Making Mergers More Successful

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The cost of failed mergers is enormous. Many mergers fail because the human and cultural sides of integration are not managed as carefully as the financial and structural sides. This paper describes a process that has been used in two mergers to address the human and cultural sides of integration and has reduced the pain and time needed for integration and cut the inevitable customer and employee losses. The process, which allows the organizations to become acquainted thoroughly and quickly and to focus on the positive aspects of a win-win merger, is a valuable adjunct to the traditional financial and structural planning for mergers.

The High Cost of Failed Mergers

Merger spending is enormous and growing. In 1998, it was 50% higher than 1997, which was more than 100% larger than 1996.[i] The larger ones involve billions of dollars. Exxon-Mobil alone was worth $80 billion.[ii] And, the merger pace does not appear to be slowing.[iii]

In spite of the money invested in mergers, most mergers fail to meet their objectives. The definitions of merger failure vary from failing to make the acquiring company stockholders better off, to failing to meet market growth or share objectives, to deals that come undone. Regardless of the definitions, however, studies of the failure rates generally agree that somewhere between fifty percent and eighty percent of mergers fail.[iv] Even those that eventually prove profitable usually go through months or years of customer and employee defections and drops in productivity.[v]

Why do so many mergers[vi] fail? Merger failure rates are surprisingly unaffected by the strategic relatedness of the merging firms[vii], so the reason is usually not a failure of the acquiring firm to understand the industry of the acquired firm. Nor is the reason usually the failure to build financial plans: After the purchase price has been agreed, cost savings and market power analyses in fact seem to be the chief focus of most mergers in order to justify the purchase price.[viii] Nor is the reason usually the failure to plan for the new structures and reporting relationships: That is one of the first things planned, as executives jockey for positions.[ix]

Many, if not most, mergers fail because the human and operational sides of integration are overlooked: The two merging organizations do not systematically plan how to build on and integrate their people and cultures.[x] Instead of thinking of mergers as marriages where both parties benefit, they are often thought of and spoken of as takeovers, where the acquiring organization's culture[xi] or point of view is applied to the acquired organization whether it fits or not. The mind set is often win-lose. The bigger or stronger firm's culture and way of operating win. The smaller firm's culture and operations lose. Naturally, the smaller organization is resentful and does its best to hang on to what it views as its strong points. The larger one pushes harder for change, and a negative spiral can result.[xii]

Even in cases where the merging organizations say they want to capitalize on the best of each firm's people and cultures, they are usually uncertain how to do this. Each organization has its own unspoken values and beliefs about how to succeed. Even while trying to cooperate, they may appear uncooperative as they act on their instincts.

A huge post-merger industry has sprung up to get failing mergers back on track. These consultants are called in after serious difficulties are apparent. They are like marriage counselors dealing with relationships that have already become bitter and acrimonious. How much easier their work would be if they could be called in before the fighting to minimize disagreements and maximize understanding.

A Proven Way of Addressing the Overlooked Human and Cultural Sides of Mergers

This paper describes a new process for addressing the human and cultural sides of mergers (called the People and Cultural Transition [PACT] process for shorthand). Given the value, relatively low cost (compared to the value of the mergers) and simplicity of this innovative process, organizations that are merging or even just combining departments may find it valuable.

There are several benefits of the PACT process. First, it reduces (although it does not fully eliminate) distrust and fear by acquainting each merging group with the other's values, ways of operating, and strengths. This helps build respect before major disputes develop. Second, the process maintains a focus on pleasing and retaining customers during the integration process, which reduces customer attrition. Third, because the process is based on proven assessment criteria and conducted primarily by people without a vested interested in the outcome, it is seen as fair and objective. This helps calm the usual political jockeying. Fourth, the process focuses on creating a new organization that is stronger than either of the original organizations. This avoids the usual "I win, you lose" mindset of most mergers and instead helps people think positively about their futures ("Things will be even better than before."), which in turn reduces the loss of valued employees and managers. Fifth, and very importantly, the process greatly speeds up integration by quickly and accurately educating each organization about the other. This time savings means people are able to get back to work more quickly and profits decline less than usual for mergers.

The PACT process is illustrated with two examples. The first merger to use the PACT process involved two Massachusetts hospital/healthcare groups, North Shore Medical Center (NSMC) and AtlantiCare Medical Center (AMC). NSMC, the acquirer in the merger, was significantly larger and had a better financial track record. AMC prided itself on its friendly environment and excellent patient care. Located only a few miles apart, NSMC and AMC had considered themselves competitors for years, and employees of each felt that their organization was superior to the other.

