After the deal

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Doing deals is easy. Mergers hit a record in 1998; this year may be even busier. Now comes hard part

After the deal

AT ONE point in the discussions between Travelers and Citicorp that led to the formation of the world's biggest financial-services group last year, a director asked the question: "Can anybody stop us?" After a short silence, someone suggested " NATO ". Such hubris is well-suited to today's merger mania. In 1998, according to Securities Data Company, there were mergers worth $2.4 trillion worldwide, a 50% increase on 1997, itself a record year. The list included several jaw-dropping deals, notably the $80 billion merger announced in December of Exxon and Mobil.

This year the deal-making is expected once again to be frantic—the exuberance of the stockmarket will help determine just how frantic. M&A people are already talking about who will do the first $100 billion merger. Old favourites, such as the drug and banking industries, have more big deals left in them. Britain's Glaxo Wellcome is rumoured to be preparing a bid for its compatriot, Zeneca, which itself is pledged to Astra of Sweden. Slower starters, such as high-tech and cars, look like catching up: it surfaced on January 5th that Britain's Vodafone is bidding for AirTouch, an American mobile telephone operator, which was already targeted by Bell Atlantic (see). This week's motor show in Detroit was abuzz with rumours of impending deals involving firms such as Ford, Fiat, Nissan, Honda, Volvo and BMW .

The merger wave, which last year was a predominantly American affair, is now expected to sweep over Europe—though Asia has been surprisingly quiet. Not only do Europeans have a new single currency, but, as in America, their telecoms and utilities are liberalising and their defence contractors are under orders to rationalise. Cross-border deals, such as Daimler-Benz's takeover of Chrysler, accounted for a quarter of 1998's mergers; more are expected as firms go global.

In many cases this consolidation makes sense—at least on paper (Exxon-Mobil hopes to make savings of several billion dollars a year). But just as certain as the flow of deals is that most will be failures. Study after study of past merger waves has shown that two of every three deals have not worked; the only winners are the shareholders of the acquired firm, who sell their company for more than it is really worth.

In the past, buyers have justified deals by citing questionable synergies (remember the hardware-software argument that lured Sony and Matsushita into Hollywood). But in the heat of a takeover battle, ego often played a greater role than even such dubious logic (read "Barbarians at the Gate"). One delicious study has noted that the undeserved premium paid is linked to the number of magazine covers the acquiring boss has graced before the deal.

Although stockmarkets seem overheated, price may prove less of an issue this time round. One reason is that there have been fewer takeover battles. In the 1980s a quarter of all deals in America were hostile; this time almost all have been agreed. Another difference is that, where cash was once king, equity rules today. In deals such as America Online's takeover of

Netscape, investors are simply swapping one piece of overvalued paper for another—and who can say which company is the more overvalued? If many investors own shares in both parties, as is likely in such huge mergers as that between Exxon and Mobil, the "price" paid matters still less.

Instead, success will depend more than ever on the merged companies' ability to create added value. And that will depend mainly on what happens after the deal has been done. Yet many deal makers have neglected this side of the business. Once the merger is done, they simply assume that computer programmers, sales managers and engineers will cut costs and boost revenues according to plan, leaving the boss free to bag the next big deal.

Yet, just when post-merger integration has become decisive, it has become harder to pull off. Not only are modern firms complicated global affairs, but executives are putting today's deals together in a hurry. Few give enough thought to the pitfalls.

One set of obstacles is "hard" things, such as linking distribution systems or settling legal disputes. In particular, many recent mergers have been undone by the presumption that **information technology** is easy to mesh together.

The marriage between Union Pacific and Southern Pacific in 1996 was supposed to deliver a seamless rail service and $800m in annual savings by using UP 's top-notch computer system to drag the ramshackle SP up to standard. But soon traffic snarled up around SP 's Englewood yard, near Houston. At one point in 1997, 10,000 wagons were stalled in Texas and California. With operating profits falling, the firm halved its dividend last year. Its share price is a third below 1997's peak of $72.

