

Critical success factors for company mergers

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Critical success factors for company mergers

Company mergers have been in the news recently, even in the tourism sector. In theory, a merger can be explained quite simply: two companies merge together, thereby strengthening their market position, reducing their costs and making use of synergy effects. Things often seem very different in practice, however: mergers are reversed and loss of market share is also not uncommon – even here in Switzerland.

1. Merger is not always the same as merger

More than 240 mergers took place in Switzerland in 2002, 20 % fewer than in the previous year. Nevertheless, the merger wave continues to run at a high level.

A differentiation can be made between 5 different types of merger:

- **Annexation of control:** Control over another company is gained by the takeover of a majority shareholding, without intervening in the company management, however.
- **Annexation:** The company being taken over is closely affiliated to the company carrying out the takeover, and is directly integrated into the line structure. It can still operate externally under its old name, or can also be renamed.
Example: Zermatt Bergbahnen AG, which, on the basis of tax considerations, chose the annexation path with simultaneous renaming of the Matterhornbahnen AG.
- **Absorption:** An existing company integrates another company into itself, related business areas are combined and the company name disappears.
- **Combination:** Two (or more) merging companies are brought together under a holding company, but continue to exist as operating companies under their previous names.
- **Merger:** A new, third company is formed from two companies, and the old names disappear. This classic form of merger takes place relatively frequently among major companies.

2. The benefits of company mergers

During times of zero growth or slow growth, companies can only grow domestically at the cost of their competitors, or must turn to export markets. For both strategies, it often seems to be easier to buy a third-party company than to carry out your own expansion work. In this way, company mergers are understood as measures for achieving market growth. A key position is thereby taken up by the often mentioned, but not always realised synergy effects.

Market-related synergies

A market-related synergy can exist for the purchaser from the fact that he can increase his market share with existing products in a market that is already being worked, for example, by buying out a competitor. In addition, access to new markets is also possible, as well as a diversification, such as the sale of new products in new markets.

Cost-oriented synergies

The merger of two companies helps to reduce parallel working and to thereby reduce costs, whether in the provision of services, the working of the market or in the area of administration and management.

Technology-related synergies

Production and logistic capacity that you would otherwise have to set up yourself can be acquired through purchase. Access to patents and licences in connection with this is also not uninteresting. Last but not least, there could be the possibility of interlinking production, whether through vertical integration (the acquisition of upstream or downstream stages of production) or through horizontal integration, in which the product lines supplement each other (e.g. as a modular system).

Know-how synergies

The process of building up and using completely new technical and economic know-how is particularly difficult and protracted. In many cases, companies that have high-tech deficits often tend towards reducing this deficit through purchase. In addition to the associated transfer of technological know-how, the utilization of management know-how and, not the least, market and country know-how, is also an important component of the know-how synergies.

3. The costs of company mergers

The fact that not a few mergers are accompanied by difficulties, or even fail, indicates that the synergy effects are in no way set up "by themselves". They must rather be actively influenced and designed, a process that, in most cases, can only really begin once the formal act of the acquisition is finished. If this is disregarded, it will quickly become clear that the "magic formula" of the synergy (" $2 + 2 = 5$ ") was simply a premature "optimistic over-estimate".

Coordination and integration costs

Reorganisation costs will arise from the coordination and merger of areas of responsibility. In addition, there will also be the costs for personnel measures, such as transfers, discharges, compensation. The technical integration in the area of production (e.g. materials, systems), but also the information and communication (e.g. compatibility), can also throw up significant problems. Last but not least, the costs for the coordination of the ongoing company policy, and the activities and committees that will be required for this, must also be taken into account.

