Faculty of Mathematics and Economics

Institute for Strategic Management and Finance

Leadership in M&A Situations

Thesis

in Strategic Management and Finance

submitted by
Lufina Mahadewi

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Supervisors:

Professor Dr. Frank Richter
Professor Dr. Dieter Beschorner

Author's declaration

I hereby declare that I am the sole author of this thesis. I confirm that the thesis does not contain any material previously submitted for another degree or an academic award. The work presented here has been done independently, solely based on the literature mentioned in the text.
I realize that deliberate submission of incorrect information will have corresponding ramifications.

Ulm, December 3rd 2007 ______________________

(Sign)

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Abstract

This thesis proposes a relation and linkage between leadership aspect and their involvement in post M&A integration process in terms of managing the soft factors issues in order to achieve the best outcome of M&A process of an optimum effectiveness and synergistic benefit of M&A process. The relation and linkage is noting from the analysis of aspect of M&A and analysis of aspect of leadership, and it shows that leadership plays a significant role during transformational changes in M&A as a fundamental mechanism to create a useful change. To achieve a successful M&A transaction, there should be integration between soft factors and hard factors as in 7s McKinsey framework in order to enhance the acceptance of the deal and lower potential risks during post M&A integration phase. The author proposes that leadership and effective post M&A integration become the key success factors in overall M&A transaction which complement and relate to each other.

Keywords: M&A, Leadership, Post M&A Integration, 7s McKinsey, Soft Factors, Change Management.

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List of Abbreviations

A

AMOCO	American Oil Company
ARCO	Atlantic Richfield Company

B

BP	British Petroleum

C

CEO	Chief Executive Officer

H

HR	Human Resources

I

IPO	Initial Public Offering

L

LSG	Lufthansa Service GmbH

M

MBI	Management Buy-In
MBO	Management Buy-Out
M&A	Merger & Acquisition

R

R&D	Resource & Development

Chapter 1
Preface

1.1 Introduction

Merger and acquisition (M&A) are often used to achieve the purpose of maximizing the firm's share value as a reflection of the owner's health. Despite of that goal, there exist some fundamental objectives underlying the M&A transaction which include growth or diversification, synergy, increased managerial skill or technology, tax considerations, defense against takeover, hubris, and agency problems. Mainly the rationalized objective and a stated motive of M&A are to achieve the synergistic benefit which includes operating and financial synergy.

There are a lot of studies and a growing body of research that have been done to evaluate the performance of M&A process such as Mercer (1996), Coopers & Lybrand (1996), A.T. Kearney (1998), KPMG (1999 and 2001), and McKinsey (2000) which documented an approximately 50-80% failure rate where the definition of failure ranges from no net growth to inferior stock performance relative to industry.[1] The failure shows that M&A companies couldn't exploit the synergies coming from a newly formed company or unit by several indications of lower share price, profitability decline, market share loss, lack of support from stakeholder, loss of key employees' retention, and a slope in customer and supplier relationship. The most common reason for failure in M&A is associated with lack of focus on soft factors or human side issues and not generally from outside factors such as market, competition, high purchase premium, degree of relatedness of both organization, and excessive leverage. Personnel problems are viewed as one of the main reasons for the disappointing financial results of more than half of M&A.[2]

The soft factors which are described in 7s McKinsey model are *Style or Culture*, *Staff*, *Skills*, and *Shared values*.[3] The lack of consideration of soft factors may reflect potentially to cultural clash, increment in employees' uncertainty and stress level, and also low perceptions of the organization's trustworthiness and employees' commitment during post M&A integration process. The post M&A

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[1] Michael J. Shelton-FTC Bureau Economics Roundtable (2002) : The Art of M&A Integration; Industry Literature, p. 3
[2] N. Hubbard (1999), p. 16
[3] Robert H. Waterman, Jr., Thomas J. Peters, and Robert Waterman (1988), pp. 9-11

integration process relates to complex tasks and activities by having time sensitive issues associated with the speed of integration. The Human Resource (HR) due diligence is essentially needed as proactive problem solving of soft factors issues which may arise during the integration process. It can be used as an early process to address the key decisions in people issues which will help in delivering higher speed of integration. Generally, M&A general due diligence does not focus on HR, research has shown that only one-third of all acquisitions perform due diligence of HR and, by and large do so only in a cursory manner and less than 10% of all buyers performs serious HR-related due diligence.[4] The negligence HR due diligence is generally caused by undermining its importance compared with financial issues or other strategic management M&A, and also by the perception that human side issues can't be managed and are difficult to be assessed or measured.

Traditionally, the acquiring company most likely tries to create change by some extent of imposition to the acquired company. This might be done with inadequate assessment of the differences between soft factors issues of merging companies which may impact in lower performance and value that was expected to grow from M&A. Post M&A integration often deals with significant transformational changes of merging companies in terms of development, communication, implementation and harmonization of a new shared vision, strategic objective, corporate culture, and also combination of best companies value practices. The transformational change is accentuated on facilitating role of leadership in providing guidance of change cohesively with the strategic management of M&A, and also in terms of removing barriers to the success of M&A transaction.

The author suggests that leadership is important to manage effectively all the soft factors during post M&A integration. Leadership plays a significant role during transformational changes in M&A as a fundamental mechanism in dealing with the change. According to studies of successful integration project, leadership is one of crucial factor for success in post M&A integration.[5] The successful M&A requires more than just effective management of M&A strategy and activities. It goes through by building the developing vision of the future, communicating the vision through the people, creating commitment within

[4] N. Hubbard, op cit, p. 15 and p. 62
[5] Gerhard Picot (2002), "Handbook of International Mergers and Acquisitions" : Thomas Koch (2002), p. 273

organizational members, engaging cultural factors, and fostering management relationships and operational guidance, not only focusing on managing the value creation but also on inspiring and influencing whole members towards the achievement of the synergistic benefit of M&A.

The role of leadership and its effect on M&A performance has sometimes been overlooked and only focused on rationalized notion of strategy development and process management of M&A. It neglects the acknowledgement of the value of leadership for employees at all levels during post M&A integration which may tend to endure initiative and innovation of the planned change. Bridging the gap of the soft factors which is usually embedded within merging companies by instilling leadership aspect can be the key to ensure that business and financial objectives of M&A will be realized.

To look insight the attributing explanation for the optimal outcome of M&A process, the Author tries to analyze the relation and linkage of the importance of leadership's role in managing the soft factors during M&A integration process in terms of achieving a potential useful change in order to accomplish optimal synergies and benefits of M&A transaction.

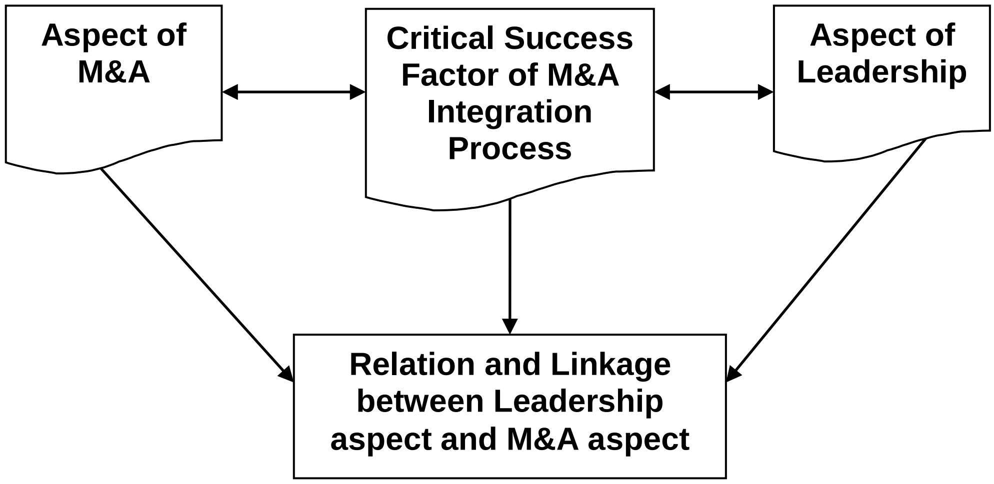
1.2 Goal

The thesis has a goal to give a good illustration, also a clear understanding and description of the relation and linkage between leadership aspect and their involvement in post M&A integration process in terms of managing the soft factors issues in order to achieve the best outcome of M&A process. Therefore, the best fit characteristics and the effectiveness level of leadership aspect in post M&A integration process can be drawn and elucidated.

1.3 Analytical Framework

The thesis has an analytical framework as drawn in the next page. The author tries to draw the relation within aspect of M&A, critical success factor of M&A integration process, and aspect of leadership in terms of analyzing the relation and linkage of the important role of leadership in M&A.

Figure 1.1 Analytical Framework



1.4 Outline of Thesis

This thesis will be arranged into five chapters and consists of:

1. **Chapter 1** is *Preface*, contains description about introduction, goal, analytical framework, and outline of the thesis which is designed to give a brief explanation and overview of how leadership relates and links to the successfulness of post M&A integration. It is also designed to give a brief illustration of how leadership is noteworthy in terms of coping with transformational change of M&A process and in dealing with soft factors issues by analyzing the relation and linkage within aspect of M&A, aspect of leadership, and critical success factor of M&A integration process.

2. **Chapter 2** is *Aspect of M&A*, contains fundamental aspect of M&A including strategic outlook and operating philosophies which include specific motives underlying the transaction, and phase's process. The thesis mainly emphasizes on post M&A integration process with the factors and aspects related on that process. This has an objective to give a clear illustration and comprehension of the M&A aspect in terms of elucidating the relation between leadership and M&A aspect.

3. **Chapter 3** is *Aspect of Leadership*, contains fundamental aspects of leadership including a brief introduction of leadership, theories, the exemplary and effectiveness practices of leadership, and also framework and model of organizational culture and change which

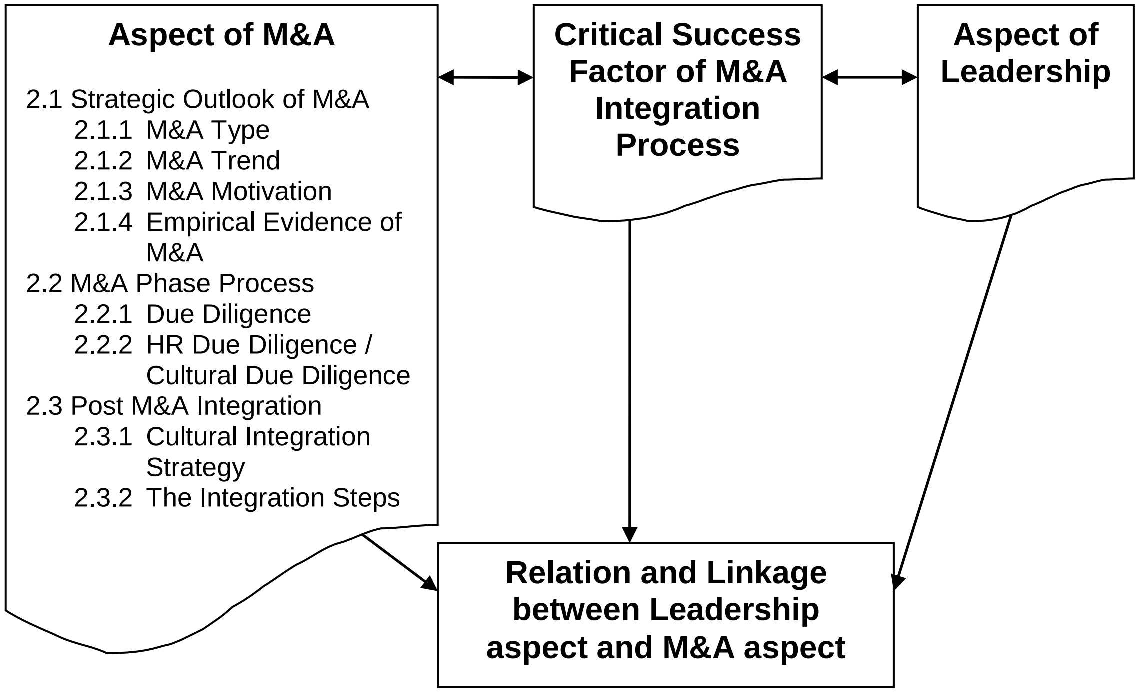
related to post M&A integration. This has an objective to illustrate and give a clear understanding of the attributing leadership factors which may give a great impact in managing the post M&A integration process in terms of achieving an optimal performance of M&A transaction.

4. **Chapter 4** is *Analysis and Relation of Leadership and M&A Aspect*, contains the author's analysis of leadership's role in managing the soft factors issues and how leadership could be addressed in M&A process especially in post M&A integration process, the critical success factor of M&A process, and the best characteristics and the effectiveness level of leadership aspect in M&A. This has an objective to achieve the relation and linkage between leadership and M&A aspect.
5. **Chapter 5** is *Conclusion and Recommendation*, contains the author's conclusion analysis of the thesis in terms of achieving the relation and linkage of leadership aspect in M&A and also recommendation which is coming out from the analysis part of the effectiveness role of leadership aspect in M&A.

