Fight M&A Failure with the Three Building Blocks of Change Management

Paper Summary

As the importance of M&A in strategic company growth plans increases, realizing value and returns across deals becomes ever more key Yet, the profound deal failure rates often cited suggest that extracting value is 'easier said than done.' Companies that build value over the long-term from their deal making have built a differentiating core competency: effective change management. These companies recognize the outsized role of people in delivering deal returns and realizing value – and ensure culture, fit, and human-centred transition issues are prioritized and executed repeatedly and effectively. To support this, change management efforts may be considered in three key phases - as discussed throughout this paper.

Introduction

In one of the more exhaustive studies on corporate shareholder returns, global consultancy McKinsey & Company distilled down the return profile for 1,000 of the world's largest companies over ten years. The goal of the study was to correlate longer-term M&A strategies with return outcomes and company survival rates. The data was clear: 75% of those companies that persisted in the top 500 used active M&A programs, including 91% that remained in the top 100. A follow-on study from Bain & Company of deals over an eleven year period has shown that as a group, companies that engaged in M&A activity averaged higher shareholder returns than inactive companies.

The most successful of these employed a strategy of smaller, programmatic deal making and built nearly 20% of their market cap from value derived from merger and acquisitions. This approach drove the highest success rates in industries ranging from high-tech to manufacturing and consumer packaged goods and retail. The study concedes, however, that these performance averages may conceal what are the most relevant and critical factors for sustained deal success including: possessing the required execution capabilities internally to realize value.

This is an essential acknowledgement for deal-makers to understand and it is around this point that this paper is focused. Regular, systematic M&A is a tool for strategic growth in the world's most successful companies. Those that have been able to absorb the disruptive impacts of a digital world – deftly out-maneuver start-up competitors – use M&A to keep pace. But the reality of M&A performance is that 70-90% of deals fail. Another widely-cited KPMG study suggests that 83% of deals did not boost shareholder returns because of some combination of mismanaged risk, pricing, strategy development, cultural integration or management capacity.

> The obvious dilemma surfaces – M&A is an apparent "must do" for success but the prospect of failure lingers as leaders acknowledge being unprepared to navigate people, culture, change management and communication issues.

Midaxo

Why Change Management Matters

PwC suggests that in the flurry of activity required for M&A integration, companies commonly miss the opportunity to design and implement an effective change management program to align and motivate people in delivering deal objectives. Often, leaders talk about making people and changing cultures the top priority when a deal is imminent. Then the practical realities of due diligence, valuation, negotiation and tactical integration planning around financial, legal, HR, IT or sales and marketing overwhelm the people and culture sentiments. These feel less relevant, less immediately critical and – to the detriment of a project's return, get de-prioritized or ignored.

The position is best summarized in a Bain & Company interview, where the experience of one industrial goods company CEO on the heels of a major acquisition serves as a strong example:

> "I have no doubts about the strategic rationale and the synergies. However, I need to build a new company now. How do I engage thousands of people globally and align them behind our ambition, while keeping our customer focus and delivering on our budgets?"