Andrew C. Riddell, CEO of AMC, came up with the idea for the PACT process because he did not want the merger to fail. He had been through one merger that came apart and one that had to be halted just before signing, and he did not think his organization could endure another failure. Looking at those past failures and at the many others that littered the healthcare market, he felt that the main cause was that the human or cultural side of the merging hospitals had been overlooked. Searching for an objective and proven way to assess and merge the human side of the organizations, he hit on using the Malcolm Baldrige Criteria for Performance Excellence[xiii] to describe and assess the strengths of both NSMC and AMC. AMC and many other hospitals had been using Baldrige for years to improve their management and performance. He proposed that he would take charge of the cultural and people sides of the NSMC/AMC merger while the CEO of NSMC and the Boards of Directors would take on the structural and financial sides of the merger. Riddell worked with a team of outside Baldrige and hospital experts to develop a process for assessing, reporting on, and building on the strengths and opportunities for improvement of both hospital groups.

Riddell explains, "My experience as a CEO convinced me that a process that was based on proven assessment criteria and conducted by impartial experts would bring the human side of this merger out of the gutter. I had had a previous experience where a large healthcare system called a team of Baldrige folks to analyze their merger *after* it had been consummated. I simply asked, in our situation, why not do the assessment *during or simultaneously* with the merger signing. In fact, companies should seriously consider this a part of their due diligence *before* the merger takes place."

The second to use the PACT process were two multinational firms, with offices on most continents. Although the acquiring firm was larger than the acquired, they were in almost identical lines of business. In this multinational case, the PACT process was used to guide the merger of parallel support functions within the larger corporations. These were vital functions that represented substantial risk to the multinationals if they were not running smoothly from the day the final merger papers were signed. The man who had been named as head of the merged support function had heard about the PACT process and wanted to apply it to his situation. The same process developed for hospitals was used again for the multinational support function but with some improvements and modifications.

This paper begins by describing the three phases of the PACT process: (1) Preparation, (2) Discovery and (3) Communication and Action. For each phase, it describes the steps taken, the resources needed, and the key outputs – with illustrations from the hospital and multinational cases. The assessment tool used during the Discovery phase is also discussed. The paper ends by reviewing how the PACT process worked for the hospitals and the multinationals, when the PACT process may be more or less appropriate, and suggestions for those considering using the process in their own mergers or re-organizations.

The Three Phases of the PACT Process

The PACT process has three basic phases: (1) Preparation (2) Discovery and (3) Communication and Action. Exhibit 1 lists the activities in each phase.

1. Preparation Phase

The Preparation Phase is vital because it builds support and enthusiasm for the PACT process and identifies who will be responsible for all key activities. The commitments made at this stage determine whether the organizations will be willing and able to act on the information produced by the PACT process.

<u>Hold Planning Meetings</u>

Preparation for both the hospital and multinational PACT processes began with several planning meetings to discuss the benefits of the PACT process and how the basic steps would be adapted to the firms' unique situations. Participants in these initial planning meetings included a senior leader who was interested in PACT (Andy Riddell for the hospitals and the head of the combined support function for the multinationals), outside business experts who either knew about the industry or about the assessment tool that would be used, and several other upper level managers from both organizations who would be involved in making the merger a success. Note that there was no guarantee which people at this meeting would retain their jobs at the end of the merger. However, those invited were key managers who were trusted to act in the best interests of the new organization.

These planning meetings answered such key questions as: Who are the key decision-makers going to be, and what are their goals? What criteria will we use for the Discovery Phase? How will the criteria fit in with the values and goals of the merging groups and how will we build support for them? Who is taking responsibility for the structural and financial aspects of the merger, and how will we coordinate with them? Will the PACT process results precede the structural and financial merger decisions, or vice versa, or will the PACT process and the structural and financial merger planning run in parallel and be open to change for a time? Once these questions have been answered, the focus of this phase is on preparing a rough project plan and timetable and on identifying the people who will be responsible for conducting and acting on the PACT process.

Identify Key People

There are several key teams of people who are critical to the success of the PACT process. These include:

- Owners. The Owners are the very senior people who approve the PACT process and resulting actions. At the hospitals, the Owners were the members of the two Boards of Directors and then the members of the merged Board of Directors. The original Boards approved the PACT process while the merged Board approved the final actions to be taken after the process was complete. From Preparation onward, there were many communications with the Owners. At the multinationals, the Owners were the people to whom the head of the new support function reported. Before the merger, the Owner of the multinational's process was the immediate supervisor of the new head of the support function. After the merger, the Owners turned out to be the various business unit heads to whom the support function reported. Since the final structure of the multinational had not been determined by the start of the PACT process, some of those business unit heads who turned out to be Owners were not included in the Preparation Phase. This slowed down the integration and emphasized how important it is to spend time identifying and getting input and commitment from all potential Owners during the Preparation Phase.

