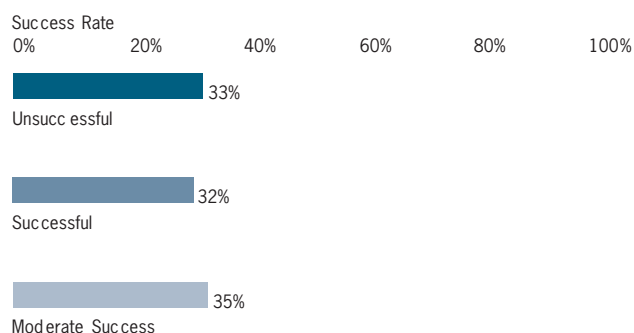
Source: Booz Allen analysis of the top ten deals by value in 2003, 2002, 2001

Acquisitions promise tangible benefits in the short term, which are particularly attractive in an environment where CEOs and senior managers need to get results quickly. A recent Booz Allen study showed that the average tenure for an Australian CEO is 4.4 years down from 5.8 years in 2001 and almost half that of international counterparts at 8.6 years. Moreover, under performing CEOs last on average only 3.6 years in their role.

The dramatic growth of M&A in the Australian market over recent years has been fuelled by a host of factors:

- The limited organic growth opportunities of relatively mature industries such as mining, banking and insurance, telecommunications and manufacturing
- The natural geographic segmentation between states making growth through acquisition far more attractive than a 'grow your own' strategy
- Regulatory changes and technological developments that have enabled greater competition in many industries which in turn have resulted in consolidation
- The increased threat of global competition and the need for Australian companies to achieve scale to remain competitive
- Historically low interest rates and, until recently,

Exhibit 3 Australian Merger Success



Source: Booz Allen CEO Best Practice Survey 2003

low exchange rates have made M&A relatively more affordable.

Why do Mergers Fail?

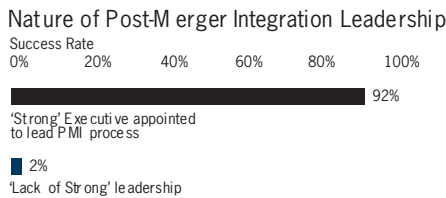
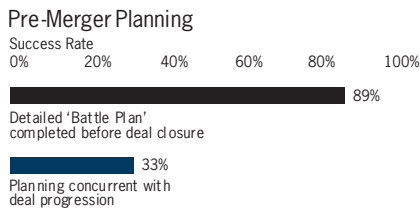
Every merger is different and there are numerous reasons why they fail – ranging from poorly thought through strategies to under-resourcing the implementation team. In our experience, the four most common reasons are:

1. The lack of integration experience
2. The inability to prioritise conflicting demands
3. The often myopic focus on getting the deal done
4. A lack of focus on managing the people and culture issues

Lack of Experience

Most organisations have very little experience in planning and executing M&A transactions. Most organisations treat the integration process as a one off project and have to learn as they go – drawing on books and articles for key lessons learnt and pitfalls to avoid.

Exhibit 4 The Benefits of Pre-Merger Planning and Leadership



Source: Booz Allen CEO Best Practice Survey 2003

Very few organisations view the ability to integrate organisations as a core competency and a very limited number have systematised the integration process to make it replicable. Marked exceptions include GE Capital and Cisco who have completed hundreds of acquisitions in the last ten years.

Conflicting Demands

The majority of organisations find the numerous integration challenges extremely difficult to balance. In conjunction with integrating the acquired organisation to capture immediate value there are concurrent pressures