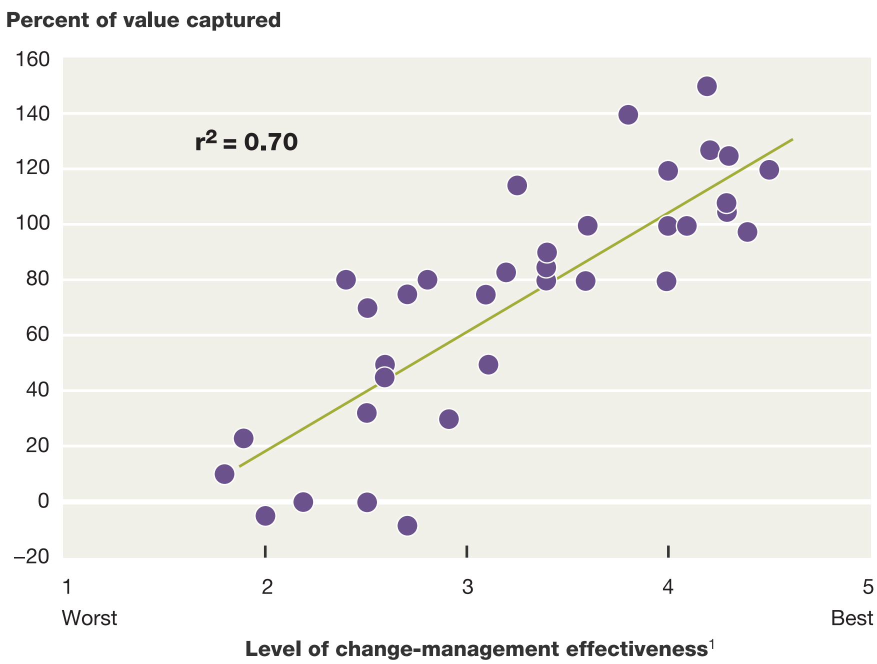
The overwhelming sense of the people-centric challenges expressed by this leader is at the heart of change management. Leaders may call it being people sensitive, or being culturally cognizant, but clearly, change management is the guiding discipline that frames how a company prepares, equips and supports employees, partners or stakeholders to successfully adopt change. It's often repeated that "organizations don't change, people do". And this reality must lead M&A practitioners to install a structured approach for supporting individuals in the organization to move from their current states to a future state to support new realities or target outcomes presented by the merger or acquisition.

There is no argument around the data: **the better change management principles are applied, the higher likelihood that project objectives will be achieved**. One study from over 2,000 data points and eight years shows that initiatives with excellent change management are six times more likely to meet objectives than those with poor change management. Even simple practice adjustments that move practices from "poor" to "fair" increased the likelihood of success by 300%. McKinsey data shows that companies that embarked on making big corporate changes found that change management drove, not surprisingly, the returns for the biggest gainers (see the chart below from the McKinsey study). These companies had buy-in and participation in all levels of leadership too - from executives to frontline employees. M&A happens because companies believe there is an intrinsic benefit to be had from deal making, but failure or underperformance happens time and again because the "people" side of the equation is misunderstood or poorly managed throughout. When process, tools and methodologies – in isolation – take centre stage, companies will miss the opportunity to extract the very benefits they initially identified.

The real value work of M&A happens *after* the deal is closed. It happens in the integration of departments, of varying corporate or geographic cultures, of customs, of managers and teams, of people with vary worldviews. Even when companies tout the need for change management, the approach is fluid, and often without specificity or fragmented – in that it addresses only a few of the critical requisite drivers to succeed.

Conversely, the creation of a holistic plan and the application of actionable plans will mean drive greater returns. It is with people that integration, adoption and execution around deal priorities and new initiatives take place. And while organizations once enjoyed the luxury of time to test and roll out new initiatives, they must now do so in compressed periods while competing with tens or hundreds of new existing projects. In this fast-paced dynamic, McKinsey advises, is where competitive advantage accrues to companies with the ability to set priorities and implement their processes quicker than their rivals. And this ability is primarily people driven.

Why Change Management Matters



r^2 = the proportion or percentage of variance explained by a regression

[1]Company's average score (on a scale from 1 to 5, worst to best) across all 12 change-management factors, n = 37 (does not include 3 outliers at high end of value-capture range).