- PACT Team. The People and Cultural Transition (PACT) Team is the body of senior- to mid-level managers who are responsible for acting on the PACT results and guiding the merger integration for the first six months to a year. For both the hospitals and the multinationals, this included respected senior managers from both firms who knew their organizations well and wielded considerable influence within them. The PACT Team met during the Preparation Phase to discuss and make improvements to the PACT process. They helped arrange the interviews and information gathering during the Discovery Phase. They played a lead role in the Communication and Action Phase in communicating to the entire organization what was happening and why and in overseeing the changes. Since it is seldom clear during the Preparation Phase which managers will be retained after the merger or what roles they will play, it may be advisable to obtain commitments from the merging companies that those managers on the PACT Team will be kept on at least through Phase 3 to plan and oversee the people and cultural sides of the integration.

- Discovery Team. The Discovery Team conducts the Discovery Phase. It also plays a major role during Preparation in planning the PACT process and in the Communication Phase in communicating the findings and recommendations. The Discovery Team begins by carefully planning the issues they will study during the Discovery Phase. Each member is responsible for developing the questions and approach he or she will use in gathering the necessary information. The Discovery Team prepares a detailed calendar and travel plans, which are shared with the PACT Team members who schedule all necessary interviews.

  In the case of the hospitals, the Discovery Team consisted of six outside experts. Of these, two had been Baldrige senior examiners and all had worked with or for hospitals in the past. In the multinational case, the team consisted of seven people. Of these, four were outside Baldrige examiners, one was a state examiner who worked for the acquired firm, and there was one person from each the acquired and acquiring firms to provide industry expertise.

People from the acquiring firm questioned whether the state examiner from the acquired firm could be impartial, and this was discussed at length because the success of the PACT process depended on the skill and impartiality of the Discovery Team. However, since all members of the Discovery Team had to agree on the PACT report, the state examiner was approved and proved to be a valuable part of the team.

Build Enthusiasm

It is important to build awareness of and enthusiasm for the PACT process beginning during the Preparation Phase and continuing throughout. At the hospitals, Andy Riddell handled this with the help of the PACT Team. They had many meetings with the Owners (Board members), with senior managers and with their peers. They also prepared talks and articles about the PACT process with the goal of reaching everyone in both organizations. At the multinationals, the communication process was much simpler since it was aimed at just two parallel functions and not the entire corporations. The new head of the support function handled communication with help from the two Discovery Team members who worked for the functions in each multinational. They communicated primarily through meetings and e-mails. The communications for both the hospitals and the multinationals stressed how objective the PACT process would be, that its main purpose was to identify and keep the best of both organizations in order to be better than ever, and that the process would move as quickly as possible.

2. Discovery Phase

The Goals of the Discovery Phase

The goal of the Discovery Phase is to educate each organization about the other as quickly, accurately and objectively as possible and to do so in a positive way so that recognizes and appreciates the strengths that each group brings to the new organization. To do this, the Discovery Phase produces two key deliverables: (1) A comprehensive description of how each organization views itself and its main business factors and (2) An objective list of the strengths and opportunities for improvement of each organization, along with recommendations of how the new, combined organization can capitalize on the strengths and address the opportunities. This allows the organizations to understand each other quickly and thoroughly and to focus on the positive aspects of creating a new organization that is stronger than either of the originals. These deliverables as well as the Discovery process itself are handled in a positive way with full disclosure throughout in order to build acceptance of the results.

- A Comprehensive Description of the Organizations and Their Main Business Factors The Discovery Phase begins by producing a business description of both organizations, covering all their key business factors.[xiv] This includes such things as key products or services, key customer segments and their requirements, key competitors and trends in the market, technological, regulatory and other important issues affecting the business, the nature of its workforce and key human resource trends and issues, and key suppliers and their impact on the business. While this may seem somewhat simplistic, it is a huge timesaver because the structured description uncovers important facts that take months to emerge in typical mergers. For instance, in the multination merger, although the merged functions appeared to provide the same services, the description revealed they had different approaches to providing these services: One focused more on preventing problems while the other focused more on finding improved ways of resolving problems that had already occurred. The description also revealed that what appeared to be similar jobs with the same job titles in the two groups actually were quite different – with different training, goals, and types of empowerment. Once this was uncovered, the managers of the new support function decided to prepare job descriptions as soon as possible for their organization. A third outcome of the description for the multinational was the decision to produce a dictionary. The same terms often had different meanings in the two organizations, which would have lead to confusion and miscommunication without the dictionary.

- An Objective List of Strengths, Opportunities for Improvement, and Recommendations for the New Organization The second output of the Discovery Phase is an analysis of strengths and opportunities for improvement with resulting recommendations. A typical assessment of a business produces a report that highlights the business's key strengths and opportunities for improvement and the key themes or issues that drive the business's success or else hold the business back. The Discovery Phase does the same, but with a variation since two organizations are involved. The PACT report describes the strengths and opportunities for improvement for each of the two merging organizations and then discusses how to capitalize on the most important strengths of each to produce a new entity that is stronger than either alone. For example, for the hospital merger, the report described the strengths and opportunities for improvement for the old NSMC for each of the assessment categories and then did the same for AMC. Then it addressed opportunities for the new NSMC, focusing on how to capitalize on the most important strengths or opportunities of each to produce a new entity that was stronger than either alone. The goal is to highlight the things each merging organization has to offer and to focus on making the new entity stronger than either of the originals.