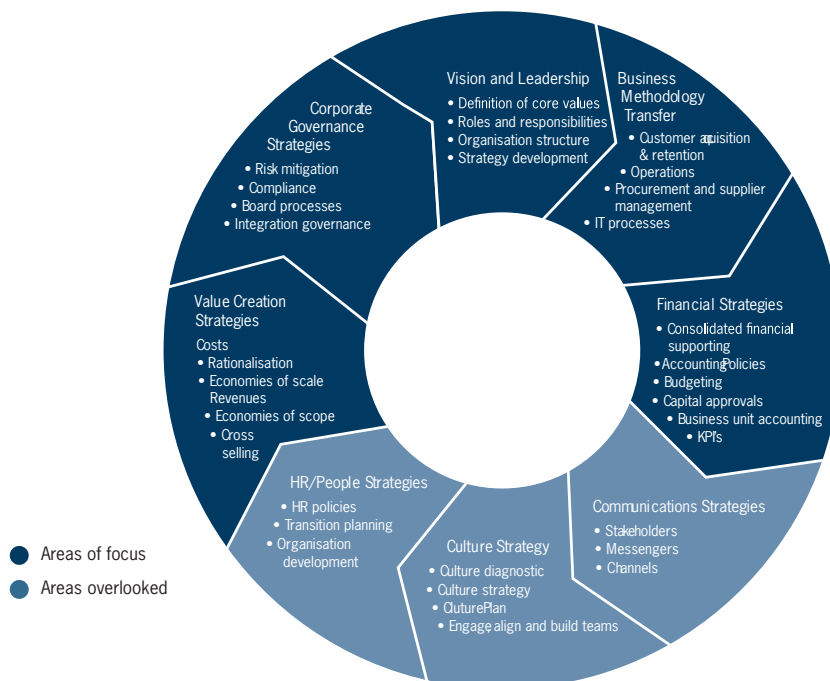
to establish the new organisation, implement the long-term vision and manage the business-as-usual issues.

Singular Focus on Getting the Deal Done

CEOs are under significant pressure to rapidly improve shareholder performance. As a result there is often immense pressure to announce “the big deal”. This is especially the case if a number of potential acquisition candidates have been pursued but have failed to be completed. The result can be an almost myopic focus on getting the deal done, rather than actually implementing the merger. This often results in the mindset that the work is over once the deal is announced.

The reality is that the opposite is true – the real work is just beginning. The end result of this is that there is often limited pre- and post-merger planning and that key components of the integration process are bypassed or skimmed over.

Exhibit 5 Required Components for Merger Integration



Obstacles to Achieving Success

An inability to sustain financial performance
Incompatible cultures
Loss of employee productivity
Loss of key resources and talent
Clashes in management styles/egos
Inability to implement change
Objectives/synergies not being well understood

Source: Making Mergers Work: The Strategic Importance of People – Schmidt

Merging People and Culture

From a people perspective most mergers occur as an unnatural and sudden event. The practice of making deals in isolation to the task of implementation planning is endemic – a scenario akin to an ‘arranged marriage’ where the deal makers (‘parents’) decide the benefits and fit, prohibit any pre-deal interactions, and force the integration managers (‘bride’ and ‘groom’) to evolve the shared values, visions and culture almost overnight.

Each merger’s own unique dynamic must be understood in order to devise the best strategy and structure for cultural integration. Deep and serious conflicts, with respect to people and culture, proliferate when acquirers introduce the acquired personnel to their “visible” ways of doing things (see Exhibit 7).

Our experience has shown that the integration agenda with respect to people and culture requires two distinct areas of focus to address the “invisible” drivers of behaviour.

- The first involves managing the initial emotional response, the state of mind, of the acquired personnel by making them feel welcome, valued and certain about their future. How they feel then determines their level of engagement with, and commitment to, the new identity.
- The second process is at the heart of the cultural integration. It is the process of aligning the mindsets of the personnel in both organisations. This deeper challenge of achieving a shift in mindsets is one that few acquirers consider, let alone understand what it involves or how to do it.

In the context of culture, mindsets typically include the beliefs and values people have about what is important. In a professional context, a different mindset is akin to

speaking a different language. When people speaking different languages attempt to co-ordinate activity to complete a task, they take longer to accomplish the task than if they had worked separately. However, if they learn to speak the same language, co-ordinating activity becomes less frustrating and time consuming and hence they are able to deliver the desired outcomes more effectively.