Compromise costs

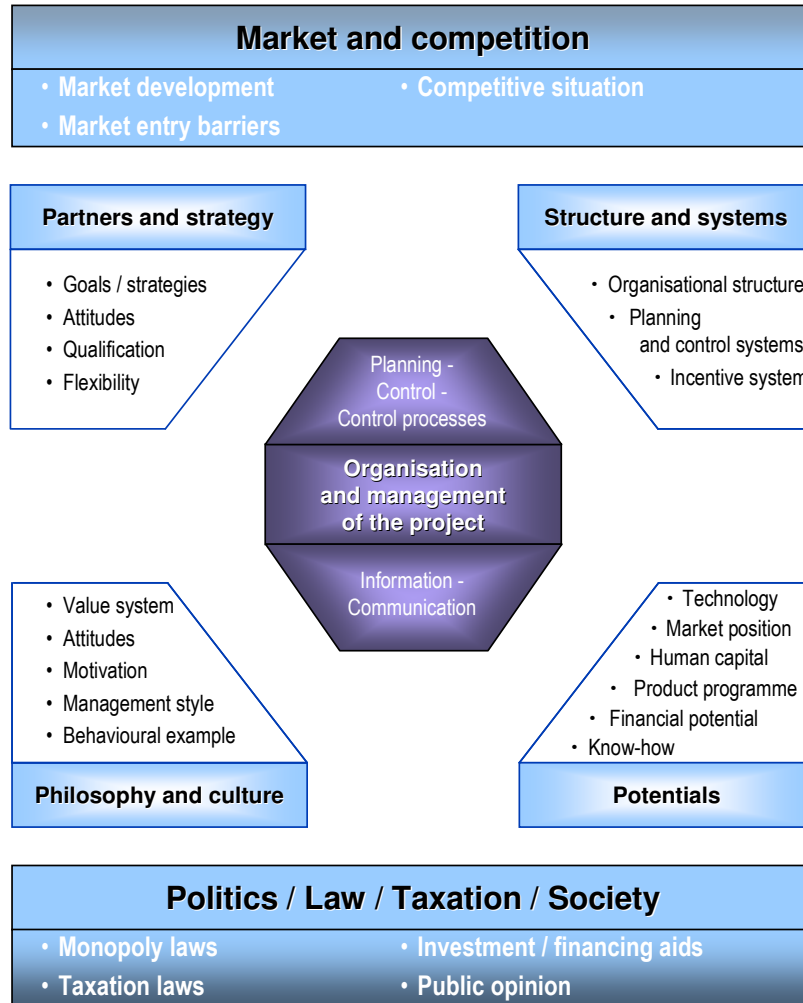
The mutual adaptation of the purchased and the purchaser requires the determination of a compromise line on the basis of different products and/or markets. A common, uniform control and management will also only be achieved by harmonization and balancing, for example, of planning concepts and incentive systems. In the new common interest that is to be defined, a common denominator must also be found for variables in the organisational culture, for values, identity and behavioural patterns.

Inflexibility costs

Depending on the volume of the merger, the resulting company structure will be considerably larger and more complex than that of the previous two companies. The organisational flexibility thereby tends to decrease as a result. This will also make common and quickly implemented reactions to competition more difficult. Last but not least, the market exit barriers will also increase with increasing size. The fixed costs of an exit (shutdown of systems, social plans etc.) will strongly increase.

4. Success factors for successful mergers

In order to be able to influence the costs and benefits of mergers, it is necessary to know their causes. Only the recognition and influencing of these success factors will ensure the success of the merger, making the influencing variables into a factor for success. The following illustration shows the most important factors in this connection.



General factors influencing company mergers

Success initially depends on external framework conditions. These include market related factors (“Market and Competition”), but also the general conditions of the business environment (“Politics/Law/Taxation/Society”)

In the core area of a merger success, the influencing factors can be bundled together to form five successful segments: “Partner and Strategy”, “Structure and Systems”, “Philosophy and Culture” and “Potentials”. These segments are to be examined and designed in an integrative manner by the purchaser and the purchased. A professional project management is required for this, as shown in the “Organisation und Management of the Project” segment. This is of central importance in exploiting synergy effects and in the limitation of the merger costs.

5. Selected problems and recommendations

Company structures and management systems

Differences in the vertical and horizontal organization make the integration more difficult. The same applies for different kinds of incentive, planning and control systems. The unification attempt can change into the opposite if the “Group directives” of the purchaser result in a bureaucratisation of the acquired company.

The organisational integration must be thought through in detail. In doing this, a balance must be found between strict allocation and excessive “dismantling”, which is not easy.

The reporting and information system must be arranged as needed. In general terms, it is not possible to do too much in order to leave or create free room for internal enterprise. This applies in particular when a large company integrates a smaller operation.