Chapter 2

Aspect of Merger and Acquisition (M&A)

Figure 2.1 Analytical Framework Focus on Aspect of M&A



2.1 Strategic Outlook of M&A

The word merger refers to "negotiations between friendly parties, who arrive at a mutually agreeable decision to combine their companies".[6] A merger is the combination of two companies in a stock-for-stock transaction, while an acquisition is the purchase of the stock or assets of a business using the stock of acquirer, cash or other securities.[7] The terms of M&A with broad Anglo-American sense relates with purchase and sale understanding; concentration between undertakings; alliances, cooperation and joint ventures; formation of companies; Management Buy-In (MBI) and Management Buy-Out (MBO); going public/Initial Public Offering (IPO); change of legal form; and restructuring.[8]

The term merger and acquisition can be seen in the same context, where the acquisition is also done with stock-for-stock transaction. Merger is related to the combination of companies which agrees to form a new single company rather

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6 J. Fred Weston and Samuel C. Weaver (2001), p. 6

7 Peter A. Hunt (2004), p. 202

8 Gerhard Picot, op cit, "Handbook of International Mergers and Acquisitions" : Gerhard Picot (2002), "Economics and Business Law Parameters for the Planning of Mergers and Acquisitions", p.15

than being remained separately, and acquisition is mostly related to the purchasing of one major company to a smaller company. But, the terms themselves in practice are not contextually different and mutually exclusive, generally merger happens when one major company purchase another company which is technically an acquisition term, but the purchase deal itself is done in a friendly environment where the main goal is to achieve the best interest within the merging companies with mutually agreement to form a new corporation. However, when the purchase deal happens in unfriendly or hostile ways, then it generally refers to the acquisition term. Although the acquisition can also be happen in a friendly or hostile deal. The main difference between merger and acquisition resides on the ways of how deal has been done and the stakeholders' reception of the purchase deal.

2.1.1 M&A Type

M&A has several ways and reasons to be negotiated and occurred. M&A can occur in friendly merger and hostile merger, also in the context of strategic and financial reason.

A friendly merger can be defined as a merger transaction endorsed by target firm's management approved by its stockholders, and easily consummated; a hostile merger can be defined as a merger transaction that the target firm's management does not support, forcing the acquiring company to try to gain control of the firm by buying shares in the marketplace; a strategic merger can be defined as a merger transaction undertaken to achieve economies of scale; a financial merger can be defined as a merger transaction undertaken with the goal of restructuring the acquired company to improve its cash flow and unlock its hidden value.[9]

2.1.2 M&A Trend

M&A activity has shown an increasing worldwide trend in recent years, the driving forces of the pace are related to the profit recovery or increasing economic growth; cheap financing or reinforcement in stock prices; forces of environment change in area of globalization, innovation, competitive edge, and technology development; higher shareholders and investor confidence of M&A activity; strong financial objective and commence of new strategic opportunities

[9] Lawrence J. Gitman (2002), p. 713

from industry consolidation, lower defense against takeover, and M&A premium level increment in recent years.

The explanation of market trends and highlights of M&A activity below can be seen in the table 2.1 which contains figures of regional distribution of M&A activity, global M&A volume, stock used as consideration, and average acquisition premium.

There are some market trends and some highlights of M&A activity in the first half of 2005 which are:[10]

a. $1.393 trillion of global announced merger activity in 2005 year-to–date with 34% increase year-over-year.
b. 16 deals greater than $10 billion, 20 largest accounted for 27% of overall volume.
c. Bulk of M&A activity clustered in North America (48% of total).
d. 7 of the 10 largest M&A deals announced through year-to-date had targets domiciled in North America, 2 in Europe and one in Japan.
e. In 2005 year to date, 39% stock is used as a consideration where the use of stock in transactions is leveled to the 5 year historical average.
f. Acquisition premium averaged 27%, slightly above those in 2004. Premium over the last few years declined from 49% at the market's peak in 1999 and 2000.

Table 2.1 M&A Highlights Trends First Half 2005

Figure 2.2 Regional Distribution of M&A Activity

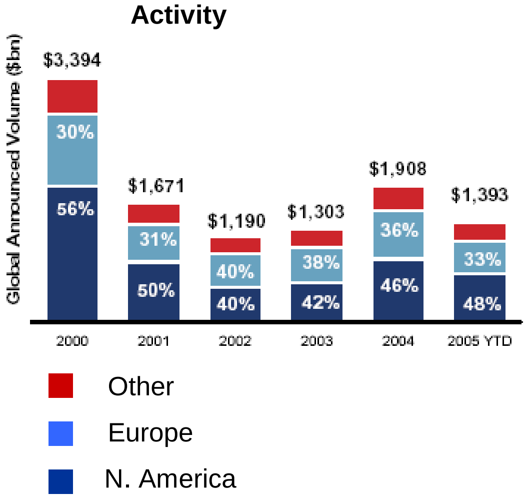
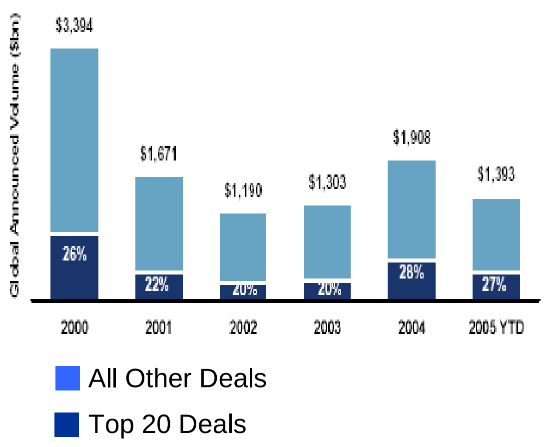


Figure 2.3 Global M&A Volume



[10] Frank Richter (2007) : Goldman Sachs, pp. 7-8

Figure 2.4 Stock Used as Consideration

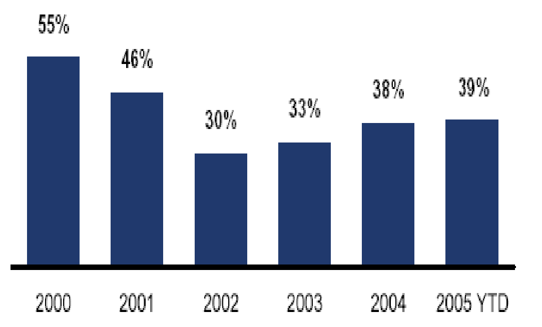
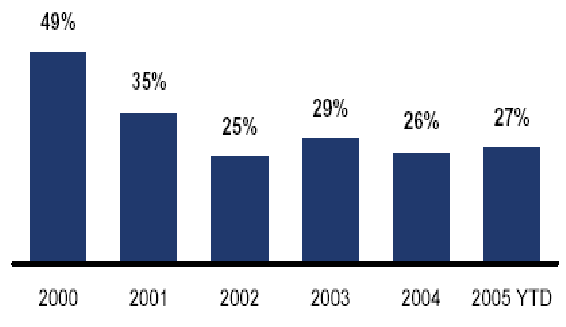


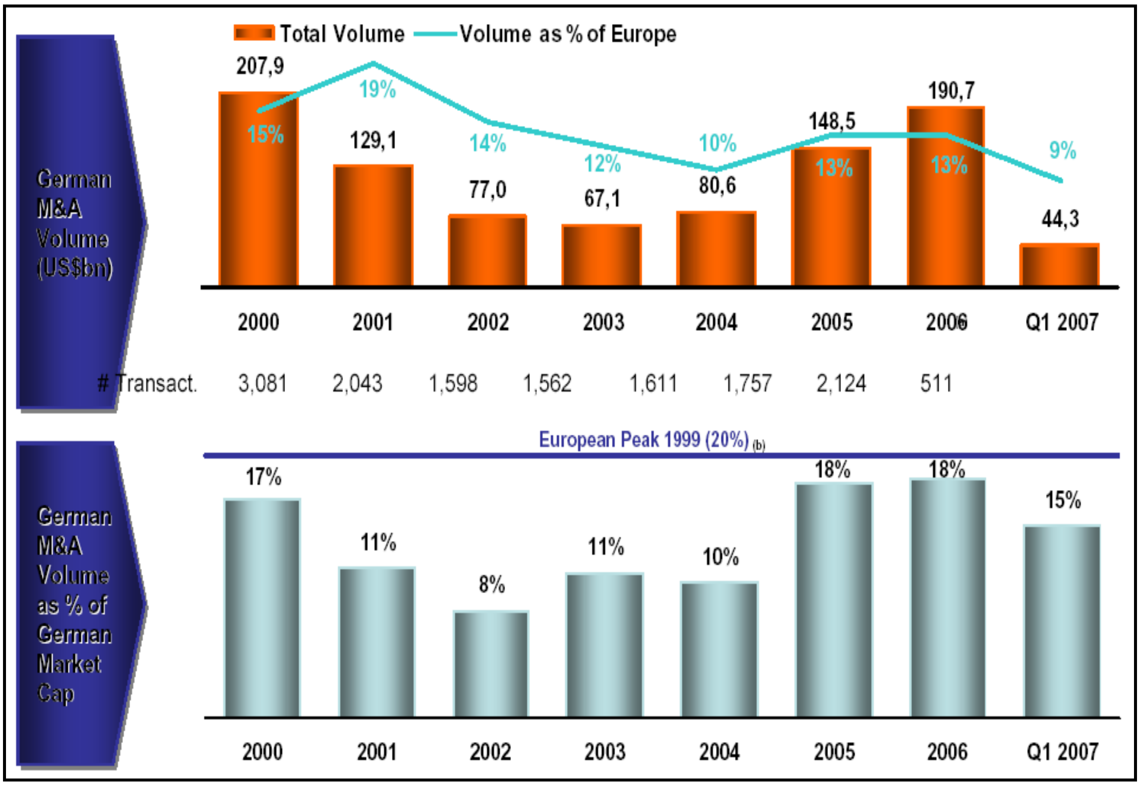
Figure 2.5 Average Acquisition Premium



Source: Frank Richter (2007) : Goldman Sachs[11]

The table below describes the German market M&A volume and the number of transactions as a percentage of total volume of Europe's transactions and as a percentage of German Market Capitalization. The figure shows an increasing trend from year 2003 to year 2006.

Figure 2.6 German Market M&A Volume and Number of Transactions



a) Excluding VW-Porsche tender offer with an Enterprise Value of US$95.5bn.
b) Q1 annualized

Source: Frank Richter (2007) : Thomson Financial Securities Data[12]

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11 Frank Richter, op cit, "Investment Banking Part 2 M&A Advisory" : Goldman Sachs, pp. 7-8

12 Frank Richter, op cit, "Investment Banking Part 2 M&A Advisory" : Thomson Financial Securities Data, p. 10

M&A become the key factor trend in business reorganization change where the number of corporate M&A has increased sharply over recent years triggered by raising in number of buyers and capital and speed in market penetration. The consideration of the needs of synergy and the needs to adapt to the environment changes lead to the structural form of M&A.

To see the pace of the M&A activity in the future, the author considers the Endgames research[13] from A.T. Kearney (2001) where the model enables prediction of upcoming consolidations, even future mergers, and industry departures of 20 years in the future in which there are positive trends of an increasingly rapid pace of merger activity and also trends of bigger merger premiums which are built into stock prices, or to be more specific, they predict that industry consolidations will correlate nearly 80% with the rise in global stock indices, which are predicted to run at about 300% over the next 10 years.[14]

Based on the Endgames model, the author considers that merger trends are going to increase significantly in the future correlated with the increment in stock prices in the future.

2.1.3 M&A Motivation

The objective of maximizing the shareholder value in the form of M&A transaction rather than in organic growth acceleration is reflected from the business time and effort saving considerations. By acquiring other company who has a high degree of relatedness in scope of business or even less degree, it is expected that goal of optimizing general business management can be achieved effectively and efficiently.

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[13] The Endgames analysis is done by A.T. Kearney database to analyze the buildup of industry concentration over time which is drawn from two databases consists of information from the securities data corporation (Thomson Financial's SDC Platinum Worldwide M&A) that tracked more than 135.000 M&A from 1990 to 1999 with a transaction value greater than US$ 500 million; and also at publicly traded companies in which the acquirer held at least 51% interest at the close of the deal. Those data are also being compared with A.T. Kearney's proprietary Value-Building Growth

[14] Greame K. Deans, Fritz Kroeger, and Stefan Zeisel (2003), pp. 2-5

There are some reasons underlying merger and acquisition transaction namely as below:

a. Growth

The main reason of the deal is to increase company's capabilities and leverage in existing or new markets, products, services, and customer's base. The M&A transactions are done in order to grow company's revenues and earnings by taking a positive effect of merger added value coming from combination resources of merging partners.

The growth objective is mainly focused on expansion in new and existing sales opportunities by having more products to offer, larger customers, and wider expansion distribution channels. The company tries to create new potential value and reduces or diversifies business risk exposure by acquiring other companies in different business lines.

b. Synergy

The existence of synergy generally implies that the combined firm will become more profitable or grow with a faster rate after the merger than the firms will operate separately.[15] Synergy mainly aims in maximizing the opportunity of cost savings from a newly merged business.