The acquired employees can quickly pick up and learn from what is visible to them, i.e. what they see and experience from day one. What they don’t get the chance to understand is the “invisible” – the beliefs and values that have been built in to the acquiring organisation over time that cause people to do what they do. Without understanding what makes each other tick and the cultural mindsets that prevail (invisible), both organisations quickly become frustrated with the different ways of doing things.

Their instinctive need to make themselves right whenever they don’t understand this new way of doing things is what inevitably hijacks day-to-day activities and interactions.

Similarly, whenever a merger does not deliver its promised business benefits, it is usually evident that the shared behaviours for making decisions, using time and interacting with others were not successfully embedded. The personal journey towards transforming these invisible drivers of behaviour is depicted in Exhibit 8.

So, How Can You Integrate Effectively?

The companies that succeed in M&A have a planned and detailed integration strategy managed by a full time integration team (see Exhibit 9). In particular the most critical elements of this process are:

Strategic Plan

The deal must be designed around strategic objectives so that search criteria for the ‘ideal’ acquisition/merger target can be defined. Screening for ‘strategic fit’ can then identify any significant issues that could derail the merger.

Due Diligence

Due diligence should address not only the financial, legal, manufacturing/operational issues but also softer issues such as organisational values, aspirations and culture. This enables exhaustive scenario and integration planning.

Integration Team

It is critical to have a dedicated 'Integration Team' to lead the two organisations through the merger while the rest of the management team can focus on business as usual. The integration team should be multi-functional and should be rapidly formed once the companies have publicly announced the merger.

Integration Planning

The detailed planning process must encompass all elements necessary to integrate the two organisations with a view to long-term performance. This means that the dominant organisation should not try to impose their organisational systems, processes and culture simply to get a quick fix – ultimately this form of integration by force will end in disaster. Management of all stakeholder groups through timely and specifically targeted communications will minimise anxieties and proliferation of negative rumours and should minimise loss of key staff to competitor organisations.

Implementation and Tracking

The implementation plan should be comprehensively designed to sustain momentum once the deal has been signed. This includes all 'Day One' activities and the formation of cross organisation teams to achieve immediate goals to aid the integration process. As the integration progresses, tracking and reporting tools should be used to monitor progress and adjust the implementation to effect any necessary changes.

Focusing on Culture as Part of the Integration

It is vital that the acquirer holds the process of cultural integration on its radar as a key success factor from day one. Cultural integration is essentially about building and

implementing the best platform for effective message management. Messages about what is actually valued, what is important, and what people do around here to fit in, to be accepted, and to succeed. Examples of where people will immediately begin picking up these messages include: Can the acquirer be counted on to deliver its promises? Does the shared future win the hearts and minds of both the acquiring and acquired employees? Are they inspired by the messages they receive about what is important? Are these messages clear, consistent and aligned to optimise the promised business benefits? Does the professionalism and speed of execution earn credibility, respect and commitment?

Our experience indicates that there are three basic strategic options for successful cultural integration. These are:

- Leverage the benefits of the acquired organisation's culture to build a new "best of both" culture
- Impose acquirer culture so that one culture dominates
- Keep two cultures separate

However, there is no one right answer to which strategy to employ. This choice requires a very thorough analysis of the two respective cultures and their fit (risks and opportunities for synergy). Key factors that determine which choice you make include what is the purpose of the M&A and where do the synergies of the value proposition lie? What business model will be used across both businesses, and what are the relative strengths of the two cultures for customers in the market in which the new entity will play? Such an approach to integration leaves the business with the best chance and platform in place to grow.

Establishing a Shared Cultural Framework

Three key phases (see Exhibit 10) are needed to ensure that a shared cultural framework is established that will deliver the promised business benefits.

Phase 1 - Consider the factors that determine which cultural strategy is best and devise a proposed integration approach; together with establishing the uniqueness

of what you have (existing culture), its implications, and the risks and opportunities for synergy. This is typically achieved by undertaking a cultural audit or diagnostic. Messages come from thousands of sources, yet our experience has found that they fit into three broad areas that we call behaviours, symbols and systems. Pinpointing these sources helps provide a language for dialogue, reduce subjectivity and provide an objective benchmark against which the progress of the cultural integration can be measured. The first phase, together with a pro active approach to managing the emotional challenges among the acquired personnel, must be completed prior to 'day one' of the merged entity.