A further measure that should be taken as quickly as possible after mergers is a rapid mutual rotation of the management personnel. It is not unusual – and in fact it occurs regularly – that the merging companies used to be competitors. Mutual respect, understanding and trust are most likely to be created within an acceptable period by means of a rotation.

Difficult assessment of the potentials

The question regarding the potentials that the target company possesses should really be quite obvious. It must relate to the market potential and the financial potential, as well as to the technology and the “human capital“. The fact that these questions are often not asked, or are answered incorrectly, is shown by the examples of failure in recent times.

The most important recommendation can only be that possible synergy effects must be sceptically examined in great detail. In doing this, attention should be paid above all to integration problems and barriers, and defined measures must be developed for coordination and integration.

The key factor of company culture

The differences in the values, attitudes and styles of cooperation of the involved companies will be greater depending on how strongly the industries and the regions of the two companies differ. This can lead to a “culture shock” on both sides. One thinks of the differences between “high-tech” and “low-tech” industries, or between large and small companies.

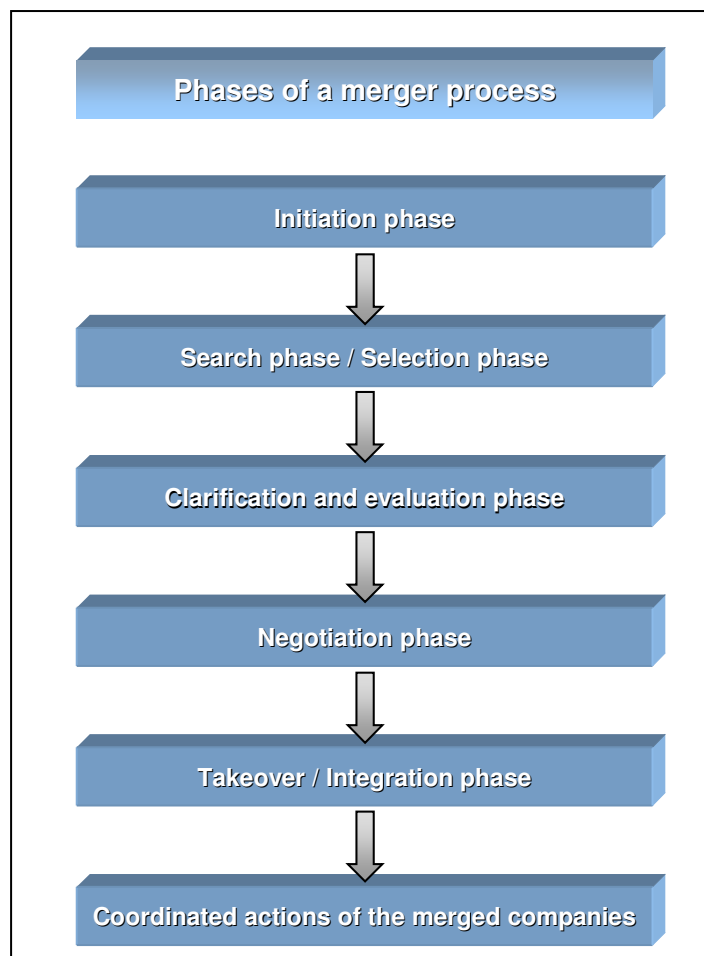
The compatibility of the cultures and values must therefore be examined at an early stage. The strengths of the acquired company are not infrequently based on their specific organisational cultures, so that a certain amount of “cultural independence” is appropriate.

The success factor of project management

Many merger decisions tend to be made at a superficial level, and are insufficiently researched, with the prospects for success being overestimated. The lack of market and technology know-how can result in one being guided too much by one's own wishful thinking. The importance of the purchase costs is over-estimated, while the subsequent costs are underestimated. The information policy with regard to the employees of the acquired company could also be handled better.

The purchaser must treat an acquisition as a project, and set up the corresponding project management. The procedure starts with the initiation, continues in an integration phase after the purchase, and only ends after the conclusion of the coordinated actions of both sides (see illustration below). Clear goals and assessment criteria must be drawn up, on the basis of which the merger candidates are to be assessed. The tasks of this project management also include the proposal of coordination and integration measures, as well as providing early and balanced information about the consequences of the merger for the affected persons.