Synergy can also be defined as increases in competitiveness and resulting cash flows beyond what the two companies are likely to accomplish independently.[16] M&A may represent value-increasing decisions regarding potential effects of M&A on firm value by creating greater efficiency and synergy.[17]

The synergy benefit is typically realized from merger of companies having similar industry's characteristic. The synergy benefit might be derived from operating savings namely cost of capital saving reflected from overhead cost saving and higher growth opportunities; and from financial synergies such as higher cash flow and revenue enhancement.[18] In terms of cost saving, the economical saving is rationalized from economics of scale and operating savings of redundant cost reductions such as reductions of staff members

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[15] Aswath Damodaran (2001), p. 695
[16] Halil Kiymaz and H. Kent Baker (2004) : Mark L. Sirower (1997), p. 7
[17] A.A. Alchian, H. Demsetz (1982), pp. 777-795
and M. Bradley, A. Desai, E. H. Kim (1983), pp. 3-40
[18] Greame K. Deans, Fritz Kroeger, and Stefan Zeisel, op cit, pp. 2-5

and inventory office cost, and higher pricing power with supplier. Whereas company's capital expenditure can be retrenched coming out from all efficiency realization. The synergy benefit can also be derived from strategic opportunities of increment in management talent and surface best people, and also stronger sponsorship and advertising partnership which lead to increment in revenue enhancement. Another benefit is increment in operating income coming from higher financing source, larger capital size, lower firm's risk, tax burden lessen, productivity increment, network consolidation, and higher earnings opportunities. Those benefits will lead to overall company value increment.

c. Increased managerial skill or technology

This objective mainly focuses on enhancement of R&D, innovation skills, and higher functional strengths. By acquiring a new technology, the company expects to increase its business competitiveness by having bigger capabilities in technical expertise and technological advancement. Therefore the time effort, research expenditures, and risk of producing the technology can be reduced.

The M&A activity often forms in foreign direct investment in order to find new advance technology, which enables company to expand abroad and have a stronger competitiveness position in local edge.

d. Tax consideration

"In such a case, the tax benefit generally stems from the fact that one of the firms has a tax loss carry forward, which means that the company's tax loss can be applied against a limited amount of future income of the merged firm over 20 years, or until the total tax loss has been fully recovered, whichever comes first".[19] The company with advantage of tax loss benefit can form M&A transaction to generalize the benefit. The combination of companies will lead to higher after tax earnings and shareholders' wealth maximization.

e. Defense against takeover

In hostile takeover where the firm's management doesn't want to be acquired, the firm bursts a strategy to avoid the takeover by such increasing the amount of debt to distract the postulant's interest to acquire the firm. The debt itself is resulted from financing the new acquisition. To achieve the objective of defense takeover, the management has to show to the

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[19] Lawrence J. Gitman, op cit, p. 715

shareholders that the value creation from previous acquisition realized higher value than unfriendly takeover will reflect.

f. Hubris

The hubris hypothesis is resulted from the concept of winner curse where the range bids will occur if the competition is tighter resulting in wining bidder pays much more than the real value of transaction and loses the money.

In this case, managers may be seen optimistic and overconfident in their valuation of target firms leading to further consequence where they tend to engage in frequent transactions and they are inclined to overpay when acquiring targets.[20] That reason is made hubris become one of M&A motives. Prior research has shown the effect of hubris where there is a little or no value creation after merger.[21] The payout impact of hubris to shareholder value of target firm will increase despite the inclining of acquiring firm's value, and as the research above stated that there were no values increasing realized from merging activities.

g. Agency Problems

Agency problems arise when managers own only fraction of the ownership shares of the firm where this partial ownership may cause managers to work less vigorously than otherwise and or to consume more perquisites (luxurious offices, company cars, membership in the club) because the majority owners bear most of the cost.[22]

The takeover is considered to control the agency problems by opening a possibility of a new management to control the organization by such tender offer transaction. Mergers are threat for a firm if a firm's management lagged in performance either because of inefficiency or because of agency problems.[23]

But on the other side, M&A activity is a personification of agency problems, managers are doing M&A transaction as a resort to improve their performance and as their interest to maximize their value rather than shareholders' value. This happens because M&A activity is done at the cost

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[20] R. Roll (1986), pp. 197-216

[21] W. P. Moeller, F.P Schlingemann and R.M. Stulz (2004), pp. 201-228 and M.C. Jensen and R.S Ruback (1983), p. 5-50

[22] Michael.C. Jensen and William H.Meckling (1976), pp. 305-360

[23] H.G Manne (1965), pp. 110-120

of shareholder. The agency problems will result in negative returns on the side of acquirer, and also at the consolidation's payoff.

Although the rational motives may differ from one merger or acquisition to another, a common measure of success of a merger or acquisition is the increased value of the combined firm.[24] The empirical evidence showed that both good and bad mergers exist from the viewpoint of the acquiring firm's stockholders.[25] To see the major motive of M&A, the author views some empirical researches as will be shown below. Based on those empirical researches, synergy is a main motive of M&A. The author wants to show that the M&A transactions are mostly done to achieve the synergistic benefit. In which synergy states companies are merging in order to be more profitable, have greater company value, and faster improvement than it was before the consolidation. Those have a meaning in shareholders' value maximization in both target and acquiring side.

Here below are some empirical researches which examined the main reasons of M&A occurrence:

a. Bhide (1993):[26] They examined the motives behind 77 acquisitions in 1985 and 1986, and reported that operating synergy was the primary motive in one-third of these takeovers.
b. Eun, Kolodny, and Scheraga (1996):[27] They tested the synergy hypothesis for cross-border acquisitions using a sample of foreign acquisitions of US firms during 1979-1990 and their findings indicate that cross-border takeovers are generally synergy-creating activities.
c. Seth, Song, and Pettit (2000): [28] They found that the synergy hypothesis is the predominant explanation for their sample of foreign acquisitions of U.S. firms.
d. Mulherin and Boone (2000): [29] They studied the acquisition and divestiture activity of a sample of 1305 firms from 59 industries during 1990-1999. They found that the symmetric, positive wealth effects for acquisitions and

[24] Halil Kiymaz and H. Kent Barker (2004), p. 9
[25] M. L. Mitchell and K. Lehn (1990), pp. 372-398
[26] Aswath Damodaran, op cit : Bhide (1993), p. 696
[27] Eun, Cheol S., Richard Kolodny, and C. Scheraga (1996), pp. 1559-1582
[28] Seth, Anuj, Kean P. Song, and Richardson Pettit (2000), pp. 387-405
[29] J. H. Mulherin and A. L. Boone (2000), pp. 117-139

divestitures are consistent with a synergistic benefit for both forms of restructuring.

e. Halil Kiymaz and H. Kent Baker (2004): [30] The study used the sample of largest M&A activity of US firms within period 1989-2003 that investigated the correlation among target, acquirer, and total gains to distinguish among synergy, agency, and hubris as motives of mega mergers. The synergy, agency, and hubris hypothesis imply that correlation between target and total gains are positive, negative, and zero, and the empirical evidence supported synergy as the primary motive for mega mergers where target and total gains are positively correlated with both positive and negative measured total gains.

Based on those empirical researches above, the author considers that M&A is mainly focused on achieving the synergistic benefit within shareholders' firms. M&A activity gives a potential value creation and offers some synergistic benefits for shareholders' merging companies.

The synergy then becomes the critical measure of successful performance after M&A activity. Companies are so called successful in delivering M&A transaction, if the new merged companies are able to show an improvement in their performance, greater profitability, and increment in shareholders firms' value as a synergy hypothesis described.

To show whether the company is achieving the synergistic benefit which is expected to grow after M&A transaction, the author considers some of empirical researches to see the performance after M&A activity. These researches are a stronger test of synergy in M&A.

[30] Halil Kiymaz and H. Kent Barker, op cit, pp. 3-21

2.1.4 Empirical Evidences of M&A

There are some empirical researches that evaluated the performance after M&A activity to see whether the companies may be able to achieve the objective of M&A in which the synergy becomes a main motive.

The researchers showed high number of failures in achieving the synergistic objective or increment in shareholders' value of M&A transaction such as:

a. Coopers and Lybrand (1996): [31] They investigated the percentage of deals that were financially unsuccessful using 124 transactions from 1993-1996. The result showed some key findings which are 66% of the deals were financially unsuccessful; by a substantial margin, surveyed companies reported that a rapid transition ("move quickly than their normal pace of work") had a more favorable effect on gross margin, profitability cash flow, productivity, and speed to market; quick transition companies also reported less difficulty with operating philosophy, management practices and information systems, and compatibility issues; and by almost 9 to 1, companies believed they should have moved the transition more quickly.
b. Mercer Management Consulting (1997 and 1998):[32] They evaluated the percentage of deals that achieve above industry shareholder returns over a 3 year period. The study used 215 transactions valued at $500 million or more and the result showed at 1980s 63% of failure and at 1990s 48% of failure to achieve above industry shareholder returns over a 3 year period. It is showed that the mergers of the 1990s are substantially outperforming those of the 1980s where the improvement was not related to strategy or price but rather to the improvement of post M&A management engaged in a compelling, ambitious vision, understood and shared by shareholders and management alive; a pragmatic approach to the alignment fall the pieces with the vision-organization structures, processes, systems and culture; and a plan for a fast and focused transition.
c. Lajoux (1998):[33] 15 studies were done between 1965 and 1997, covering over 7000 M&A transactions where the result showed that 55-77% of all

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31 Michael J. Shelton-FTC Bureau Economics Roundtable, op cit : Coopers and Lybrand (1997),"The Art of M&A Integration, Speed makes the difference", p. 10

32 Michael J. Shelton-FTC Bureau Economics Roundtable, op cit : Mercer Management Consulting, "The Art of M&A Integration; Making mergers work for profitable growth", p. 9

33 A.R. Lajoux (1998), pp. 49-53

mergers failed to deliver on the financial promise announced when the merger was initiated.

d. A.T. Kearney (1998):[34] They evaluated changes in profitability after M&A transaction of 230 companies where 57% of all transactions didn't bring the desired increase in values and greater return on investment; 29% of all transactions brought improvement; and 14% of all transactions had no change in the values. They also found the frequent effects of M&A where after three years profitability of merged companies decline on average by 10%, and 50% of all alliances in the USA fail within four years.

e. KPMG (1999):[35] They investigated the percentage of deals that failed to increase shareholders value which is measured against a change in equity price pre-deal and in approximately 1 year after. The study used 107 companies who involved in a major deal between 1996 and 1998, the result showed 83% of failure. The study found that successful deals engaged in a combination of the following key best practices: synergy evaluation, integration project planning, due diligence, selecting the management team, resolving cultural issues, and communications. Furthermore, the study also found that chance of success increased for companies which undertook a combination of these practices early in the deal.

   Using the similar measurement of change in equity price pre-deal and in approximately 1 year after, KPMG did the research in 2001 to measure the percentage of deals that failed to meet the success criteria: [36] The sample used 118 companies involved in a major deal between 1997 and 1999 where the result showed 70% of failure and the study found that the successful deals used a robust and a well managed process, priorities' allocation of activities which are going to be carried out, and clear decisions about how and by whom the activities should be handled.

f. McKinsey (2000):[37] They investigated the percentage of deals that failed to meet the success criteria from 47 companies involved in major deals

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34 Gerhard Picot, op cit, Handbook of International Mergers and Acquisitions : Gerhard Picot, op cit, "Economics and Business Law Parameter for the Planning of Mergers and Acquisitions" pp. 7-9

35 Michael J. Shelton-FTC Bureau Economics Roundtable, op cit : KPMG, "Unlocking Shareholder Value", p. 6

36 Michael J. Shelton-FTC Bureau Economics Roundtable, op cit : KPMG, "World Class Transactions – Insight into Creating Shareholder Value", p. 7

37 Michael J. Shelton-FTC Bureau Economics Roundtable, op cit : Bekier, Dollenberg, Fox and Heede," Improving Merger Success by addressing Organizational Issues, p. 5

between 1997 and 1999. The result showed 65% of failure to meet the criteria for success of change in performance ethic profile, and improvement in a combination of market indicators (share price, analyst opinion, and revenue growth). The study found that failures were due to significant dilution of performance ethic, poor implementation, and loss of key people where the characteristics of successful mergers are strength of performance ethic, quick implementation, retention of key people, targets achieve, and positive market indicator.

g. AT Kearney (2000):[38] They evaluated percentage of companies who showed an increment in shareholder value and profitability over a 3 year period post M&A. The study found that 58% of all mergers failed to reach the goals they set out to achieve an improvement in stock prices and profitability where the issues were included failure to put corporate vision first, failure to move quickly enough in establishing leadership team, overemphasis on cost cutting versus growth, failure to overcome cultural differences, failure to communicate, and failure to manage risk.

The author also considers some findings which have shown high number of failures in M&A transaction as below:

a. 1983 a survey demonstrated that only 36% of mergers in Germany were successful.[39]
b. The success of mergers and acquisitions over the last decade gets a grade of C-[40] at best.[41]
c. In 2000 an average takeover premium of easily 50% was paid; in the 1990s, the average comprehensive premium was 40%.[42] On the side of shareholders of the buying company, for all transactions of companies carried out at the NYSE/AMEX between 1995 and 1997, a statistically significant value loss of 10.26% in the five years following the closure can be

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38 Michael J. Shelton-FTC Bureau Economics Roundtable, op cit : Bangkok Post, 5/12/2000, " Seven Sins Can Snag Company Marriages", p. 8

39 Thomas Koch, op cit : W.P. Moeller (1983), p. 272

40 Grade C- means that the companies have not been as successful as hoped for with their M&A transactions

41 J. Robert Carleton and Claude S. Lineberry (2004) : Timothy J Galpin and Mark Hendon (2000), p. 9

42 Müller – Stewens (2000), p. 54 based on figures from Goldman Sachs

observed.[43] According to other studies, the value loss for buyers amounts to about 7% in the first six months.[44]

From the empirical evidences above, it was shown that mostly M&A activity failed to meet the objective of M&A transaction with a quite significant failure rate above 50% of overall transaction. The soft factors issues, such as cultural clash, resistance of change, communication, unwanted turnover, productivity decline, clarity of process, lack of consideration to implement cultural due diligence also to involve HR in the beginning of M&A process, and unmanaged change transition in fast and quick post M&A management become the major causes of significant failure rate. Managing soft factors issues should be included as a factor in calculating the integration cost to estimate the real overall valuation of company. That consideration will be useful to avoid losing the synergy benefit.