Phase 2 - Choose which cultural strategy is best, describe the culture that you want (desired vision, culture, systems, values and benefits), build a very specific plan about how to get there, and begin building the new identity with an aligned team at the top. This process also includes designing a detailed communication strategy and education programme on culture, and defining the desired mindsets and behaviours needed to drive the promised performance. Establishing formal (temperature check focus groups) and informal (identification of opinion leaders and influencers) mechanisms for information flow are also effective for identifying rumours, and resolving hot issues found on the grapevine.

Phase 3 - Roll out the engagement strategy for the new vision, build and develop new teams, and hold the line on the new expectations. The engagement strategy is typically used as a continuation of the communication strategy and ensures closure with the "letting go and moving on" process. Once the purpose, roles and charter of the different teams are defined, it is critical to take the time needed for members to understand the invisible aspects of the culture. For example, what makes each other tick, along with what it takes to make decisions together, and view the new identity through the same "coloured glasses". Embedding the desired behaviours also involves stamping out any sabotage behaviours that result from "us/them" and "top dog/underdog" syndrome. Clearly, the biggest challenge to this third phase of operating as "business-as-usual" is maintaining internal M&A cohesion, commitment and momentum whilst ensuring external

customer focus.

What Does Success Look Like?

If done right the pay-off from a merger can be considerable (both in terms of bottom line impact as well as retention of key staff) but done poorly the results can be disastrous. When we look more closely at recent high profile M&A deals we find that it is far easier to find examples of deals that have failed than examples of those that have succeeded. A consistent trend however is that those that do succeed place a critical focus on cultural integration and those that failed attributed this primarily to cultural incompatibility

Look Before You Leap

For many Australian organisations M&A will continue to be the best strategic choice. By applying the experience and frameworks outlined here, companies can dramatically increase their chance of success. The M&A 'leap' will always be great but those companies that look, plan and integrate their cultures most effectively will reach the other side in the best shape.

What Booz Allen and Mettle Group Bring

Booz Allen Hamilton and Mettle Group have worked on many of Australia's largest and most complex mergers of the last ten years. Our pre- and post-merger integration programmes have brought about considerable benefits to our clients. Booz Allen provides rigorous program management and depth of experience in transformations, managing benefit realisation, project interdependencies, program risks, stakeholder management, communication and cultural change within large and complex organisations. Mettle Group provides extensive change management capabilities with more of the 'hearts and minds' dimension to change management utilising cultural diagnostic tools and team off-sites. In working together we responded collectively to our client's business needs at all levels.

Booz Allen Hamilton

Booz Allen Hamilton has been at the forefront of management consulting for businesses and governments for 90 years. Booz Allen combines strategy with technology and insight with action, working with clients to deliver results today that endure tomorrow.

With over 14,000 employees on six continents, the firm generates annual sales of over US\$2.5 billion. Booz Allen provides services in strategy, organisation, operations, systems and technology to the world's leading corporations, government and other public agencies, emerging growth companies and institutions.

To learn more about the firm, visit the Booz Allen web site at www.boozallen.com. To learn more about the best ideas in business, visit www.strategy-business.com, the web site for strategy+business, a quarterly journal sponsored by Booz Allen.

Mettle Group

Mettle Group's ability to understand what makes people tick and how to engage their hearts and minds has established them as the industry leader in culture, behaviour and mindset change. Mettle Group aligns people with business strategy to deliver sustainable results.

Mettle Group has built its reputation and experience by tackling everything that is irrational about what happens in companies – the gap between what looks right on paper and what actually happens is described as “the people factor”.

During 18 years of operation Mettle Group has partnered with over 1,000 organisations in Australia, the UK and the USA to develop cultural solutions that support the implementation of new business strategies, mergers and acquisitions, and restructuring and deliver competitive advantage. To learn more about Mettle Group visit www.mettle.biz.

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