The Discovery Process

1. Determine Discovery Criteria. Both the hospitals and the multinationals used the Malcolm Baldrige Criteria for Performance Excellence as their assessment tool or template for Discovery. AMC and one of the multinational firms had successfully used the Baldrige criteria in the past to improve their management and performance, so it was a natural choice for them. While it is possible for other firms to develop or find other Discovery criteria, Baldrige is an excellent tool for several reasons.

First, the Baldrige criteria are comprehensive – covering all aspects that are important to the success of an organization. These aspects are collapsed into the seven categories shown briefly in Exhibit 2. For example, they cover all the human or cultural aspects of running a business – including leadership, strategy and goals, human resource development and motivation, values that are implicit as well as explicit, and how the organization defines its purpose and market. At the same time, they include all the operational processes and results of the business, which means they dovetail well with the usual financial and structural issues that must be considered during mergers.

Second, there is strong evidence that firms using the Baldrige criteria have experienced business success that is well above average. Various studies based on a hypothetical Baldrige mutual fund show that winners outperform their industries year after year by about 2.5 to 1.[xv] One firm, Solectron, which is the only whole firm to win twice, has been a gold mine for its shareholders – going up nearly 1800 percent since winning.[xvi] While these studies may not be conclusive, since they are based on several assumptions and a limited sample, they do suggest that managing based on Baldrige principles can make a firm more successful.

Third, the Baldrige criteria do not specify *how* a firm must meet the criteria but only that the firm should do them in some way that is appropriate to that firm's business situation. The criteria are descriptive rather than prescriptive, which gives the firms considerable latitude in developing approaches that are best suited to their particular skills and needs. This open-minded approach is important in a merger situation because it doesn't automatically presuppose that one approach is superior to another.

If firms do not want to use the Baldrige criteria for some reason, they could use other assessment tools (such as the European, Canadian, or Mexican quality award criteria or other customized templates) as long as the tools are complete and accepted by those being merged. Tools that just look at the traditional elements of culture (such as values and decision styles) but do not include the review of operations and their results would not be appropriate. Similarly, tools that look at operating processes but not the human side of running a business would not be appropriate. Also, tools that have not been proven or tested in advance may not be accepted and may diminish the effectiveness of the PACT Process.

This does not mean, however, that the Baldrige tool cannot be modified to meet the merging firms' particular situation. In the hospital merger, a new category – The Healing Connection – was added to the Baldrige categories. This was felt to be appropriate for healthcare groups because of the strong connection between having healthy caregivers and healing patients.

<u>2. Conduct Self-Discovery.</u> It saves time and money and increases manager buy-in to begin the Discovery Phase with a self-assessment done by knowledgeable managers. The hospital Discovery process did not do this, but the multinational process did and benefited from the experience.

For the multinationals, the senior managers of the two support functions assessed their own organizations using the Baldrige criteria. Each self-assessment began as one of the outside Baldrige experts trained the managers on the purpose and meaning of the Baldrige criteria. There was considerable discussion about how the PACT process would be used to guide the merger. Then, the managers spent about two days preparing the description of their business (including their key business factors) and assessing their strengths and opportunities for improvement for each of the seven Baldrige categories. This was captured on flip charts, typed up and sent to the Discovery Team to guide them in planning their Discovery interviews. From that point on, the multinationals' process looked similar to the hospitals' except that the multinationals' Discovery Team started the Discovery interviews with a great deal more knowledge about the organizations than the hospitals' Discovery Team.

Several people in the multinational situation said they wished they had received copies of their counterpart's Self-Discovery document as soon as it had been edited and approved by the managers. They thought this would have saved the time needed for the Discovery Team to conduct its assessment. However, since the Self-Discovery documents are not unbiased, may not be complete and have not been verified by the outside experts, this may cause some confusion or concern and is not recommended.

3<u>. Conduct Discovery by Discovery Team.</u> At the hospitals, the Discovery Team conducted all of the Discovery. They prepared the interview questions, conducted all the interviews and wrote up their findings. A total of 450 people were interviewed in 100 interviews over a two-month period. This included members of the Boards, all the senior managers and a large proportion of middle managers. Some interviews were conducted one-to-one, while others were group discussions much like focus groups. Both NSMC and AMC appointed senior people to the PACT Team (vice presidents with many years of experience at the institutions) to coordinate the interview and communications schedules. These senior people suggested the appropriate people or groups to be interviewed by the Discovery Team, and their offices arranged the detailed logistics of the interviews.