Building Blocks of Change Management

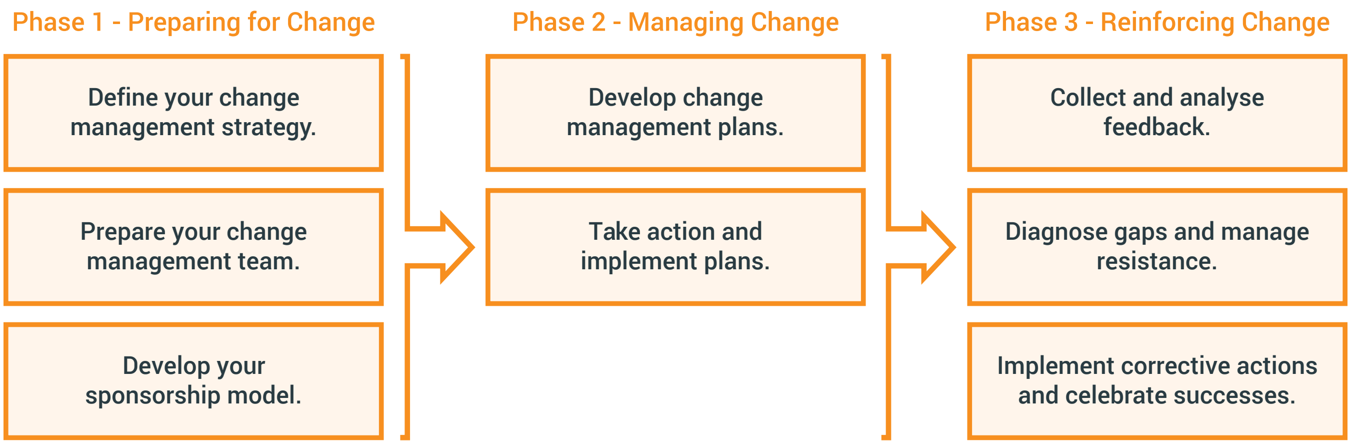
One often-cited statistic suggests that 70% of change programs fail to achieve their goals – primarily because of resistance from employees and little support from management. Another notes that when people are truly invested in change it is 30% more likely to stick for the long term. It is between these bookending realities that we propose the following blocks to frame an effective and repeatable change management practice.

Through consistent application of the concepts discussed, companies will find success integrating companies or departments and teams. Their efforts will mature beyond just simply trying to integrate processes and tasks and extend to those managing these. Quickly they'll find that they achieve fuller project potential through their people-centricity.

Danish human resource consulting company Proacteur offers a helpful framework for thinking about the basics of change management practices. Their model breaks down planning into three core areas. These ideas support the basis of Midaxo's view on simple organizing of change management focus areas.

[See figure below]

As companies consider a phased approach to change, keep in mind: the first change management best practice is to be planning for it at the same time of project initiation. Corporate studies acknowledge that 'the earlier, the better' during a deal or disruptive project. When one considers the strain presented by any sizeable project, especially one that is behind, changes scope, or exceeds budget, it makes sense why an acquirer is wise to begin people engagement early. At a minimum this can help keep disenfranchisement or frustration at bay.



Block One

Preparing for Change

From the outset companies need to set an effective stage for supporting cultural change. A clear definition is critical; this includes – defining desired behaviors, propping up role models or examples and providing meaningful incentives.

In the preparatory or design stage common questions asked may include:

- How much change management is needed for a given project?
- Who is going to be impacted by this initiative and how?
- What sponsors or leaders need to be involved to ensure success?

This situational awareness is essential for effective change management. By performing this initial step, companies will create outputs helpful for subsequent planning stages. Change management advisory firm Prosci generally recommends the target outputs during this block or phase to be similar to the following:

Establishing a 'change characteristics' profile:

This is essentially a summary of the change being proposed, the timing for desired changes and the size, organization scope and general impact areas. Project or deal sponsors should lead this effort early on with leadership across affected business units.

Defining an organizational attributes profile:

This is a profile of specific teams or groups that are being impacted and sets out specific attributes, dependencies, ongoing projects or existing priorities that may cause issues during the changing effort.

Organizing the change management team and resource structure:

Deal team leads may perform this assessment in the early phases of deal planning. This effort helps define how many change management resources (e.g., people, trainings, town halls, etc) are needed for the effort and where and when they are assigned in relationship to deal timeline. Within this as well, it is important to establish the sponsorship structure. In this, change management sponsors will be assigned to act as primary advocates for change. While executive leaders may often be key sponsors, they should also be engaged to drive buy-in and engagement from mid- or front-line level leaders that need to participate in the change effort.

Clarifying the impact assessment:

Here, a more detailed assessment of the groups of individuals being impacted by change is scoped. Done thoroughly, this effort will conclude with a report on the level of impacts, change expectations and any foreseeable challenges associated with each group.

Block Two

Managing Change

Based on assessments and guiding change summaries developed in the previous phase, companies will move on to the managing change phase. Here, a strategy is specifically articulated that captures the scale of change being targeted and aligns with the nature of change that is needed. It is also within this phase where specific actions and workflows are assigned and executed to begin the reorientation of people and processes to meet desired targets.