Summarizing those causes above, in overall the main reason of failure in M&A is lack of leadership role in managing the soft factor issues during M&A preparation, integration, and implementation phase.

2.2 M&A Process Key Milestone

In overall, M&A activity consists of two types of transaction which are traditional transaction and auction process, where the main difference between them resides on the use of M&A advisory role during the process.

A traditional transaction is basically a normal ‘shake-hands’ deal between contracting parties, it is generally through contacts at a higher or the highest level of the companies concerned or through the services of professional M&A advisers that the contracting parties first come into contact.[45] In this traditional transaction, the role of investment banking or any financial advisory is rarely used and the transaction phase such as negotiation of the deal price occurs only within merging companies.

On the other hand, compared to a traditional corporate transaction, an M&A transaction by the way of the so-called (restricted) bidding or auction process is

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[43] A. Agrawal, Jaffe J. and Mandelker G.N. (1992), p. 1605-1621

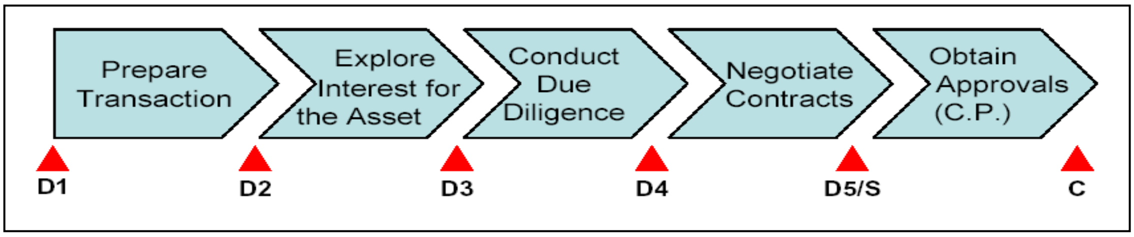
[44] Müller – Stewens, op cit, p. 54

[45] Gerhard Picot, op cit, “Handbook of International Mergers and Acquisitions” : Gerhard Picot, op cit, “Economics and Business Law Parameters for the Planning of Mergers and Acquisitions”, p. 18

distinctive in that the process is determined primarily by the investment and corporate finance or by other M&A advisers to advise, solicit or select the potential interested parties.[46]

The use of M&A advisers is usually determined by the volume of transaction; the higher the volume, the more important of using M&A advisers in order to keep the fairness of transaction, to give the concrete suggestion regarding the optimization of economic value opportunity, and to give best projected picture in each transaction phase. The merger waves as in the table 2.1 and in the figure 2.6 show an increment in M&A transactions' volume, and therefore the author sees that the role of M&A advisers is more needed in M&A activity which means that the M&A transaction is more likely formed in bidding or auction process. Based on that concern, the author here considers M&A process key milestones on a sell side auction as below:

Figure 2.7 M&A Process Key Milestones



Source: Frank Richter (2007)[47]

From the figure 2.7 above, after obtain approvals; the process will go through to closing of transaction. That phase will be mainly focused on post M&A integration and implementation phase of M&A activity. In this thesis, the author mainly focuses on the post M&A integration process including any aspects inside that phase that give a contribution in creating a smooth and fast transition integration process.

Based on empirical evidences of M&A, it was shown that some of causes of M&A failure are related to insufficient information of potential knowledge and risk transfer of merging firms in which this information might be important in terms of managing the integration phase, and another cause is related to overestimation of revenue and synergistic benefit from M&A transaction. Due

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[46] Gerhard Picot, op cit, "Handbook of International Mergers and Acquisitions" : Gerhard Picot, op cit, "Economics and Business Law Parameters for the Planning of Mergers and Acquisitions", p. 20

[47] Frank Richter, op cit, "Investment Banking Part 2 M&A Advisory", p. 13

diligence might be useful in mitigating and preventing those causes above by providing an initial deterrence of potential risk. Therefore, the author in this thesis concerns to the importance of due diligence where it will be more emphasized on HR due diligence as a part of leadership role in managing soft factor issues in M&A activity.

2.2.1 Due Diligence

Due diligence is the methodical investigation of all legal, financial, and strategic facets of a company and a transaction; it is a process that involves obtaining and verifying very detailed information about a company that is not usually found in its public document.[48] The concept itself forms into a systematic observation related to potential value creation, risk of M&A, and business opportunity cost. It may also help company to see the indication whether the transaction should be consummated or it should be terminated.

Based on Jansen (2001), data coming out from the due diligence despite estimating the internal valuation of company, it also values the synergistic benefit and cost of integration to calculate the real value of the bidder which coming out from the sum of stand alone company's value and calculation of integration planning (resulted from synergy benefit minus the cost of integration).[49] The valuation will cover whole potential realization value and not only on financial side of company, but will also exercise the risk of acquisition in part of strategic company and external environment. The result emanating from the valuation will be a based in structuring the transaction's contract covering the projected of warranties and indemnities value of purchase price.

The information and data needed in due diligence activities can be obtained from internal management such as key executives, head of functional department, external party such as law firm and consulting company, and other key accounts such as supplier and distributors. The issue which often arise in due diligence is related to the insufficient access to the information which is generally related to confidential areas. The possible solution of that problem is by issuing some secrecy agreement such as Letter of Intent within potential merging companies so that each one can provide the relevant information with confidence and trust as a foundation.

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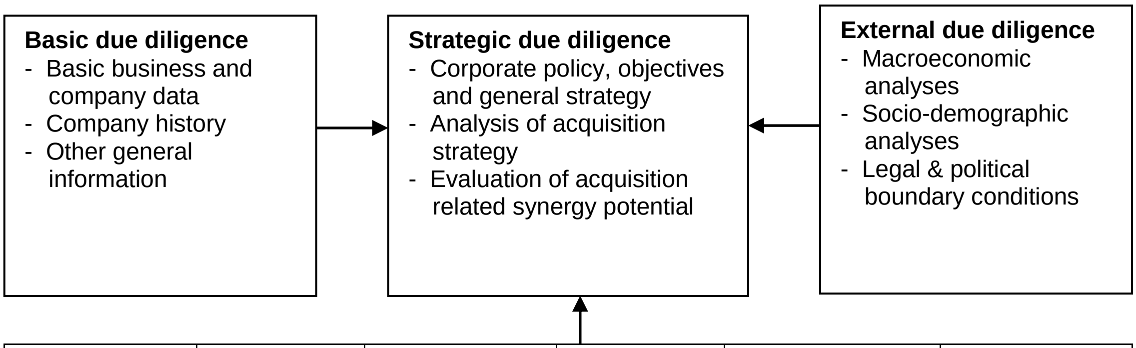
[48] Peter A. Hunt, op cit, p. 691
[49] S.A. Jansen (2001), p. 193

The due diligence activities can be classified into basic due diligence, external due diligence, functional due diligence which all of them give an input to the strategic due diligence of acquisition strategy, as elucidated in a figure of due diligence activities below:

Figure 2.8 Due Diligence Activities



Financial due diligence	**Marketing due diligence**	**Human Resources due diligence**	**Legal & Tax due diligence**	**Environmental due diligence**	**Organizational and IT due diligence**
- Accountancy systems and organization - Annual financial statements and projections - Analysis of the internal accounting system	- Sales organization - Prices /conditions marketing - Sectors Competition Growth	- Management - Employees - Effect on personnel - Evaluation/ analysis	- Internal legal structures - External legal structures - Litigation - Tax-efficient contractual structure Fiscal risk	- Environmental regulations - Products/ Production processes - Industrial pollution and soil contamination - Indication of asset value reductions	- Organization - Information technology

Source: Wolfang Berens, Hans U. Brauner, and Joachim Strauch (1999)[50]

In this thesis, the author focuses on Human Resources (HR) due diligence. HR due diligence contains in depth analysis of management teamwork, staff, structure, and managerial capacity of merging companies which can give a potential input to general strategic due diligence. The strategic due diligence here covers the whole analysis of acquisition strategy and objectives. The real people issues should get a high attention and devotion during merger negotiation and integration phase, because those issues are the core of integration process. That is enforced by key findings of M&A empirical evidences as described earlier in point 2.1.4. Another evidence of the importance of managing soft factor issues is from the Tower Perrin (2007) which observed the problem encountered in M&A; they found that 33 % of general issues are related to management style and inability to implement the

50 Wolfang Berens, Hans U. Brauner, and Joachim Strauch, 1999, “Due Diligence bei Unternehmensakquisitionen“, p. 364

change.[51] Therefore HR should be involved earlier and actively be participated at level of M&A discussion mainly in the HR due diligence stage as one of value added contributor and transformation planner focused on people and potential liabilities issues in M&A process.

2.2.2 HR Due Diligence / Cultural Due Diligence

Initial aspects of a value accounting model for human resources accounting can be found in Flamholtz and Coff's approach where the value of human resources is defined as the present discounted value of their future benefit or related to the quantification of future performance potential and job related replacement cost.[52] Problem related to the value accounting model resides on the assumption that potential benefits are just coming out from cost cutting and economical saving on HR side. The model itself neglects the potential value creation that employees may bring if they are willing to collaborate in integration phase. Employees in M&A activity should be regarded as a company's asset with their potential contribution in delivering the objective of M&A. Therefore the value accounting model is not really a good estimator in valuing the human resources. The wrong perception of HR benefit will create a false assumption of HR due diligence. The false assumption of HR due diligence relates with the assumption that HR due diligence is only done as a subsequent part of financial due diligence in such area of pension liability and cost cutting opportunity, and also as a part of legal issue due diligence related to employees' contractual agreement.

HR due diligence should be considered as important as other due diligence activities and should be done separately as part of functional due diligence area. HR/Cultural due diligence is a diagnostic process conducted to ascertain the degree of cultural alignment or compatibility between companies that are party to a merger of acquisition.[53] It is useful to measure the compatibility level within potential merging companies, and also can be a major consideration in selecting the potential interested parties. It can also act as a good conjecture for new merged companies in designing the new infrastructure, philosophy, norms and practices, objectives and desired cultures, and ideal values. The compatibility evaluation will be a basis to measure the complexity level of

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[51] Tower Perrin, Life Insurance CFO Survey # 16 (2007), p. 3 based on Exhibit 6
[52] E.C. Flamholtz and R. Coff (1989), p. 43
[53] J. Robert Carleton and Claude S. Lineberry, op cit, p. 53

integration and to give an initial estimation of number of resources and projected time needed in integration phase.

The table below consists of the critical HR/soft factor issues or compatibility issues with their impact to the transactions process and also the types of documents needed to be observed by HR due diligence.

Table 2.2 Critical HR Issues to Examine During Due Diligence

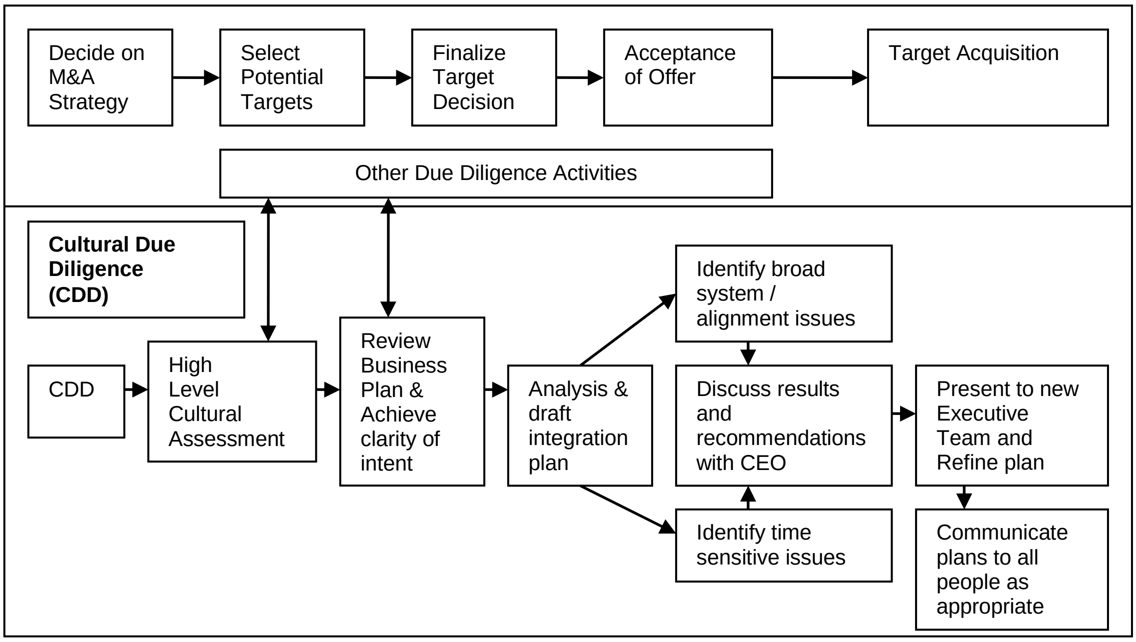
Issue	Impact	Documents to examine
Organizational culture	Cultural differences most often have a significant impact on integration, but only in rare situations is a "show stopper" or have an impact on price. In those situations, where culture has been the deciding factor in stopping a deal, it is typically a result of senior leadership incompatibility or indications of strong differences in ethics/value systems	a. Customer lawsuits b. Employee lawsuits c. Industry/governmental audits d. Employee surveys e. Retention/turnover statistics f. Grievance reports
Employment practices	Excessive problems discovered around HR policies and practices on the surface can portend much more significant problem underneath. The number and type of employee lawsuits (both closed and active), grievances, work stoppages, and negative audits results all can be indicators of much deeper problems	Same as above
Health and welfare benefits	The currency of insurance premiums; accruals for medical, dental, sick pay, vacation, etc.; and reserves for incurred but unpaid claims (medical, dental, short term disability, and other self funded plans) can have a material financial impact	a. Plans documents b. Financial reports from third party administrators or carriers
Retirement benefits	Unfunded obligations of current, frozen, or terminated pension plans can be significant, including situations where the plan financial obligations exceed the value of the deal. In addition, the unfunded employer contribution for a defined contribution plan can present both a significant financial obligation and a compliance issue	a. Defined benefit plan document b. Most recent actuarial valuation c. Trust statement
Compensation commitments and compliance	It is important to quantify existing and future compensation commitments. Expenses for commissions, incentives, bonuses, etc., can be both significant and unpredictable. It is also critical to examine compliance with FLSA job classification of exempt/nonexempt positions, as FLSA violations can result in significant back pay and fines	a. Variable pay and retention program plan documents associated communications b. FLSA policy manual
Executive change-in-control provisions	Significant or excessive severance/change-in-control payments could trigger excessive costs in absolute terms or in terms of percentage of market capitalization, as well as potential image issues. In some circumstances, the magnitude of 280G gross-ups may stop the deal	a. Deferred compensation plan documents b. Executive contracts Change-in-control agreements c. Broad-based severance plans d. Stock option plan/ agreements and data e. Associated communications f. Proxy statement executive compensation disclosures