In addition to interviews with managers, the Discovery can include interviews with suppliers, customers and employees as a way of determining their needs, levels of satisfaction and views on the merger. This is especially important in order to obtain comparable information about each organization's strengths and opportunities for improvement. Although both hospitals had surveyed their patients in the past, the surveys were not comparable and it was not possible to determine whether one hospital was doing a better job of serving its patients than the other. However, this was learned too late in the Discovery process to conduct a patient survey across both organizations. Since it was clear from the beginning that the two hospital groups did not have comparable and recent employee surveys, a short culture survey was handed out to everyone who participated in the merger interviews. This helped identify the differing strengths and opportunities of each hospital as seen by their managers and employees.

Based on the hospitals' experience, the multinational Discovery Team decided to conduct focus groups with customers, employees and suppliers to determine their needs and levels of satisfaction. While the information from these groups was qualitative rather than quantitative, it did help identify different strengths and opportunities for improvement and provided some comparable insights. If time and budget had permitted, customer, employee and supplier surveys could also have been used.

<u>3. Identify Strengths and Opportunities for Improvement and Recommend Actions for New Organization to Address Them.</u> After the Discovery interviews were completed, the Discovery Team members wrote up their findings for each entity for each of the seven Baldrige categories and for the overall description. When their findings were merged, all the Discovery Team members received a copy to study.

Then, the Discovery Team met to make corrections, fill in gaps, and agree on their main conclusions and recommendations for the new organization. They looked for the underlying strengths and opportunities for each merging organization – identifying what had made them successful and what had held them back. The Discovery Team identified a series of recommendations for capitalizing on each group's existing strengths and finding new ways of doing things if neither group was particularly strong in an area. For instance, both hospitals had excellent means of studying patient satisfaction and responding to any complaints that might arise. However, since neither had systematically studied the needs and satisfaction of their physicians – a very important group for their success – the Discovery Team suggested that the new NSMC should quickly find ways to study and please physicians as well as patients.

<u>5. Prepare Reports.</u> The Discovery Team prepared several types of reports. They started with a complete written report that went into considerable detail on the description,

strengths and opportunities for improvement for each of the two merging organizations. Then they prepared a written summary report with recommendations for the new organization. These written reports were aimed at the Owner, the PACT Team and selected other senior people.

They also prepared oral/Power Point presentations to be used in all the meetings. Some of these presentations – aimed at the Owner, the PACT Team and senior people – were very detailed and were accompanied by the written reports as handouts. Other presentations – aimed at a broader and lower level audience – were shorter and focused on the highlights rather than the details of the Discovery results.

3. Communication and Action Phase

Communicating the results of the Discovery assessment is vital. The magnitude of the effort depends on the size of the merging organizations, but the goals are always to: (1) Allow each group to see the other's strengths in order to overcome fear and distrust as much as possible, (2) Quickly help the groups understand each other so they can to move forward with a minimum of misunderstanding and (3) Instill a sense of excitement for developing a new and even stronger new entity, allowing both groups to win.

In the case of the hospitals, the reports were cascaded from the top (the original Board members, the new combined Board members, and senior leaders of the original and the new organizations) downward through the organizations until every employee had the chance to attend a live presentation or to hear about it from a supervisor who had attended a session. Dozens of presentations were held. It was common to hear people say, "This report has captured my hospital so well that I have to believe what's being reported about the other group. And I now see that the other group is not so different in its care for the patients and in wanting to be successful."

After the presentations, the PACT Team began to work on the recommendations. This group, which was identified in the first phase and was made up of senior people from both NSMC and AMC, prioritized the Discovery Team's recommendations and mapped them out across time. The Board told the PACT Team that their mission was implement the best of the Discovery Team's recommendations and also to save a substantial amount of money within the first nine months of the merger. One of their first successes was in bringing together NSMC and AMC people from over a dozen duplicate departments (such as laboratories, maintenance, and libraries) to plan their ideal new structures and goals given the Discovery findings and the financial and structural goals set by the new Board. The day ended with cheers and songs and a level of enthusiasm unknown in a typical merger setting.

The senior managers of the multinational's PACT Team were responsible for acting on the Discovery findings for the new support function. They met for several days to hear the Discovery findings and to determine how to proceed. They spent nearly a day discussing the differences revealed by the two business overviews. For instance, they learned that there were important differences in accounting definitions and in contracts with key suppliers that they would have to address. After discussing the recommendations made by the Discovery Team, they mapped out a month by month merger plan for the coming year. For example, they began by writing a business overview description of the new support function that served as a quick version of a strategic plan for the coming year. This was recommended by the Discovery Team as a way to avoid the problems that might have been caused by the many subtle differences in daily working language.