Similarly, Aetna, an insurer, bought US Healthcare, a health-maintenance organisation, partly for its computer systems, which could sift out the best doctors. But the two firms had terrible problems combining their back offices. And when Wells Fargo bought First Interstate in 1996, thousands of the banks' customers left because of missing records, queues and administrative snarl-ups.

Then there is **antitrust.** In times past, people would pay more attention to legal issues, sounding out regulators in advance. These days firms jump into bed within weeks of meeting, and regulatory concerns come later. The Pentagon's objections shocked Lockheed Martin and Northrop Grumman, and scuppered their planned merger; MCI and WorldCom, two American telephone companies, were also surprised by objections to their $37 billion marriage from European regulators. The trust-busters may yet nobble Exxon and Mobil; last week BP and Amoco had to shed 134 petrol stations in return for approval.

A soft trap

Most difficult are the "soft" issues. Another reason Wells Fargo and Union Pacific ran into problems was that they sacked too many of the wrong people. Sony's and Matsushita's hardware-software dreams may have been mad from the start; but the Japanese also had in common with the Hollywood smoothies they hired. Look behind any disastrous deal— 's acquisition of NCR (bought for $7 billion in 1991; spun off in 1995 for $3 billion); or Oats's takeover of Snapple (bought for $1.7 billion in 1994; sold for $300m in 1997)—and same word keeps popping up: **culture** .

People never fit together as easily as flow charts. Nobody can fault the strategy behind the merger between AOL and Netscape and their joint venture with Sun Microsystems to push electronic commerce. The deal links the biggest Internet service provider, a leading creator of software and the firm that invented the Java computer language, which can run on any Yet the plan may go awry all the same. Netscape is staffed by idealistic hackers, but AOL is a mass-market firm devoted to making on-line services unthreatening. Sun has had many with Netscape over Java. This unlikely trio will be up against the powerful, coherent cultures of IBM and Microsoft.

Culture permeates a company, and differences can poison any collaboration. After one large American merger, the two firms had a row over the annual picnic: employees of one were accustomed to inviting spouses, the others were dead set against the idea. The issue was resolved by allowing spouses only in alternate years.

Often rivalries go right to the top. The hastily announced drug merger between Glaxo and SmithKline Beecham collapsed when neither boss was prepared to pay second fiddle. vogue for appointing co-chief executives, a common feature of today's friendly deals, looks a case of avoiding hard decisions. At the new Citigroup, employees spend much time trying work out whether Sandy Weill of Travelers or John Reed of Citicorp is top dog. The firm's troubles recently led to the loss of a high-flying manager, Jamie Dimon. Each side to think it is better: asked about the group's integration in South-East Asia, one Citibanker quipped that Travelers "doesn't even know how to spell emerging markets".

Two new things have made culture clashes harder to manage in mergers. The first is the growing importance of **intangible assets** . In advertising, for instance, most of the value can walk out of the door. But in an age where almost anything can be outsourced, even humdrum companies rely on webs of relationships with suppliers and customers that become during takeovers. John Harbison, a consultant with Booz Allen & Hamilton in San Francisco, identifies Quaker's uncertainty over Snapple's distribution network as one reason why the takeover failed. He advises clients that competitors' mergers offer a great opportunity to distributors and customers.

The second new thing is the number of **cross-border** mergers. The link between Sweden's Pharmacia and America's Upjohn in 1995 was supposed to be driven by cost-cutting and matching drug portfolios. But time was wasted on rows about "American" practices, such as banning alcohol at lunch. Even worse, Pharmacia had not integrated an earlier Italian acquisition. The new company started with power bases in Stockholm, Milan and Michigan. After a botched attempt to make everybody report to a new office near London, the firm to New Jersey and appointed a new boss, Fred Hassan.

