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Lessons M&A Experts Can Learn from Strategic Alliances

by Dorothy Langer

Amidst today's merger mania, it is sometimes difficult to keep in mind that many mergers do not live up to expectations. For instance, in a McKinsey & Co. study of 115 acquisitions in the U.S. and the U.K., only 23% of the transactions earned returns greater than the annual cost of the capital required for the acquisitions. In contrast, a Booz Allen study of mergers and alliances found that over a five-year period, the average ROI for alliances — nearly 17% — was significantly higher than the average ROI of the individual corporations involved in the alliances. Furthermore, this study showed that alliances have a higher success rate than mergers, 60% compared to 50%.

Such figures indicate that M&A experts might do well to look at corporate partnerships for ideas on how to improve the payback on mergers. Looking at how alliances and mergers differ provides clues to the attributes of partnerships that can be transferred to mergers.

Here are six key differences I've noticed in working with both alliances and mergers over the past decade:

Buddies From the Get-Go

Alliances are always friendly and generally have a strong focus on mutuality, with equal commitments and balanced risk-sharing by the partners. This win/win attitude is often missing in mergers, which can be one-sided and hostile from the very start. It's like the difference between a marriage based on love and a shotgun wedding; which union do you think is more likely to succeed?

Consider, for instance, what occurred in Wells Fargo's 1995 take-over of First Interstate. Not wishing to go to the altar with Wells Fargo, First Interstate gave golden parachutes with two years' salary to hundreds of executives and granted all other employees severance packages that were double the industry average. As a result, a mass exodus among First Interstate employees left branches understaffed and produced serious erosion of the customer base as Wells Fargo's staff was spread too thin to implement a smooth integration. The hostility that set the stage for this debacle simply would not exist in an alliance.

Money Isn't Everything.

The primary motivation behind a successful alliance is to complement and leverage each partner's resources — for example, to integrate two technologies. Although financial gain is the eventual goal, it is frequently secondary or indirect. In contrast, with most mergers, the driving force on both sides is direct

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and short-term financial results. The acquiring firm desires visible revenue and earnings growth or tax advantages while the acquiree's leaders want to cash out or anticipate significant career growth for themselves within the merged organization. Because the primary motivation is financial, the two parties often fail to leverage the synergy of their resources, thereby making it unlikely that the financial objectives that drove the deal in the first place will be achieved.

Some mergers are winners because they are more like alliances with regard to motivation. Take, for instance, IBM's highly successful acquisition of Lotus Development Corporation. Having viewed this deal from the inside, I believe that the primary focus was not price or short-term gain but a true leveraging of resources; IBM got Notes, and Lotus got IBM's presence in corporate America. It is, of course, interesting to note that this merger began as an alliance, and the two organizations, in effect, lived together for a while before getting wed.

Focus! Focus! Focus!

Most alliances are formed, at least initially, around very narrow objectives, such as increasing market share, expanding into new markets, blocking a competitor, or developing a new product. This focus on a few well defined — and attainable — goals

"The all-important issue of culture is treated differently in mergers and alliances."

enables the partnership to deliver clear value. As a result, many partnerships enjoy initial success and often then go on to broaden their objectives and relationship.

In comparison, when two entire companies are melded together in a merger, objective-setting may be done so broadly that no single goal receives enough attention to achieve the potential synergy. Some experts are predicting that this is what will befall the Travelers-Citicorp marriage. As the two giants try to succeed with the financial supermarket concept - success has eluded others in the past, including Sears Roebuck and American Express - they may have set themselves an objective that is so unwieldy that it simply is not do-able.

Give Due Diligence Its Due.

This is a corollary to the previous two points about motivation and objectives. If your motivation is to leverage specific resources and you have very focused objectives, you instantly know where to direct due diligence efforts.

In many merger situations, the due diligence is done so broadly, or becomes so focused on the financial and legal aspects of the deal, that important specifics can get overlooked. Important business issues, such as current partnerships and target market niches, that would be reviewed thoroughly in a partnership situation because they would ultimately determine the relationship's success or failure, may receive short shrift in a merger that becomes totally focused on "the big picture."

It's the Culture, Stupid.

The all-important issue of culture is treated differently in mergers and alliances. In an acquisition, cultural differences tend to be ignored, overlooked, or downplayed during due diligence because either the buyer's natural instinct is to force the acquired company to adopt its culture or the deal is just so enticing that both parties may disregard warning signs of impending culture clashes. When Upjohn and Pharmacia merged in 1996, for instance, they saw the opportunity to significantly accelerate revenues and position themselves better against the giants of their industry. Instead, they became mired in endless policy differences, such as employee drug testing, vacations and management reporting methods, which quickly drained much of the vitality from the merger.

In contrast, the two halves of a partnership can zero in on cultural issues that might impact the success of their narrower objectives. And, while they may, in fact, uncover serious cultural differences, potential partners often can find ways to tolerate those differences because they aren't partnering permanently. With no one trying to force cultural change, the chances for success increase.

No Personal Angst Among the Personnel.

Mass layoffs and executive infighting about who will stay and who will go are not part of the alliance model. Unhampered by such distractions, people at all levels of partnered organizations are free to focus on achieving the alliance's objectives.

With mergers, however, such issues often take on a life of their own and become paramount to the business purpose that initially prompted the relationship. For instance, just one day after Bell Atlantic and GTE announced their merger, *The Wall Street Journal* published an article about the anxiety being felt among the two organization's top execs about their future roles. Senior level distractions or defections that arise from such unease can create a leadership vacuum that imperils the merger's success. Combine this with layoffs or an exodus of people at other levels of the organization due to similar uneasiness about the future, and the merger is in big trouble.

A study of mergers earlier this decade by a professor at the University of Chicago and one at the University of Arizona found that about 44% of the companies that were acquired were later sold off, many times at a loss. This high corporate divorce rate should prompt M&A experts to look for new ways to avoid some of the thorny issues that consistently trouble mergers. In cases where these problems are apparent, a strategic alliance might make more sense than a full-fledged merger. And even when a merger is definitely the right way to go, the potential of an improved payoff make it worthwhile to examine how that union can take on the best characteristics of alliances.

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