Communications at the multinational did not end with the senior managers. In order to help all the employees understand their counterparts and what they could expect in the future, the new head of the group attended many meetings at the two firms before and after the final merger papers were signed, talking about what had been learned and plans for the future. In one case, a member of the Discovery Team spoke at an annual meeting of one of the multinationals about the similarities and differences, strengths and opportunities for improvement for them and their counterparts.

The PACT Process Wins Praise

The test of the PACT process is whether it improves the success of a merger enough to be worth the time and money involved in the effort. In the first year, the hospital merger saved fifty percent more than the cost reduction goals set by the Board before the PACT process. At the same time, employee turnover, which is usually high during a merger, was much lower than anticipated. And patient satisfaction, which usually takes a huge dip during hospital mergers, remained high with only a small dip during the first quarter of the merger. In fact, many aspects of service rose dramatically after the merger.

The head of the new multinational support function says, "Would I do this again or recommend it to others? Yes. There's no doubt in my mind that we are moving ahead faster and with fewer complications than would have been possible without the process. There are still thorny issues to resolve. I can't say that there aren't. But I believe there would have been more of them and they would have been tougher without the assessment." And, the PACT Team managers who participated in the PACT process all rated it "Excellent" or "Very Good" in a blind survey. Typical comments were that the process "brought out the facts about each organization in an objective fashion", "takes the most positive aspects of each company and blends them", was "comprehensive, focused, structured and interactive", and "was extremely enlightening with lots of good recommendations."

Challenges for the PACT Process

Although the PACT process worked well for the hospitals and multinationals, it faced some important challenges. First, there was the challenge of integrating the PACT Process's focus on the human and cultural issues with the structural and economic decisions that also had to be made. Ideally, the new management and structural decisions would have been made first so that the new leaders and PACT Team members would have been able to act promptly on the information and recommendations from the PACT Process. However, in both cases described here, the structural plans that were in place at the beginning of the PACT Process had changed by the time the Discovery results were ready. This meant that action on the PACT recommendations was delayed until the new structure and leaders could be identified. Since many mergers seem to experience these fluctuating structural decisions, a real challenge for the PACT process is to work within this uncertain environment. One solution might be for the merging companies to appoint decision-makers to the PACT Team who will retain their authority during the merger process regardless of how the structure is modified.

A second, related challenge was winning approval from all key parties for the PACT Process during the Preparation Phase. This was not too difficult for the hospitals, since the original

Board members and the members of the new, combined Board had been identified. They, along with Andy Riddell were clearly the Owners of the PACT Process, and their input and approval was sought for all important decisions. In the case of the multinationals, however, some key executives were not identified as Owners during the Preparation Phase. These were the SBU heads at the acquiring firm. Although the SBU heads yielded considerable power in the acquiring multinational before the merger, their influence after the merger was not fully understood. As a result, some of the key SBU heads were not included in the PACT process and were understandably reluctant to accept all the PACT recommendations.

A third challenge was the difficulty of finding comparable data across the merging organizations. Data are important to the Discovery process because they tell how well each organization is performing financially, operationally and with customers, employees and suppliers. It is very difficult to obtain comparable data even for relatively straightforward measures. For example, head counts varied at hospitals and the multinationals depending on how part time and contract workers were counted. Similarly, the organizations maintained very different financial data, even computing similar things using quite different methods. One suggestion for dealing with this challenge is to begin immediately pulling the data together and to have a data team made up of experts within the merging groups assist the Discovery Team in defining and comparing the results data.

Important Elements of the PACT Process

The success of the PACT process is due to several important elements that anyone adopting the PACT process is advised to maintain.

First, it is vital to have a senior person own or champion the process and be committed to acting on the PACT process results. At the hospitals, it was Andrew Riddell and the new Board. At the multinational, it was the new head of the support function. Both were active supporters and users throughout all three phases and continued to champion the plans that were developed as a result of the process.

Second, it helps if at least one party to the merger is familiar with the Discovery criteria and understands how effective they can be in making businesses more successful. AMC and one of the multinationals had had years of experience with the Baldrige criteria and communicated their enthusiasm for it to their counterparts. If other criteria are substituted for Baldrige, it would help if at least one of the parties had experience with the criteria and could explain their value to the other party.

Third, the objectivity and comprehensiveness of the Discovery criteria are vital. The Baldrige criteria used by the hospitals and multinationals were complete and non-prescriptive. They identified all the key tasks and results in running a successful business but they did not prescribe exactly how a business needed to perform those tasks to obtain good results. Discovery criteria that did not cover all aspects of running a business – from leadership to customer focus to human resource focus to process management, to the financial and operational results that are obtained – would have missed important aspects during Discovery.