While change happens at the individual level, it is impossible to manage change on a person-by-person basis. So, it is in this phase where organizational change management efforts take shape and where custom plans tailored to the targeted groups and activities – and integrated with the overarching deal plan – are built and rolled out.

Starting a communication plan:

Recognizing that change begins with people, communication becomes perhaps the most critical part of successful change management. Having moved past phase one, a company now has the vision for change, targeted change outcomes, an impact assessment and a sense of the level and disruptiveness of change on an individual and group basis.

Mainstream change management methodologies highlight two particularly critical elements of this phase: *awareness and desire*.

Awareness is about making sure that those impacted understand the underlying point of change. [Of course, this demands that the proposed deal has true strategic imperative and a legitimate 'why']. This also requires sponsors and ranking leaders to present the opportunity the deal affords, propose how change will benefit the company and justify the effort involved in terms of impact to the individuals. These cannot be abstract arguments. Change is people-focused, thus, the benefit explanations must be also.

The awareness conversation naturally bleeds over to desire. Inspiring change is about seeding the desire in impacted individuals – and it demands both logical and emotional appeals. It is encouraged to give real-world examples, promote relevant benefits, listen to feedback and create ownership by giving impacted parties a voice and responsibility in the process.

Consider a recent example of communication success during a major change management initiative. After being named CEO in February of 2014, Satya Nadella undertook a major restructuring of Microsoft. His desire was to reinvent productivity and business processes, do away with destructive internal competition, build cloud offerings and prioritize more personal computing. During this upheaval, Nadella reinforced a new sense of mission: to empower every person and every organization on the planet to achieve more. He recalled his thought process:

> "Over the past year, we've challenged ourselves to think about our core mission, our soul — what would be lost if we disappeared...We also asked ourselves, what culture do we want to foster that will enable us to achieve these goals?"

Microsoft had lagged under a purposeless culture and low morale and weak employee engagement. Today, that commitment to building current-state awareness and nurturing future-state desire has allowed Microsoft to flourish.

In the case of M&A in particular, one thought leader reminds that "[...] Bringing two companies together is not unlike a marriage. Sometimes opposites attract and complement each other, but for a marriage to work, you really need to share the same values."

Mapping the sponsor roadmap:

The sponsor roadmap outlines the actions needed from those primarily responsible for sharing the vision behind the deal. This effort orders executive participation, keeping them active, visible and aligned. It will organize even the practical detail on what communications are being sent, to whom and where they need to be present for in-person events.

Analyzing system changes and process updates:

Systems and existing process changes are common M&A execution points of failure. Here, companies need to define the gaps between post-change requirements or results and where things currently stand. Whether related to financial, ERP, HR or customer-facing systems or processes, thought needs to be given to what needs integrated, retired and created. Some of this will have been captured in the Impact Assessment effort above, however, now is the time to capture the specific changes to be made. Give significant thought to sensitive, employee impacting areas such as sales compensation plans, territory assignment or payroll and benefits updates.

In the popular 7-S Change Model, McKinsey recommends that during systems review companies should pose the following questions:

- What are the core systems in your business (HR, finance, document management, team management/meetings, etc)?
- How are these systems and/or processes stored and used?
- How are they updated?

- Are these systems accurate (are they being used word-for-word)?
- How do you track and assess the results of these processes?
- Who has access to these systems?

These sorts of questions will likely trigger further questions and new insights to grow a full view of change steps related to systems and process changes.

Assigning Integration Owners:

Integration efforts, especially those specifically related to business systems and processes, require ownership assignment for the maintenance of completion accountability. As sponsors' communication efforts build awareness, desire and engagement, they should crescendo with a message of accountability. Here, identified activities are assigned and project leaders or responsible individuals are engaged to deliver on what's been assigned.

Developing a training and coaching plan:

Companies cannot assume that the new post-deal vision will be seamlessly adopted. Individuals require training to build the knowledge and ability needed to work in a new way. Training plans flow from the analysis of cultural, business and process changes in store. They need to follow communications so impacted people will have already been conditioned with appropriate messaging before being asked to do new training. Embedded in this training for managers is coaching.