DaimlerChrysler may prove a case study in differing management cultures. One worry is compensation. Chrysler's boss, Robert Eaton, who took home at least $70m in the takeover is used to earning some $6m a year, has to report to the more modestly rewarded Jurgen Schrempp. An American manager posted to Stuttgart, say, may end up reporting to a German manager who is earning half his salary. Mr Schrempp talks about overcoming this with a low basic salary and a high performance-based bonus. But if Chrysler cuts pay, its managers may depart. And egalitarian Germans dislike huge pay disparities. Jurgen Hubbert, the firm's passenger-car development director, shudders to think of his reputation in his small home if it was reported that his pay had tripled.

Nor is pay the only difference. Chrysler likes to pride itself on its buccaneering approach, speed and ingenuity are prized. It builds cars around common platforms, with teams of engineers, designers and marketing people working on each model. Daimler-Benz has a more traditional "chimney" structure, in which designers and marketing people mix less—and engineers are in charge. One reason why Mr Schrempp bought Chrysler was precisely to pick its lean ways; but it will need to be done subtly—and, ominously, Dennis Pawley, Chrysler's respected head of manufacturing, has already said he is leaving the new company.

Culture clashes could also undo another German-American merger, the takeover of Bankers Trust by Deutsche Bank. It would be hard to find two financial-services firms with more different approaches: buzzy deal makers and traders at Bankers, stodgy commercial bankers Deutsche. The German bank has a sorry record of trying to succeed in the racier field of investment banking; its prospects with Bankers look little better.

Thinking it through

There is a dire shortage of managers able to make a go of mergers on the huge scale of many recent ones. For every Jack Welch (of General Electric) and Percy Barnevik (formerly of Asea Brown Boveri) who have bullied companies together, many more have foundered. deals, such as Disney's takeover of Capital Cities/ ABC or Grand Metropolitan's marriage to Guinness, have simply been disappointments. But some takeover artists have crashed spectacularly—most recently Cendant, a services conglomerate.

Some recent deals will no doubt prove a stunning success. Nevertheless, there are three signs about the current merger boom. First, much of the attention seems to be on the deal, than the integration, especially in the United States. In a 1996 survey by Booz Allen & Hamilton, European and Asian managers awarded their American merger partners high for pre-bid skills, such as negotiating; the area where they did worst was in planning and executing the integration of the firms. Cendant ended up with two bosses and two different accounting centres: neither side really knew what the other was doing.

Second, many deals are rushed. Cendant clocked up 12 big deals in four years, increasing its share price by 2,000%. This week AT&T added to investors' fears that its $37 billion takeover Tele-Communications Inc (TCI), America's biggest cable-television firm, had been much speedy by suddenly changing the blueprint for how the firms would be joined together. Recognising the differences between the cable and telecoms industries, the firm will no list its long-distance business with TCI 's cable business and its own mobile subsidiary, as planned.

Many bosses argue that rapid negotiations are necessary. Given the inevitable conflicts rival managers, they say, the sooner the ink is dry the better. There are also often genuine mover" advantages. On the other hand, integrating two firms successfully requires advance planning: unless decisions are taken swiftly, resentment builds.

Third, mergers have too often become a strategy in their own right. For instance, most bank deals have been done in the name of cost-cutting. Yet when Anthony Santomero, of the Wharton School, examined the cost-cutting performance of banks in America, he found that merged banks had generally cut costs more slowly than their non-deal making peers. His explanation is that the mergers probably distracted managers' attention from the real business cost-cutting. This can have terrible consequences. Boeing had a ghastly 1998, reporting its loss in 50 years and writing off $4 billion, partly because it was distracted by implementing merger with McDonnell Douglas.

So the things that are so impressive about today's mergers—their size, complexity and downright daring—could count against them if the economy turns down. In one way the Citigroup wag was right: the new colossi look as powerful as NATO. But equally powerful people may be needed to clear up the mess when things go wrong.

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