Fourth, it is important to use impartial, objective experts to conduct the Discovery Phase.[xvii] For the multinationals, the concern than the acquiring group felt at having an acquired group person conduct Discovery was a warning flag. Even though this person knew the Baldrige criteria very well and did not have anything to gain or lose personally based on the results of the PACT process, her company affiliation troubled some people at the acquiring firm. At the hospitals, acceptance of the PACT process was increased because everyone knew the Discovery Team members were impartial outside experts, and there was no hint of bias because they focused on the facts.

Fifth, the PACT process works best when it is done quickly and early in the merger. At the hospitals, the PACT process took about five months (including two months for Preparation) and was completed three months after the merger was finally signed. For the multinationals, the PACT process took about two months and was completed three weeks before the final merger papers were signed. In both cases, the speed and early timing of the process helped prevent misunderstandings and conflicts that might have occurred if the results were available to aid planning only after other integration activities had occurred.[xviii]

Sixth, the focus on creating a win-win situation instead of a win-lose situation is vital. It is at the core of the PACT process. It builds enthusiasm and goodwill among even those who have to do the most changing. Although mergers are inevitably difficult to live through, this PACT Process can minimize the pain and maximize the gain.

Considerations in Deciding Whether to Use the PACT Process

The PACT Process might not be appropriate for pure acquisitions, where the people and operations of the two companies are not integrated or where the acquiring company intends to impose its culture on the acquired firm. The PACT process focuses on creating a new organization that is stronger than either firm before the merger, so there is no point in using it if the acquiring firm does not intend to change. However, it might be worthwhile to prepare the business description (one of the Discovery Phase deliverables) even for acquisitions and to use this to educate the two organizations about each other since this will speed up the learning process.

The PACT process might not be appropriate when the structural and financial decisions are still being hotly debated. Since the success of the PACT process depends on identifying the Owners of the process and the PACT Team that will be responsible for acting on the PACT process, if these people cannot be identified it is premature to start the PACT process.

The PACT process is not perfect. The hospital and multinational mergers still faced many challenges. The process does not remove all uncertainty or hard feelings. Not all its recommendations will be implemented. And changes in leadership can hurt the effectiveness of the process. However, for firms that want to create a win-win merger and feel they can put together all the necessary elements, the PACT process can make mergers more successful.

Exhibit 1

Key Steps in the PACT Process

1. **Preparation Phase**

   Step 1. Hold Planning Meetings
   Step 2. Identify Key People (Owners, PACT Team, Discovery Team)
   Step 3. Build Enthusiasm

2. **Discovery Phase**

   Step 1. Determine Discovery Criteria
   Step 2. Conduct Self-Discovery (If Possible)
   Step 3. Conduct Discovery (Business Descriptions plus Lists of Strengths and Opportunities for Improvement)
   Step 4. Identify Strengths of Merged Organization and Recommend Actions to Address Opportunities for Improvement
   Step 5. Prepare Reports (Written and Oral)

3. **Communication and Action Phase**

   Step 1. Present Report to PACT Team and Make Improvements
   Step 2. Cascade Presentations and Communications to All
   Step 3. Plan Integration for 3, 6, 9 and 12 Months
   Step 4. Integrate

Exhibit 2

A Brief Overview of the Baldrige Criteria for Performance Excellence

Category	Aspects Included
1 – Leadership	How senior leaders set direction (mission, vision, values, and customer commitment) for the organization and communicate that direction to everyone so that all are working toward the same goals. How the organization develops itself as a strong corporate citizen.
2 – Strategic Planning	How the organization plans for its future in light of all relevant input from customers, employees, suppliers, the market, etc. How it projects its plans out into the future,
3 – Customer and Market Focus	How the organization develops strong relationships with its current and potential customers, based on understanding their needs. How it determines how it is performing compared to the competition in the eyes of the market.
4 – Information and Analysis	How the organization uses data to communicate its progress toward its goals and to determine what remedial actions need to be taken. How the organization uses its data to understand the key forces driving its success.
5 – Human Resource Focus	How the organization develops its employees (including reward and recognition, performance reviews and training) and encourages them to do their best and cooperate. How the organization meets its employees' needs.
6 – Process Management	How the organization designs and monitors the processes it uses to produce superior good or services. How the organization's support services perform for the good of the organization. How suppliers are integrated into the organization's efforts to produce superior good or services.
7 – Results	What results the approaches and their uses in the first six categories have produced. This includes market and customer results, financial and profit results, human resource and supplier results, and daily operations or process results. All results should be high, trending positively, and superior to relevant others' results.

Malcolm Baldrige National Quality Award Criteria for Performance Excellence, 1999.

[i] "How to Make Mergers Work," *The Economist*, January 9, 1999, p. 15.

[ii] Ibid.

[iii] Laura M. Holson, "The Deal Still Rules – Mania for Mergers Defines the Market," *The New York Times*, February 14, 1999, pp. 3-1 and 10.