Source: Robert A. Bundy (2005)[54]

54 Robert A. Bundy, 2005, "Making the most of M&A Due Diligence; Paving the Way for a Smoother, Faster Integration", p. 6

To do the cultural assessment, the author considers a framework of cultural assessment from J. Robert Carleton and Claude S. Lineberry (2004).[55]

Figure 2.9 Cultural Assessment



Source: Modified from J. Robert Carleton and Claude S. Lineberry (2004)[56]

Based on the model above, the due diligence is done after companies decide M&A strategy, and within the phase of selecting potential interested parties, finalizing target decision, and accepting of an offer or as in the figure 2.7 is after explore interest for the asset phase. The cultural due diligence is conducted as part of other due diligence of hard factors analysis activities by reviewing some internal documentations such as retention and company's history, employees' survey, and company's intent. Despite analyzing those documents, the observation can also be formed in customized assessment such as a quantitative survey of soft factors attributes. The survey itself will be a systematic observation formed to identify and profile the characteristic of soft factors' domains. The domains consist of intended direction and results, key measures, key business drivers, infrastructure, organizational practices, leadership/management practices, supervisory practices, work practices, technology use, physical environment, perceptions and expectations, and cultural indicators and artifacts.[57] However, to have more an exquisite

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[55] J. Robert Carleton and Claude S. Lineberry, op cit, p. 76

[56] Modified from J. Robert Carleton and Claude S. Lineberry, op cit, "Achieving Post M&A Success", p. 77

[57] J. Robert Carleton and Claude S. Lineberry, op cit, p. 53

assessment, in depth interview with key executives, management presentation, and site observations can also be considered important.

Then, after gathering and estimating key people issues, risks, and also potential compatibility benefits of new merged companies, those findings will be analyzed and translated into integration planning draft. The integration planning also considers the alignment issues or degree of relatedness with potential merging companies, and also the time commitment of integration. The comprehensive integration planning will be reviewed with Chief Executive Officer (CEO). Those reviews and feedbacks will become major consideration for key executives in refining the integration strategy to win the merger. The remit of HR audit within overall due diligence process can be as an initial precaution to determine the effects of a takeover on employees, and to analyze and assess existing HR assets.[58] And for the final step of cultural due diligence of communicating strategy merger plan to all employee will be discussed as part of steps in post M&A integration.

After formal closing of the transaction and signing the contract, the next activity will be post M&A integration. In this thesis, the main focus will be on post M&A integration phase, and as explained before the author considers the due diligence activities especially HR due diligence as a great potential input to create a smooth integration and to tackle pitfalls in post M&A integration. To have a clear understanding, the author tries to give an illustration regarding post M&A integration and the aspects inside that phase as will be described in the next point.

2.3 Post M&A integration

Post M&A integration is the important process in overall M&A activity, without a good preparation and a deep understanding of overall integration task, M&A transaction will result in bad performances then affect in financial and synergistic benefits of M&A. The study by A.T. Kearney 1998 showed that 49% of weighted success factors in the entire merger process are in post M&A integration.[59] Despite other focus of increasing synergies as a realization of hard factors, the major focus in post M&A integration is related to the managing

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[58] Gerhard Picot, op cit, “Handbook of International Mergers and Acquisitions” : Heinrich Pack (2002), p. 172

[59] Gerhard Picot, op cit, “Economics and Business Law Parameters for the Planning of Mergers and Acquisitions” : A.T. Kearney (1998), “Business International”, p. 15

soft factors issues which remain as the hardest one such as the integration of cultures and the coordination of all processes and systems inside the cultures. Companies should determine the type of cultural integration that they want to build around by considering the strength and weakness from each company. Integration strategy and the implementation planning will be based on type of cultural integration that they choose to pursue.

2.3.1 Cultural Integration Strategy

There are three different strategies for cultural integration:[60]

a. *Monoculture strategy* where the larger corporation more or less superimposes its corporate culture on smaller corporation in a kind of ‘cultural colonization’.
b. *Multiculture strategy* where the acquisition retains its own culture, the resulting peaceful coexistence is rated positively and viewed as enrichment.
c. *Mixed culture strategy* where both corporations merge into one, and the workplace is combined, a new, joint culture develops that is supported by everyone.

The cultural imposition as in monoculture strategy may lead to high resistance from employees and somehow may impact in destroying the value of the merger. In this strategy despite imposing the culture, to minimize the effect of disruption, the company should consider the importance of managing other potential soft factors issues such as communication and management style issue. According to A.T. Kearney research study, it is a problem in many mergers that the more powerful partner imposes his culture on the less powerful one, especially when both partners are very different; it needs a closer evaluation, which culture will be best for both together.[61]

Multiculture strategy may work if merging companies have less similarity in scope of business or have different patterns in industries activities. They prefer to retain their own culture, so each company may perform their normal work pace without any interference or change from other company. Multiculture strategy may work if the major motive is a growth strategy, and the M&A is done

[60] Gerhard Picot, op cit, “Handbook of International Mergers and Acquisitions” : Peter H. Pribilla (2002), pp. 316-317
[61] Oliver Recklies (2001), p. 2

with a small or new company. Variety of culture is expected to give potential added value of shareholders' companies. Differences can be valued as a potential source of synergy.

Although in monoculture strategy, the stronger company will impose the culture to the weaker company and in multiculture strategy, each company will retain its own culture, those cultural integration strategies will result in developing shared corporate values incorporated with a new vision, mission, value statements and company's code of conduct. Those also require a proactive change management process.

The most common cultural integration is in a mixed culture strategy, this happens usually in horizontal mergers or merger of equals.[62] The integration strategy will result in setting up new cultures. New merged company will have a new culture with new feasible vision, mission, and shared values aligned with structure, systems, strategic direction which expected to be realized from M&A activity. This strategy mostly focuses on fit approach within merging companies, and the strategy to capture and compound their best practices. Merging companies aware the differences within inheritance cultures and use the differences as a basis to create new culture that give the new company high competitiveness edge in business position. The author emphasizes here on mixed culture strategy because this integration strategy needs an intensive effort and longer implementation related to a higher degree of difficulty. Another reason is although the mixed culture strategy has a higher difficulty in implementation process, the mixed culture strategy is an ideal integration strategy which pledges better achievement in future M&A related to the balancing best elements from merging companies. This has also been invigorated by some recent conceptualizations of integration as described below:

a. Integration is a more complex and interactive mutual adjustment between two organizations.[63]
b. Integration requires more of a facilitated dialogue than a linear, unilaterally directed change process initiated by the acquiring organization to gain administrative control.[64]

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[62] Gerhard Picot, op cit, "Handbook of International Mergers and Acquisitions" : Peter H. Pribilla, op cit, p. 317
[63] A.L. Pablo (1994), p. 803-836
[64] Sim B. Sitkin and A.L Pablo (2004) : W. Isaacs (1999), p. 2

c. Integration requires a significant change on the part of the acquiring organization as well as by the acquired organization.[65]
d. The mutual adjustment conceptualization of integration takes into account the relative difficulties of managing a range of degrees of boundary disruption, which may be managerially more difficult to implement than either a largely hands-off or an all-encompassing approach, because it implies the need for selectivity and restraint on the part of the acquirer.[66]

The mixed culture strategy needs a manageable change process to cover the whole objectives of M&A. The new culture, vision, and any other alignment process are created by taking into account the recommendation from due diligence including HR due diligence.

2.3.2 The Integration Steps

In the integration phase which mostly focuses on mixed culture strategy, companies use the analysis and integration plan coming out from strategic due diligence. Strategic due diligence becomes an instrument to indicate the hard and soft factors issues in M&A. The due diligence can be considered as start up phase of integration. In this thesis, the author points out on HR due diligence as pre initial analysis in managing soft factors issues. The soft factors analysis result will be integrated with the hard factors of company's strategic and organizational structure of M&A transaction towards achieving overall M&A objectives. Thus, due diligence will be a formal tool to asses the potential problems and preventive action of post M&A integration. If the soft factor issues relating to the critical concerns in M&A change such as culture disparity and any other alignment domains have already addressed early on since the phase process started, the technical issues such as framing the rewards system, integrating organizational structure and detailed functional platforms will have more time to be managed in post M&A integration process.

The integration process as a whole can be divided into two phases, the first phase is design integration, which usually takes 2-3 months depending on the scope and complexity of the merger, and the second phase will be an executing

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[65] Sim B. Sitkin and A.L Pablo, op cit : P.C. Haspeslagh and D. B. Jemison (1991), p. 3

[66] Sim B. Sitkin and A.L Pablo, op cit : D.T. Bastien and A.H Van de Ven (1986); P.C. Haspeslagh and A.B. Farquhar (1987); P. Haspeslagh and D.B. Jemison (1991); A. Nahavandi and A.R. Malekzadeh (1988), p. 3

integration which takes around 1-2 years.[67] The refined integration plans from strategic due diligence consists the whole topics of post M&A integration. In integration design phase, the whole topics related to issues in post M&A integration should be prioritized using some evaluation criterion to derive the importance of the topics with their potential impacts, and also to fetch the level of decision making and reporting requirements for each topic. The result of the prioritization will be derived into post M&A integration organization structure. The post M&A integration structure consists of merger team where each team comprises of key executives, managers, and all employees from merging firms who handle the project topics.

The main points to be highly considered and managed in integration design in area of soft factor issues are:

a. Build a new vision which covers the whole objective of M&A.
b. Determine the shared values and attribute cultures that companies want to build.
c. Seek employment opportunities of company by identifying the composition of management structure and personnel capacities that the merged companies want to build. The merged companies should try to secure the high performing talent and minimize the redundant employees. As additional for creating new structure, despite on sourcing with existing personnel, the external hiring might be considered to maximize performance of new organization.
d. Decide the new managerial and functional capabilities. The new platforms of HR function such as reward system should also be built as a critical point to ensure an effective integration process. That is designed and built by a group consisting of HR staff from whole merging companies by reviewing current company's practices and strategy integrated with the new objectives and formulated integration plan from merged companies. In the case of cross border M&A, in designing the reward system, companies should also consider some regulations and policy from each country, therefore it might be able to employ by employees from each merging countries.

   The consideration of managerial and functional capabilities is invigorated by main focus of retaining key employees where according to some studies the

[67] Thomas Koch, op cit : McKinsey (1998 and 1999), Industry Survey, p. 277

retention level increases after M&A activity and may destroy a substantial part of M&A value.

There are some findings regarding the increment of retention level which are:

- Up to 50% of a target's management leaves the company in the first 3-5 years.[68]
- In US companies, a much higher number of managers leave during the first 2-3 years after an acquisition than before the acquisition or in comparable companies.[69]
- When no coordinated retention actions are taken, 47% of all senior managers leave within the first year of the acquisition. But the exodus doesn't stop there. Within the first 3 years, 72% end up heading for the door'.[70]

e. Build a good communication strategy and create an open environment.
f. Build a realistic estimation of potential value creation.
g. Employ a strategic due diligence as a basis to employ an effective integration.
h. Build qualitative soft factors measurement and review based on business performance drivers to measure the success of integration, therefore the further improvement of post M&A integration can be built.

