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Whether your own company or a customer is involved, it is important to be aware of the . . .

Hidden dangers in mergers

By Terence N. Flanagan

WHAT'S behind the urge to merge? Companies absorb other firms for many reasons—to broaden their markets, fill out their product lines, avoid seasonal slumps and for many other purposes. However, the real but hidden reason behind many mergers is the fact that companies want to obtain new executive and technical talent.

The most valuable asset acquired is often not the markets, the machinery nor the materials but really the management which has put these ingredients together in a winning combination.

But the fact is that in most acquisitions and mergers, the acquiring company really has very little idea of the kind and quality of management talent it is getting. Companies usually fail to make an accurate appraisal of the management strengths and weaknesses of the acquired enterprise.

How then can such a company truly understand its own needs, how a new company can help fulfill them, and how the two management teams can blend into an effective organization? Still the numbers of mergers continue to rise. Last year there were acquisitions in various fields of business totalling 1,234 as compared with 1,012 in 1960 and 1,050 in 1959.

The result too often in these mergers is that the acquiring company must endure a trying period of hiring still additional executive talent. Or, perhaps even worse, the acquisition, made after long and costly effort, is sold off at a loss.

The personnel director of Surburban Trusts of Maryland, Norman C. Martin, bears this out. He has found that in the absence of objective information on the management men being obtained through merger, the acquiring company usually takes on the whole staff. Determining which executives are assets and which are liabilities is a time-consuming process. Too many companies simply find a place for everyone, and then six months or a year later, they weed them out. Carrying this extra load for many months is an important *hidden* cost of the acquisition or merger.

For example, a company was attracted to another firm because of its record of bringing out new products. Only after the company acquired the firm did it learn that one man had been almost solely responsible for new product development and that unfortunately he had resigned three months earlier.

In another instance, a company that wanted to be acquired had prepared an elaborate report including the pictures and biographies of its six key executives. When the company was bought up, the new owners discovered that the president had made all the major decisions and was a one-man band, while the five other men were simply window-dressing. These five were fired, and after a lengthy and costly period of confused operations, new executives were finally located.

Another common mistake is the failure to arrange in advance for the continued employment of valuable key executives. Too many companies have learned after an acquisition that they obtained only a shell—that the important men had either left or made commitments to join other companies.

Since many managers of acquired companies look upon the very announcement of the acquisition as the signal for them to look for greener pastures, it is important to make special efforts to retain the desired

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executives. Says Frank McGilvery, the executive director of a well-known food company, Hot Shoppes, Inc., Baltimore:

"When news of the sale of a company breaks, often the best men will decide to pull out. Being able to identify the talented executives far in advance and to negotiate for their continued employment is a great advantage. It is thus vital to have a reading on every management man *before* negotiations enter the final stages. Such knowledge also helps avoid costly commitments, which can so casually be made during the fever of negotiating, and prevents assigning weak men to key spots during the crucial early months after the change."

It is equally important, before merging, to have a realistic knowledge of one's own management talent. Suppose, for example, that a conservative railroad company is acquiring a dynamic electronics firm. The director of engineering for the electronics company must report functionally to the vice president of engineering for the railroad, who may have no understanding of the other man's work or temperament. As a result, they fail to get along and hinder each other's jobs.

This kind of costly waste could be avoided if, before merging, a company made a "management audit" of its own key men and those in the other firm. Recently a company which did take such a precaution asked us to evaluate the technical skills of a firm it wished to acquire in order to obtain a first-rate technical staff. The study revealed that most of the technical contributions were actually made many years before and that the people responsible for them had either left or been promoted a long time ago to general management jobs.

We therefore reported to the client that, for the intended purpose, the technical skills they sought actually no longer existed. Since the purpose of the acquisition would not be served, we recommended that this firm did not constitute a good buy. The advice was taken.

When a management audit is made, at least the six key officers of each company involved are appraised. When a merger of larger companies is seriously being considered, the study may move down to the next level of management. The six top people appraised are usually the president, chief financial officer, directors of sales and marketing, engineering, manufacturing, and industrial relations.

The person conducting the management audit must strive to obtain as complete a picture of the individual under appraisal as is humanly possible. Naturally, he first interviews the individual himself and then an average of six associates who are familiar with his work. If there is a trace of negative factors about the man, even more will be seen.

The best criterion for measuring future success is past performance. This cannot be ascertained by psychological testing or other devices, but only by knowing how well a man did on the job at hand. Figures and reports will not provide this information accurately, for they usually don't tell the complete story. For example, we recently encountered a man who, on paper, had been responsible for a big sales volume, but in fact had derived most of those sales from one or two key customers. And those were two house accounts he inherited!

In making a management audit, therefore, there is no substitute for the personal interview. The facts and opinions gathered in the management audit are carefully separated, and only the verified facts are passed on in the final report. A written appraisal of each key executive, of course, is submitted.

Knowing the financial position is not enough. It is vital for companies on the verge of merging to know precisely the assets, liabilities, strengths and weaknesses of the top executives whom they will soon be clasping to the corporate bosom for better or for worse.

Consider these points before you merge or acquire a company

1. Assess management capability, including strengths and weaknesses of the key executives of the company under consideration.

2. Probe to discover if the principal scientific contributors to the product line are still active in the company you plan to acquire.

3. Determine the company's contractual obligations to its key executives prior to your acquiring it. You may be startled to find long-term contracts, guaranteed bonus arrangements or other financial considerations that saddle you with an unnecessary burden after the acquisition.

4. Determine the P.I.F. (Personality Integration Factor) of the joint executive staffs. Except when a new acquisition is to manage itself on a decentralized basis, it is essential that a high degree of personal and business compatability be achieved.