[iv] For an excellent review of the merger failure literature, see Alexandra Reed Lajoux, *The Art of M&A Integration* (New York: McGraw-Hill, 1998), pp. 16 and 17.

[v] Price Pritchett with Donald Robinson and Russell Clarkson, *After the Merger – The Authoritative Guide for Integration Success* (New York: McGraw-Hill, 1997), pp. 118-119; and

Sue Cartwright and Cary L. Cooper, Managing Mergers, Acquisitions and Strategic Alliances: Integrating People and Cultures (Oxford: Butterworth-Heinemann, 1996), pp. 45-48.

[vi] This paper focuses on merger integration (where the acquirer and acquiree integrate their cultures, people, processes and financial results) rather than arm's length acquisitions (where the acquirer and acquiree remain mostly independent). The success rates of the pure acquisitions appear to be higher than that of the merger integrations, although the payoffs may not be higher.

[vii] Mark L. Sirower, The Synergy Trap (New York: The Free Press, 1997) pp. 90-91.

[viii] Philippe C. Haspeslagh and David B. Jemison, *Managing Acquisitions – Creating Value through Corporate Renewal* (New York: The Free Press, 1991), pp. 41 and 42.

[ix] Ibid., pp. 129-132.

[x] See Lajoux (pp. 15-24) for an excellent synopsis of the reasons for merger failures. The most commonly stated reasons for merger failures appear to be lack of a compelling strategy, overly optimistic expectations of synergy and conflicting corporate cultures.

"Incompatible Cultures Cause Merger Failures," *Global Workforce Supplement to Workforce*, Vol. 3, no. 6, November, 1998, p. 9 reports a study of 200 firms showing that people issues (the role of the leaders and knowledge transfer) were responsible for merger failures.

"HR Issues Neglected in Merger/Acquisition Planning," *Employee Benefit Plan Review*, Vol. 52, no. 5, p. 33 reports a Conference Board report showing that neglecting the people side of mergers becomes increasingly important once the deal is signed and integration begins.

[xi] Culture is often defined as the shared attitudes, beliefs, assumptions and expectations that lie behind actions. See Cartwright and Cooper, pp. 57-92 for a discussion of cultures and the interactions of different types of cultures. However, in this paper we are focused on more than just culture. We define the "human and operational" side of the business to include everything from leadership and strategy, to interactions with employees, customers and suppliers, to how key processes are defined and carried out, to the results that the organizations obtain.

[xii] Cartwright and Cooper, pp. 38-42.

[xiii] The Malcolm Baldrige National Quality Award for Performance Excellence was established in 1988 to provide a means for increasing the competitiveness of American businesses by improving the way they were managed. It is given annually to the US businesses showing the greatest evidence of performance excellence along seven key dimensions or categories. Winners share their experience and practical knowledge with other businesses at public conferences and seminars. Applicants who don't win benefit from the insightful and helpful assessments they receive. A free copy of the *Baldrige National Quality Award Criteria for Performance Excellence* is available from the National Institute of Standards and Technology (Department of Commerce) at 301-975-2036 or nqp@nist.gov.

[xiv] This description of both parties is unique in the merger literature. Most do not recommend it at all.

Cartwright and Cooper recommend learning about the acquired company through acquiree executive visits and focus groups with acquired company personnel. And

Edgar Schein, *Organizational Culture and Leadership: A Dynamic View* (San Francisco: Jossey-Bass, 1985) recommends trading insider-outsider visits to learn about cultures, but does not recommend full business descriptions.

Mitchell Lee Marks and Philip H. Mirvis, *Joining Forces* (San Francisco: Jossey-Bass, 1998), pp. 196-200 recommend a cultural clarification activity where teams from each firm describe their own cultures and their view of each other's cultures but do not recommend full business descriptions.

Haspeslagh and Jemison, pp. 320-325 recommend that the acquiring company prepare a complete description, similar to the PACT description, of the acquired company before the merger occurs but do not suggest describing the acquiring company or repeating the description after the merger agreement when more complete information is available.

[xv] Kevin B. Hendricks and Vinod R. Singhal, "The Long-Run Stock Price Performance of Firms with Effective TQM Programs as Proxied by Quality Award Winners," (Williamsburg, VA: The College of William and Mary and Atlanta, GA: Georgia Institute of Technology working paper, 1997). This has been widely publicized and quoted in many journals. See, for instance, US Department of Commerce News press release (NIST 99) of February 4, 1999 which summarizes the results.

[xvi] Ibid.

[xvii] Lajoux (p 50) discusses the importance of having outside advisors for their "experience, expertise and objectivity" to assist with merger integration.

[xviii] Studies show that the faster the pace of the merger integration, the greater the earnings and profitability. See the Coopers & Lybrand study reported in "Most Acquisitions Fail C&L Study Says," *Mergers & Acquisitions Report 7*, No. 47, November 19, 1996, pp. 2ff.