After setting the integration design, *the next phase* will be an integration execution. This phase is done to implement the detailed plans which have been set up in the integration design phase. The detailed plans should be communicated persuasively with all employees to reduce the rumor and ambiguity within employees. This stage will be formed in a large working change team where each team performs its project plans. Each team is being represented by a functional manager of each department such as corporate culture, human resources, and so forth. Those teams will work together in cross functional departments supervised by integration board projects. Ideally the

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[68] C. Hermsen (1994), p, 133
[69] N. Sewing (1996), pp. 107
[70] P.Pritchett (1997), p. 101

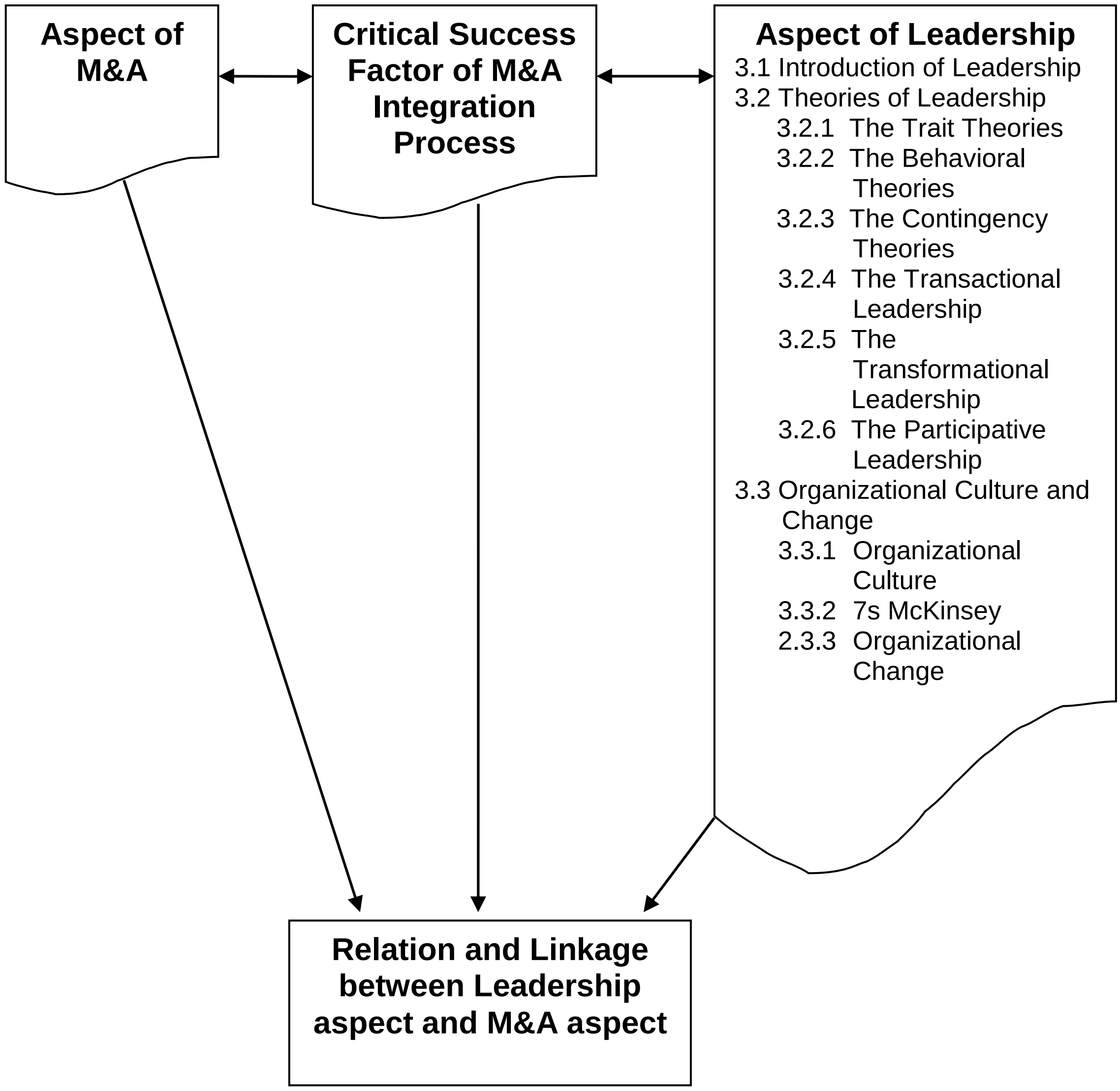
integration board projects consist of the CEO and key executives from whole merging companies. The knowledge integration database should be created to facilitate in monitoring M&A integration activities such as project integration improvement, and in simplifying information access for every members of project merger integration team. The knowledge database can be modeled in some form like knowledge management system or some IT assisted system.

As described earlier, post M&A integration relates with significant change in soft factor area of new development vision and shared culture values. As a relation to the next chapter of aspect of leadership, the author tries to relate and incorporate the post M&A integration phase with leadership aspect in the explanation of chapter 3. The author tries to find a leadership role in managing the M&A integration change.

Chapter 3

Aspect of Leadership

Figure 3.1 Analytical Framework Focus on Aspect of Leadership



3.1 Introduction of Leadership

Leadership is “a set of processes that creates organizations in the first place or adapts them to significantly changing circumstances and defines what the future should look like, aligns people with that vision, and inspires to achieve it despite the obstacles”.[71] There are different ways to define the terms between leadership and management. Management is “about results, resources, expected roles, activities, contributions, performances, and about solving problems that arise, and preventing them from recurring or occurring in the first

[71] John P. Kotter (1996), p. 25

place".[72] In another way, management focuses attention on organizing, running the vision and strategy coming out from the leader, and managing the complexity and technical issue in order to achieve the consistency proceed which occur in daily or even in short term period. Leadership, however, is defined as a province of art in management and is more likely to be about people: knowing them; respecting them; respecting their individuality; and bringing them towards the conclusion that they are working for their own best interest when they give their best to the team.[73] Leadership can also be defined as the ability to influence a group towards the achievement of the goals.[74] It has an image of mobilizing people to tackle tough problem.[75] In the context of leadership, the main focus is in optimizing the will power of people to handle change where the change itself has a tendency to shift towards to a steep or dramatic level. Leadership works "through the connection that people feet to social groups (i.e., to the team, the organization, or the institution within which leadership is being exercised), while management works through the reward and punishment or other behavior and attention channeling system".[76]

The success of an organization depends on both effectiveness of management and leadership. Management and leadership terms can't be separated, but should be solidified and act as a complement even though they subject to different focus and risk preferences.

To achieve the optimum performance of post M&A integration, despite demonstrating a good management in managing daily procedures and process functions, the author suggests that leadership should be also considered as a key factor for post M&A integration process in the terms of coping and nurturing the change. Leadership also acts as a change initiator, plays an important role in the beginning of change at creating and communicating new shared values and also in handling the human side or soft factor issues of M&A integration process.

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[72] Andrew EB. Tani (2002), p. 4
[73] Andrew EB. Tani, op cit, p. 5
[74] Stephen P. Robbins (2003), p. 314
[75] Ronald A. Heifetz (1998), p. 15
[76] LeBoeuf, et al. (2006), p. 1

3.2 The Theories of Leadership

3.2.1 The Trait Theories

Trait Theories are defined as theories which consider personal qualities and characteristics that differentiate leaders from non leaders.[77] They suggest that leader is almost always thought of as only men in that era, was assumed to have inherited combinations of traits that distinguished them from followers, the notion then was those destined to be leaders were born not made.[78] These unique traits theories can be a ground for an organization in choosing the appropriate person to become a leader in organizations even there is no assurance that the person will lead effectively. However, these orientations of common traits have several shortcomings, which are people have some illusion of being a born leader without envisaging leading effectively. Followers, who appear themselves and do not exhibit traits as a great leader, tend to become passive and not being empowered to take some necessary action when it is needed. The effectiveness of traits theory can only prevail for some considerable context or it is quite influenced by situational conditions. Trait theory can be effectively used by leaders in terms of leading through the crisis. The directive style of leadership is often used in dealing with crisis and to emerge as a good crisis manager, a leader having the personal attribute qualities and traits in this theory may lead a company out of a crisis with higher probability of success. The six traits of leaders described in trait theory are ambition and energy, the desire to lead, honesty and integrity, self confidence, intelligence, and job relevant knowledge.[79]

The author suggests that the trait theory can't work out in post M&A integration process because the need of high employees' engagement and empowerment during post M&A integration process. Followers are less likely to be engaged and participated in change integration process. "Organizational reorganization, including merger and acquisition, represent a major transformative event for organizations and the people in them".[80] Even if leaders have some personal qualities of effective leaders, it doesn't mean that they may lead effectively in managing transformative change and handle the risk of avoidable problems of integration process. Another reason is a consideration of situational factors,

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[77] James G. Clawson (2006), p. 1
[78] Michael A. Hitt, J. Stewart Black and Lyman W. Porter (2005), p. 361
[79] S.A. Kirkpatrick and E.A. Locke (May 1991), pp. 48-60
[80] G.K Stahl and M. Mendehall (2004), chap 8 p. 2

post M&A integration requires leader to be able to adapt their leadership style contingent on different particular situation during integration process.

3.2.2 The Behavioral Theories

Behavioral theories propose “that specific behaviors differentiate leaders from non leaders”.[81] The underlying assumption of this theory is that inborn traits or personal qualities are not a determination factor of a leader term but rather than come from some specific behavior characteristics which possibly can be learned. The absence of this theory is a lack consideration of situational factors. Situational factors become a critical point for the effectiveness of leadership behavior. The most appropriate use of different leadership behavior in a leader’s decision style depends on a number of organizational contingencies including task complexity, the leader’s formal power, time frame available, and follower characteristics such as competency, motivation, goals, and attitude toward the leader.[82] For post M&A integration, the author suggests that this theory might be difficult to apply because of its flaw. The lack of situational factor is considered a reason for a behavior theory not to be appropriately applied in post M&A integration process.

3.2.3 The Contingency Theories

Contingency theories examine “which decision making style fits with situational contingency, in order for the decision maker to maintain control of the process”.[83] Situational factors such as leader’s capability, follower readiness, and aspects of the situation become major differences in determining the suitability of the leadership’s style in terms of decision making. Contingency theories show there are no unique traits or behaviors to show the effectiveness of leaders. To show their effectiveness, they should be able to adapt their style and behavior according to some specific situational condition. The contingency theories are an optimistic approach where it moves toward the assumption of the appropriate way to lead. They attempt to "specify the conditions or situational variable that moderate the relationship between leader traits or behaviors and performance criteria".[84]

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[81] Stephen P. Robbins, op cit, p. 316
[82] Phillip L. Hunsaker (2005), p. 423
[83] Ronald A. Heifetz, op cit, p. 15
[84] Wayne K. Hoy and Cecil G. Miskel (1987), p.274

The author suggests that these theories can be used in post M&A integration in terms of developing a team merger. In post M&A integration process, a transition merger integration team should be set up to help in establishing the new structure, shared vision, strategy, and guidance process of merging companies and be a good example for demonstrating the learning process within merging companies. Another contribution is that the successful transition process guided by merger integration team might imparted their affect as a lesson for a future organization in terms of managing new restructuring or any new engagement process.

The leader should be adaptable to use their leadership style to create a positive dynamic merger team. The follower readiness is a factor for a leader to assign their style in a merger team development. The effectiveness of leading a team resides on a leader capability to analyze the group needs, to adapt their leadership style to some situational conditions, and to enhance the performance of a member team.

Because of the importance of developing merger team, the author gives a further description of contingency theories by taking into consideration four windows of leadership from John DW. Beck. Whereas each leader's profiles will highlight the way leaders make decisions, the way they communicate, and the recognition they give to team members.[85] The author uses these windows as part of contingency theories which might effectively be used to build a dynamic merger integration team regarding to some situational aspects within the stages of team development. As mentioned before that each situation is unique, especially in a new M&A process where key executives and managers within merging companies are unfamiliar within each other and without the ability to facilitate and coordinate the gap, the slower outset will occur. That will reduce the speed of integration also waste a valuable time to foster strategic benefits of the merger.

The first window is *director or dominator*. In post M&A integration process, this style might be effectively applied in order to reduce employees' ambiguity in the beginning of change process. The leader gives the complete explanation of the integration process, and the consequences of the M&A change process. The leader also clarifies the mission and expectations of merger transition team. Here leader as director gives an orientation to the merger integration team

[85] John DW. Beck (2001), p. 35

about ground rule task and resolves member's anxiety in the beginning process of team's formation.

The second window is *problem solver*. The problem solver leader can be effectively used to build employees' engagement of merging companies which aims to decrease resistance to change and increase commitment to organizational goals. The leader shows willingness to hear the followers' view and opinion, although the final decision will come from the leader. The problem solver will act as a motivator by influencing key people to participate to champion the strategic direction of M&A. The problem solving type is needed to make employees buy in and get organized. The problem solver leader plays a role to solicit employees' viewpoint to build an effective common system covered the new shared vision and values, infrastructure, and strategy for merging companies. But, leader should be careful to be efficient in managing the process because of time constraints during post M&A integration and because the involvement of employees sometimes may lead to time consuming discussion. The leader should also be aware of not being over involved and lacking the ability to tap the formidable talents on their staff. The leader should create an atmosphere where team members are comfort, able to explore their view despite leader's influence. This leadership style is needed in the discussion and exploration of ideas of executive and all managers in setting a new direction for an organization.

The third window is *developer*. The employees are given more responsibility in making their decisions with less intervention from the leaders. For post M&A integration, this leadership style might be effectively applied to generate the continuous effort in achieving benefits and objectives of M&A transaction. This style works if the bond of working relationship between team members of merging companies is already strongly built, and there exists a trust within merging companies. The developer leader is needed to help team merger integrations identify upcoming strategies for continually improving performance of M&A, to empower people to refocus their energy in a forward goal and direction, and also to reinvigorate the process. Even though the critical decisions for integration process have been achieved like the establishment of a new structure, process, and shared value also vision.

The fourth style is *delegator.* In post M&A integration, delegating leader may not be used effectively because the leader should provide the high support and guidance to the employees in coping with the change process and act as change initiator. The leader's attention is required in handling the change process and creating an effective relationship within merging companies.