A coaching plan, complete with tools and messaging, dovetails with training initiatives to help leaders figure out how to aid the change management effort within their areas of responsibility. The effort should offer leaders guidance on dealing with resistance too. Resistance can be prepared for in advance through proactive identifying of people or teams that are essential to the change effort but may be inclined to push-back. Identifying, understanding and combating resistance should be covered.

Block Three

Reinforcing the 'Change' in Change Management

The scorecard for change management success isn't how quickly or fully the implementation plan was executed, but how sustained the change actually is. A big merger or deal may incite some early interest and energy from individuals. Even those whose roles or responsibilities are impacted may be intrigued by the change and show some buy in; perhaps they initially welcome a respite from the same day to day work. Quickly, however, people revert to old norms and customs unless there are mechanisms in place to ensure the new prescribed way of doing business is being done.

This third phase of change management is about reinforcing the change initiatives. Here is where the target synergies and value-creation opportunities identified early in the deal making actually materialize.

Measuring changes and correcting actions:

When change is introduced and new solutions, processes, systems and roles go live, it is important to a) determine meaningful measures, and b) report on progress. These will vary depending on the change scenario, but companies will want to establish quantitative indicators of progress. Perhaps it's a published usage report on a legacy system versus the new system or peer-led scoring on how collaborative members on newly integrated teams are. Regardless of the measures, they should provide easy means to measure performance around expected behaviors in the changed state.

In areas of underperformance, or where changes are slow to be adopted, corrective actions should be prepared. In general, slow uptake is individually driven and so sponsors or business line managers should consider training, 1-on-1 coaching or other communicative means to help people embrace the change.

Reinforcing with recognition:

Embracing change takes more of a mental and emotional toll than many would assume. Leaders must recognize the propensity for people to revert to what's easy and known (e.g. old behaviors) and recognize those that have embraced change and redesigned how they work to meet the outcomes set out when the deal was announced. Affirmations and incentives should be public and compelling. They should be meaningful enough for people to pass 'go' and start adopting a new way of doing business. Furthermore, they should not be sunset after just a few months. Momentum may wane even a few quarters post deal close. Check in regularly, honor often and ensure that change persists.

Performing the post-mortem:

Given the expanding place of M&A deal making in corporates' growth strategies, companies must expect that change-management efforts will be constant and ongoing. Acquisitions, spin-offs, other divestitures and merger activities will keep change initiatives front-and-center. To navigate these effectively, companies must schedule periodic reviews of change management plans/process/playbooks and seek to grow their internal competencies. These questions offer a starting point for review efforts:

- Was our change management planning timeline ideal?
- Where were we over- or under-resourced during the project?
- Was leader sponsorship and engagement sufficient?

- What feedback did we hear from impacted individuals, teams or departments?
- What aspects can we templatize, or otherwise systematize to improve efficiency?

Change management is more than a philosophy about smoothing the natural bumps brought on in disruptive business activity. For enterprises that prioritize it, it becomes an important organizational core competency at the same, or even higher, level of priority as deal planning, pipeline management or due diligence. It is a means for competitive differentiation when many companies underestimate it. Embracing a systematic approach to change management and building rigor in the "pre", "during" and "post" phases of change will start to embed this capability into every role, structures, process, project and leader. While change won't necessarily become easy, it can certainly be more readily and rapidly embraced. People will grow their abilities to apply changed behaviors to achieve outcomes, leaders will have sharpened skills to motivate teams and market shifts or new technology and other strategic initiatives can be absorbed quickly with less disengagement, loss of morale and productivity declines and, ultimately, lost value.

One industry observer has quipped that successful companies "defend against the five horsemen of merger apocalypse: risk, price, strategy, culture and management capacity." Change management aptitude brings a hedge against a few of these – and with M&A failures rates soaring, the proficiency is a virtual must-have.

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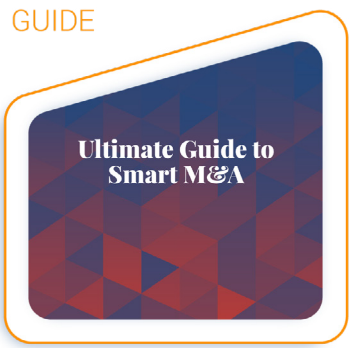

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