Wherever possible, the project management should ensure that quick, initial (if also small!) and visible successes are achieved by means of a special "Programme of the first 100 days". These successes should indicate that things are already moving in the right direction and/or that the direction is correct.



Phases of a merger process

„Merger of equals“ – more often than not a lazy compromise?

If two companies want to merge, but both lay claims to the operational management, a “merger of equals” is often agreed in order to avoid having to admit the failure of the merger negotiations. The apparent equals have very different strength-weakness profiles, however, which, at most in their total, are regarded as „equivalent“. – possibly through compensation payments from one or the other side. The conclusion: Very few joint companies with the relationship 50:50 survive over the long term.

Taxes as a possible brake pad

Fiscal questions play an important role in mergers. They often actually prevent a merged company being structured and organised in the manner that would be most practical from an economic viewpoint. The major barriers (a selection) are: the fiscal handling of “hidden reserves”, changes of ownership, issuing charges, taxation on moving away, participation deductions etc.

6. Presentation of a successful example: Zermatt Bergbahnen AG

The merger of the four Zermatt mountain railway companies (Matterhornbahnen AG, Rothornbahnen AG, Suneggabahn AG and Snow Sport division of the Gornergratbahnen AG) to form the new „Zermatt Bergbahnen AG“ is an impressive example of a merger in the tourism sector in recent years.

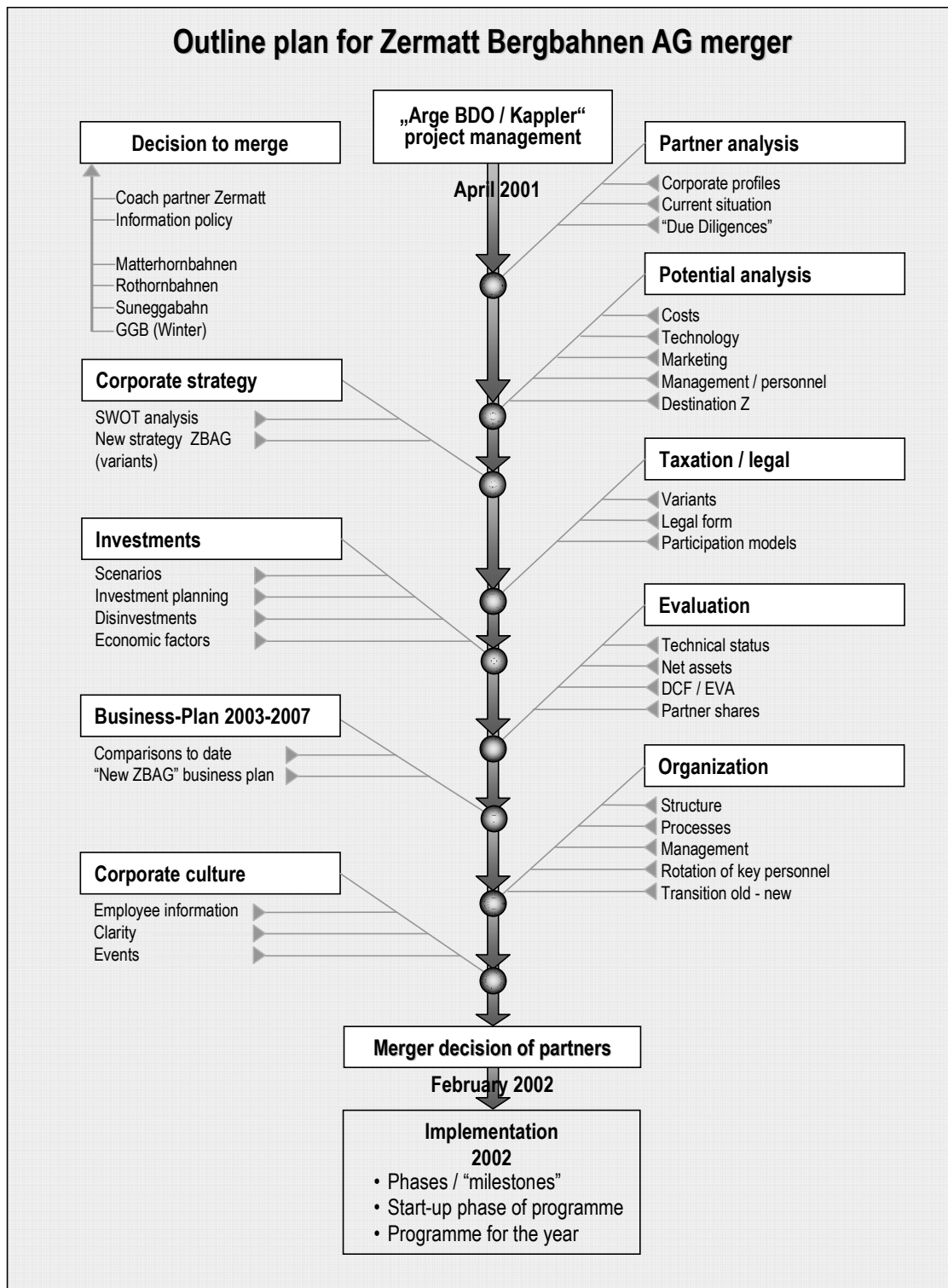
The starting point for a merger was very favourable at the end of the year 2000:

- Political calm in Zermatt after the elections in December 2000.
- A fundamental interest of the four railway operators to jointly look for new solutions.
- Special situations in the individual companies:
 - Restructuring process in Matterhornbahnen AG
 - Considerations of a new strategy at the Gornergratbahnen AG
 - Clarification of area developments at the Rothornbahnen AG
 - New discussions regarding the „distribution key“ for railway income
 - Debt reduction of the „Municipal Community“
 - Reorganisation of the „Civic Community“

In a relatively short time, the leading exponents of the individual railways made the forward-looking decision to implement of a cooperation project. In doing this, however, they initially left the definitive form of the merger open. A corresponding project organisation was defined and implemented, and an external project management was installed for the order processing. The client laid down a binding schedule (with “milestones”), so that the merger process could be concluded as early as February 2002 (after 10 months of project work).

The following rough plan very clearly shows the importance of the various influencing factors on the procedure followed. The rough plan also demonstrates the influence of a thorough and systematic procedure by the established project management.

A further preliminary remark should be made here: the individual merger phases did not mainly run in a linear manner, or in other words sequentially, but contiguously, like a network. It is therefore necessary that merger processes should be managed by specialists in a coordinated, structured and revitalised manner, and, above all, with psychological skill in order to successfully achieve the agreed goals. In addition, it must not be forgotten that the partners involved in the merger process will also have to continue to carry out their daily business (their main business!).



Within the scope of the merger process, the project control and the project manager paid special attention to the individual company cultures of the former companies. From the very start, it was clear to all involved that the subsequent success or failure of the merger would be largely determined by the people involved in the merger. The following rules for dealing with employees were used as a guideline for the project management during the Zermatt merger process.

7 Rules for dealing with employees during mergers

- **Honesty:** Do not make any promises (workplace guarantees, etc.) that cannot be kept at a later date. Broken promises, incorrect information, excuses and meaningless phrases undermine confidence in the new owner. Honesty and clear, and even tough, statements will be accepted, and create trust.
- **Information:** The management quickly needs clear information about the new direction being followed. Will there be a new management crew? Which is the new management crew? What is the new company philosophy? What measures are planned? The senior management must also provide the employees with a clear vision of the future.
- **Competence:** The behaviour of the new owner must give rise to credibility and respect. Resistance and reservations can be reduced as early as the very first meeting and in the first actions through professional competence and attention to detail.
- **Benefits:** It must be demonstrated to the employees that the merger or takeover will bring benefits to all areas and all levels. Synergy effects in the cost area, new marketing initiatives or better management systems benefit everyone. The loyalty of the employees will increase considerably when departments that were previously neglected are equipped with the necessary tools.
- **Decision-making competence:** The areas in which the takeover or merger will change something must be quickly clarified. Wherever something has to be changed, a responsible person must always be introduced who can communicate this in good time.
- **Rules of the game:** The employees must know where they stand. Reporting paths and responsibilities must be clearly regulated, and career plans outlined.
- **Remuneration:** Improved payroll systems, performance-related pay, new incentives and benefits will increase the motivation of the employees.

Working together with the BDO Visura (Solothurn) on behalf of the Zermatt Bergbahnen, the author realised the merger of the former Zermatt competitors to form the new „Zermatt Bergbahnen AG“ (2002).

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