Despite of the advantages of these theories, there are some limitations which are: it oversimplifies the options available to leaders and the range of situations that leaders encounter; it makes an illusory promise to make leaders' lives less confusing and perplexing, and has to become a secular religion in leadership theory, it neglects the Pygmalion effect,[86] and it fails to distinguish between support for a person and support for specific actions.[87]

The limitation of these theories is related to the inconsistency in the application result of contingency theories. The theories are related to an intuitive consideration. Leaders should have a proper skill to specify and isolate the situational conditions before they adopt their style contingent on isolating situational conditions. In post M&A integration, these theories may lead to leaders' ambiguity in assessing and distinguishing the situational conditions during integration process or related to situational aspects within the development of post M&A integration team, and adjusting their style according to the unique situational conditions.

In spite of their limitations, the author suggests that the contingency theories are a good basis to manage the M&A process, the contingency theories of leadership help leaders to make appropriate decisions contingent on unique situational aspect during integration process. Although these theories focus less on other context of leadership terms such that inspire follower to participate on the M&A change not only due to leader's expectation as in the Pygmalion effect. Disregarded the importance of leader to inspire follower on the needs of change will result in lower commitment and involvement of employees to new organizations.

[86] Pygmalion effect also called self fulfilling prophecy effect enables staff to excel in response to the manager's message that they are capable of success and expected to succeed. The Pygmalion effect can also undermine staff performance when the subtle communication from the manager tells them the opposite. Whereas J. Sterling Livingston in the September/October, 1988 Harvard Business Review state that "The way managers treat their subordinates is subtly influenced by what they expect of them"

[87] Lee G. Bolman and Terrence E. Deal (1991), pp. 419-420

3.2.4 The Transactional Leadership

Transactional behaviors are leadership actions that focus on accomplishing the task at hand and on maintaining good working relationship by exchanging promises of rewards for performance.[88] The transactional leadership works as a management function with some clear standards and structure to achieve the established goals. This kind of leadership behavior is falling within two broad categories or influences, one is transactional leadership which seeks to motivate followers by appealing to their own self interest with principles to motivate by the exchange process, and the other is transformational leadership which will be described later on.[89]

The author suggests that transactional leadership can play a beneficial role in maintaining the stability during the integration process; it helps the organization to focus on meeting ongoing business commitments, operational performance targets throughout the integration process and also in monitoring the key decision of M&A transaction. Despite the advantage of this leadership in M&A integration process, it has a limitation in which the subordinates' tend to be engaged and perform their effectiveness based on rewards motivation such as promises of reward for good performance and recognized accomplishments. Though the limitation, the author considers that the transactional leadership can be a good approach to motivate employees to give their extraordinary effort and participate during post M&A integration regarding to its role as described above. However, the post M&A integration process not only emphasizes control of value creation but it also deals with coping a transformative process for whole organizations and employees there. Therefore the author considers that in terms of leading M&A changes despite transactional leadership, the transformational leadership is also required to realize a successful transition process where the detailed description will be seen as below.

3.2.5 The Transformational Leadership

Transformational leadership refers “to the process of influencing major changes in the attitudes and assumptions of organization members and building commitment for the organization’s mission, objective and strategies”.[90] They are responsible for leading a corporate transformation that “recognize the need for

[88] Garry Dessler (2004), p. 263
[89] James MacGregor Burns (1979), p. 36
[90] Garry Yulk (1989), p. 324

revitalization, create new vision, and institutionalize change".[91] Generally, transactional leadership and transformational leadership are viewed as a contrary, but the transformational leadership is an advanced approach of transactional leadership. The leader should not only consider on achieving the established goals but also taking into account the increment of moral level of followers by injecting enthusiasm, energy and passion in order to achieve extraordinary effort from followers towards to lower turnover and increment in employee's productivity and satisfaction. The terms of transformational leadership has several characteristics, such as charisma, but is not viewed as pure charismatic leaders, and employees' encouragement in seeking alternative approaches to solve the problem. Transformational leaders cultivate employees' acceptance and commitment to those visions.[92] The balance between attention to the action and the emotional state is being the focus from transformational leadership.

The author suggests that in post M&A integration, transformational leadership can be used as a good practice to implement organization's transformational changes. It works to build commitment of employees and align them with the new mission and vision of shared merging companies with trust and integrity as a base principal. Transformational leadership aids the leader to empower the follower to participate in the change process and build employees' engagement during the integration process. M&A transaction may lead to major disruption in the organization. Therefore, the transformational leader is needed to reduce employees uncertainty by providing an effective communication and building their confidence to tackle the risk during the change. Transformational leadership is needed in terms of managing the soft factor issues that arise in post M&A integration process. However, transformational leadership may not be worked out if employees are less likely to be affected and motivated by the change terms.

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[91] J. Setzler and M. Bass (1990), p. 694
[92] R. J. Deluga (1988), p. 457

3.2.6 The Participative Leadership

A participative leader is "a leader who shares the problem with subordinates as a group so that together, they can generate and evaluate alternatives in order to reach consensus on a solution".[93]

Participative leadership suggests that employees should be encouraged to participate, get involved, and give input in the decision making process. The author suggests that participative leadership might be useful in increasing employees' level of engagement and willingness to deliver effort on changes process during post M&A integration process. A participative leader helps to establish employees' sense of urgency of the importance of change and involvement in the direction of new organizations. If the urgency is Iow, then M&A change may not succeed because only a few followers show their interest in working on the change problem. Participative leadership may be affective in enhancing the speed of post M&A integration resulting in higher possibility of the M&A success. However this theory can only be applied if the members are willing to collaborate in the process. The resistance of this theory may come from people who tend to maintain their stability in the working environment such as people in higher level of work or people have less initiative in participating in a new learning process. Those people see an alteration as a disruptive event and may give negative impacts to their career.

Based on the descriptions above, the author concludes that the contingency, transactional, transformational, and participative leadership can be effectively used for a leader in order to cope with M&A change. The contingency theory will be useful for a leader to make an effective decision depending on some situational conditions during post M&A integration process; the transactional, transformational, and participative leadership will be effectively used in terms of inspiring and motivating employees to participate in integration process and achieve established M&A objectives.

[93] V.H. Vroom and A.G. Jago (1978), pp. 151-162

3.3 Organizational Culture and Change

3.3.1 Organizational Culture

Organizational culture refers "to a system of shared meaning held by members that distinguishes the organizations from other organizations".[94] The culture itself is embedded in employees in several ways namely in a selection process where people who enter the company should match with intangible values of company; in top management's behavior in which norms and official rules impose the culture; and in socialization where employees learn to employ the culture.

Research suggests that there are seven characteristics that, in aggregate, capture the essence of an organization's culture which are innovation and risk taking, attention to detail, outcome orientation, people orientation, team orientation, aggressiveness, and stability.[95] Strong culture tends to increase level of organizational effectiveness driven by a strong dedication of employees in doing their task.

However culture can also be a major obstacle for an organization to implement some changes. The strong and arrogant culture will make the change process difficult to implement. M&A relate with some transformative change and culture incompatibility can be a potential clash within merging companies. The indication of strong differences in values system or culture incompatibility is laying on the differences of seven characteristics of an organizational culture from each merging companies. Strong culture can lead to resistance of change and it might complicate the restructuring process in capturing the value of merging companies. The full M&A integration is more likely difficult to achieve if merging companies have different broad types of business. Therefore the deep understanding of merging partners' culture is needed to get some impression of appropriate methods and steps process should be taken in rebuilding a new organization or even in imposing the exist culture to other companies.

A.T. Kearney (1999) have done surveys of 115 transactions around the globe, it has discovered why many mergers are unsuccessful and the cultural differences are being blamed as a reason, those are related to cultural imposition without a further consideration of cultural clash where in some cases is a valid strategy but in others it destroys the value the merger was supposed

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[94] Edgar H. Schein (1985), p. 168

[95] C.A. O'Reilly III, J. Chatman, and D.F. Caldwell (Sept 1991), pp. 487-516

to create.[96] As a conclusion the major obstacle in the phase of post M&A integration is coming from soft factors clash where cultural clash is part of that. The term culture clash is defined by its symptoms namely as described below:[97]

a. Observable differences between the companies involved in a merger about: *what is believed; what is important; what is valued; what should be measured; how people should be treated; how people treat one another; how decisions are made; how to manage and supervise; and how to communicate.*
b. The disruption that occurs when the way one company conducts its business and treats its people is folded in with another company's way of doing business.
c. Differences of opinion, disagreements, arguments, and different assumptions regarding the internal process of implementing the new business plan and strategy.
d. Perceived differences in organizational beliefs, values, and practices.
e. Perceived differences between the two companies in degree of formality in style of dress, language, work space, communication, and so forth.
f. "*Winner-Loser"* language used by either organization's people.

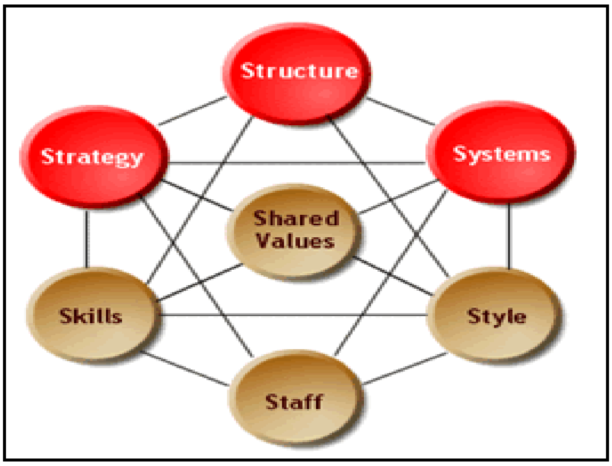
The soft factors are based on the 7s McKinsey framework which consists of shared values, skills, staff, and style where the detailed explanation will be given in the next point. Those soft factors are correlated with hard factors of 7s McKinsey which are structure, strategy, and systems which all together serve as a unity framework for analyzing and improving the organizational effectiveness which is in this thesis used to achieve the relation of leadership aspect in M&A. Unmanageable and clash in soft factors issues may result in longer time of integration and losing the momentum of the transaction. Leader should be able to identify the culture disparity within merging companies upfront and build a well managed process to address the differences related to the core objective of M&A.

[96] Greame K. Deans, Fritz Kroeger, and Stefan Ziesel, op cit, p. 115
[97] J. Robert Carleton and Claude S. Lineberry, op cit, pp. 13-14

3.3.2 7S McKinsey

The soft factors above are drawn in the "soft S" in the McKinsey 7S Model. The lack of intention in managing the soft factors of shared values, style, skills, and staff will result in failure of M&A change processes.

Figure 3.2 7s McKinsey



Source: M. Rasiel and Paul N. Friga (2002)[98]

The soft factors are a major concern in M&A change based on empirical evidences of recent M&A transactions with some issues of clarity of new shared values, employees' communication, key retention, knowledge transfer, and alignment of culture. In cross border M&A, the issues of discrepancy of soft factors mostly take a major attention during post M&A integration.

These seven factors of McKinsey can be divided into hard factors and soft factors, in which seven of them correlate each other. **The hard factors** consist of *Strategy* as the direction and scope of the company, *Structure* as the basic organization of the company, its departments, reporting lines, area of expertise, and responsibility (and how they inter-relate), and *Systems* as formal and informal procedure that govern everyday activity, covering everything from management information systems, through to the systems at the point of contact with the customer, and **The soft factors** consist of *Skills* as the capabilities and competencies that exists within the company, *Shared values* as the values and beliefs of the company, *Staff* as the company's people resources and how they are developed, trained, and motivated, and *Style* as

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[98] M. Rasiel and Paul N. Friga, 2002, "The McKinsey Mind: Understanding and Implementing the Problem Solving Tools& Management Techniques"

the leadership approach of the top management and the company's overall operating approach.[99]

To achieve the success of M&A overall process, an efficient management and integration of hard factors and soft factors of 7s McKinsey factors are becoming the key success factors for managing the overall M&A process. All the 7 factors should be correlated and managed to realize the synergistic benefit of M&A.

In this thesis, the author focuses on managing the soft factors in terms of achieving the successful M&A process by instilling leadership practices in overcoming the soft issues problems which remain as the toughest issues in M&A integration process. Strong leadership in managing soft factor issues will give a great leverage in making quick and effective fundamental decisions regarding the human side problems with the intention to cater the characteristic of successful mergers. Those are being focused in order to be integrated with the hard factors of company's strategic and organizational structure of M&A transaction towards to achieve the objectives of M&A transaction.

3.3.3 Organizational Change

In traditional management, the effectiveness organization is being measured by the degree of stability and orderliness; the managers tend to neglect emotional factors from their work. But now, organizations have become less stable and predictable and leader should have the ability to adjust with the dynamic and changing environment. Leaders have to see the advantages of the change rather than being threatened.

Change is "the coping process of moving a present state to a more desired state in response to dynamic internal and external factors".[100] As described above the strong culture can be a potential resistance of change; below are some resistances of change based on human nature and others which are created from organizational dynamics which consists of selective perception, lack of information, fear of the unknown, habit, resentment towards the initiator, sub optimization, and structural stability.[101] Those resistances become major roadblocks in M&A change process because one company perceives other as an external disruption. Some experience resistances are being caused by a fear of being dominated by other company, lost the job and responsibility, reduced

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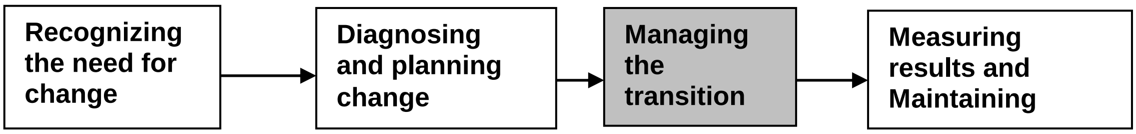
[99] Robert H. Waterman, Jr., Thomas J. Peters, and Robert Waterman, op cit, pp. 9-11
[100] Phillip L. Hunsaker ,op cit, p. 423
[101] R. Likert (1967) and Rosabeth Moss Kanter (1989)

salary and compensation, personal conflicts and malignity among employees, and so forth.

In the rapid economic of change, forming alliances or consolidation such as merger and acquisition are considered as a strategy against competition. M&A related to the integrating the entity of existing companies with changes that have to be managed proactively. To manage the planned M&A change, these steps below are required in planning and implementing M&A change in order to avoid the pitfall of the transaction and cope with obstacles generally arise from soft factors issues (as factor of 7s McKinsey) during the integration process.

The author considers the use of a workable change management plan based on figure 3.3 below with its detailed explanation of relation steps which incorporated post M&A integration planning and executing phase where the detailed issues of the M&A integration phase have been described in chapter 2.

Figure 3.3 Managing the Planned Change Process



Source: Phillip L. Hunsaker (2005)[102]

The first step is recognizing the need for change in merger integration for every employees from merging companies; the leader should promote the benefit and the necessity of change to every employees where this change affects many key areas of organizational structure of knowledge, skills, technology, customers, regulators, competitors, and suppliers.

The second step is diagnosing and planning change; the leaders should make a specific, detailed plans about implanting desired cultural factors and management practices, eliminating the discrepancy in soft factors issues, capturing combination best practices within merging companies, and finding opportunistic benefit around the shared culture; and leaders should also give clarity to the employees regarding the post M&A change. Leaders should formulate and measure the gaps of current conditions to a newly combined state of merging companies, and they should consider the effect of change of several domains forces such as the board of directors, staff and employees,

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[102] Philip L. Hunsaker, op cit, “Management a Skill Approach”, p. 474

volunteers in the organizations, suppliers, and customers. The force field analysis can be used as a consideration to promote change which is defined as the process of analyzing the forces that drives change and the forces that restrain it.[103]

The third step is managing the transition; the author focuses on this process as a main concern of the change's step process. Here, the author gives a detailed explanation of how to manage the transition process before the fourth step of managing the planned change which is measuring results and maintaining change is going to be described. The considerations of the focus are: leaders should be aware of the disruptive effect of M&A changes and able to manage the negative influence during the transition process. Inappropriate in managing transition process can result in diminishing potential benefits and value creation expected from M&A. During transition process, leaders should also be able to give appropriate support and facilitate a condition that helps to minimize fear, uncertainty, and doubt; enables employees to focus, and builds positive employees' viewpoint also involvement in the change.

M&A creates a stress and anxiety in the life of an organization, and during this period, merging companies have to manage the change effectively. By using an effective change in management practices which combine change management techniques with cultural integration tools and techniques, it will enhance the chance of achieving a smooth integration. In which the change itself has to increase the value of a new future organization such as increment of cash flow, expected growth rates increment, longer growth period, and cost of capital reduction.

To manage this transition change process, the author in this thesis uses the practices of exemplary leadership of James M. Kouzes and Barry Z. Posner. These ten commitments serve as the guide of how leaders get extraordinary things done in organizations and as the structure for what is to follow.[104] The main consideration is that the ten commitments of leadership embedded in this practice can be useful to apply during transition change process of post M&A integration to build employees' engagement and alignment in M&A changes process. These practices can be a great model for M&A integration process to

[103] Don Harvey and Donald R. Brown, 2001, p. 140
[104] James M. Kouzes and Barry Z. Posner (1995), p. 17

build a newly effective system of merging companies in which there exists a balance and high integration between soft factors and hard factors in producing potential useful M&A change. Those ten commitments of leadership below function as a model to manage the M&A change transition.

Table 3.1 Ten Commitments of Leadership

Ten Commitments of Leadership	
Practices	**Commitments**
Challenging the Process	1. Search out challenging opportunities to change, grow, innovative, and improve 2. Experiment, take risks, and learn from the accompanying mistakes
Inspiring a Shared Vision	3. Envisions an uplifting and ennobling future 4. Enlist others in a common visions by appealing to their values, interests, hopes and dreams
Enabling Others to Act	5. Foster collaboration by promoting cooperative goals and building trust 6. Strengthen people by giving power away, providing choice, developing competence, assigning critical tasks, and offering visible support
Modeling the Way	7. Set the example by behaving in ways that are consistent with shared values 8. Achieve small wins that promote consistent progress and build commitment
Encouraging the Heart	9. Recognize individual contributions to the success of every project 10. Celebrate team accomplishments regularly

Source: James M. Kouzes and Barry Z. Posner (1995)[105]

***The first practice is challenging the process*:**

Post M&A integration process deals with changing from status quo of companies with their traditional hierarchical structure and companies should work together to create a newly effective common system.

M&A transaction create a major disruption of ambiguity, rejection, insecure feeling of employees. Leaders here contribute to build a sense of urgency by pulling employees' attraction with opportunistically rallying on benefit and value creation of M&A process such as international horizon, career perspective, competitiveness, and job security. The sense of urgency can also be build by flattening the priority of the projects. The terms of establishing sense of urgency above can also be achieved by examining the market and competitive result, and also by identifying and discussing potential crises, or major opportunities.[106]

Challenging the process can also be used to build creative tension of increasing

[105] James M. Kouzes and Barry Z. Posner, op cit, "The Leadership Challenge", p. 18
[106] John P. Kotter, op cit, pp. 35-49

motivation and the urgency level of employees from merging companies by promoting the future benefits of M&A. The creative tension is unavoidable gap between one's vision and the current reality where truly creative people use the gap between what they want and what is to generate energy for the change, and they remain true to their vision.[107]

Leaders' primary contribution of this process is to be change initiator, leader should move quickly into action by taking and managing risks of M&A change in their decision. Leaders have to be able to consider the real cost, impact, and benefits of their decision in M&A change process. By challenging the process practice, it is expected that executive leader of merging companies will buy into M&A change process and may able to work effectively and fast enough to build a development of a vision and best shared values to support the strategy plan of M&A. In this practice, leader should be deep thinkers who are smart enough to see new possibilities and to conceptualize them.[108]

Based on Ronald A. Heifetz, there are two types of the shifts which require authorities role with five dimension social functions (direction, protection, role orientation, and norm maintenance), which are technical and adaptive situation.[109] Post M&A integration is a type of adaptive work according to the characteristics of social functions where problem definition, solution and implementation of the process require learning process. By challenging the process, leaders might be able to identify the adaptive challenge that appear in soft factors for every stakeholder during integration process and find innovative ways to generate an effective alternate solution for those issues.

This practice may also profound in retraining mental model as part of fifth discipline of learning organizations of employees from both companies that seen others as an external threat and are being persistence of change. Mental model governs how we make sense of the world and how we take action in it; mental model limit us to familiar ways of thinking and acting, much to our detriment.[110]

***The second practice is inspiring a shared vision*:**

[107] Peter M. Senge (1990), pp. 150-155
[108] Rosabeth Moss Kanter (1995), p. 97
[109] Ronald A. Heifetz, op cit, pp. 126-127
[110] Peter M. Senge, op cit, pp. 174-204

Here shared vision is beneficial as a foundation of company's agreement in the way of doing business and value practices of company. The shared vision also gives direction of employees towards achieving the strategic objective of M&A and gives some motivational platform. Leader here should hold forth vision of the organization's future in compelling ways that ignite the spark needed to build inclusive enterprise.[111] In inspiring a shared vision, leaders engage all employees within merging companies to participate in development of effective vision and new practices values which aim to make employees buy into the vision and reap their support.

Based on fifth discipline of learning organizations, shared vision creates commonality that gives a sense of purposes and coherence to all activities the organizations carries out, it vitals to provide focus and energy for its employees.[112] Vision will be the main outline of a winning strategy objective and be the inspiring strategy of M&A process. During post M&A integration, vision acts as a platform of direction which covers details M&A objectives and decisions. Vision also helps leaders to bring people commit to the change and have their willingness to step out their uncertainty fear and give their best effort during the process, and it also gives a fundamental coordination of employees' action related to strategy business of M&A.

Leaders in this practice should also defined their jobs in terms of identifying and constantly communicating commonly held values such as vision, shaping such values to enhance performance, and living the commonly held values.[113] Effective communication program is a combination of communications goals, flexibility, and feedback where it becomes essential because mostly from 86% respondents of A.T. Kearney research 1999 said that they failed to communicate their new alliance sufficiently which lead in failure to realize value of the merger.[114]

Leaders here have to be able to promote the expectations of merger and communicate to all stakeholders after the major investment and restructuring decisions are taken, and by effective communication, it is expected that the soft factor issues related to poor communication, extraneous feeling, anxiety, and ambiguity can be resolved. Leaders in this practice should communicate

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[111] Frances Hesselbein (2002), p. 8
[112] Peter M. Senge, op cit, pp. 205-232
[113] Frances Hesselbein (1996) : James L. Heskett and Leonard Schlesinger, pp.113
[114] Greame K. Deans, Fritz Kroeger, and Stefan Ziesel, op cit, p. 115

persuasively and truthfully, and also must decide what few pieces of information people really need to know to avoid high anxiety of people.[115] To inspire the shared vision, leaders should be able to create a successful communications within several target groups of M&A in terms of communicating the new strategic focus, vision, and business targets. The target groups affected of M&A transaction are employees, CEO, investors, and customers. The major thematic problems are related to the direct impact of their existences in the new company and also the continuation of the future contract and relationship. There are several tools that will be useful to solve the communication logjam such as using a personal conversation, media relations such as intranet, call center, conference calls, and also press guidelines such as press conference, road shows, and company visits.

The third practice is enabling others to act:

The leader should try to engage people in post M&A integration process by involving employees in establishing the solid structure which will be future emotional home of an organization under the leader support and supervision. For most companies the biggest barrier to merger integration is failure to achieve employees' commitment, and some 37% respondents of A.T. Kearney research 1999 listed this as their primary challenge, well ahead of obstructive behavior and cultural barriers.[116] Leaders should give their support and assistance to make the change project work. This practice is also related to transformational and participative leadership associated with employees' empowerment.

In this practice, leaders should know the importance of trust to increase the interaction level and openness between employees of merging companies towards to a high degree of understanding, engagement, and appreciation of new integrated vision.

In enabling others to act, leader holds on the importance of building merger integration team to work together to set the infrastructure and make detailed decisions of strategy of M&A change, based on a new shared vision and practices. Post M&A integration should embrace the employees, where the team of post M&A integration should consist of key executives, managers, and

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[115] Francess Hesselbein (1996) : Judith M. Bardwick (1996), p. 136
[116] Greame K. Deans, Fritz Kroeger, and Stefan Ziesel, op cit, p. 115

all employees from merging firms to weld together and to mediate conflicting or misperception within them. Merger integration team will become committing resources of whole companies to propel the M&A change. The contingency theories in this practice can be applied to enhance team performance. The team forms as team learning which play critical role in the success of newly merged organization. Team learning is a process of aligning a team to avoid wasted energy and to create the results its members want, and builds on the disciplines of shared vision; it involves mastering the practices of dialogue and discussion.[117] By enabling others to act in scope of merger integration team, it will make employees feel bonded, capable, and committed.

The fourth practice is modeling the way:

The leader including team merger integration should rule out the compelling vision and new strategy in real life to get employees apply and use them. The board of directors of key executives is structured as a sounding board of change. The new managerial composition will be shown as an identity of new company and image of shared values. This is another effective way to communicate the change process to employees. Leader here must behave with integrity where leader have a clear conviction about values and a steadfastness of purpose in distinguishing between right and wrong, wisdom and foolishness.[118]

During post M&A integration, leaders should create small winning to show to the employees that the change is valuable and to make employees refocus in forward direction. The small wins are also useful to see whether the compelling vision and strategy are effective and viable in application and also as a temporary estimation of the likelihood of successful integration. Therefore, some corrective actions, improvement methods can be built. The infrastructure and strategy which does not fit with the transformation vision might be adjusted quickly. By modeling the way, leaders can empower, energize, and build long term commitment of employees in post M&A integration around an established common sense of purpose and shared vision. The small winnings also help to inject enthusiasm, kindle the spirit by principles consistently espoused by the leader, and gain support from employees of the change also block the

[117] Peter M. Senge, op cit, pp. 233-269
[118] Francess Hesselbein, op cit : Judith M. Bardwick (1996), p. 137

persistence of M&As change. Early wins will bring a good sign to the employees that the deal will potentially succeed. However, the company must be carefully assigned their early wins. Some of 61% of merged companies search for early wins, but frequently tread on dangerous territory by turning to job shedding, factory closings, or inward looking cost moves.[119] The early wins might be predicted and analyzed using the due diligence as part of risk management effort where the result of small wins might be seen in short term sales report, HR report regarding the work performance, and also in relationship with other stakeholders such as customer, supplier, and stockholders.

The fifth practice is encouraging the heart:

Leader should motivate employees by visibly cherishing wins and accession of the change. Leader can gain more consolidating gains by recognizing employees' contribution in the change process by giving some motivational rewards such as promotion, compensation benefit, and job security. This will be important during post M&A integration regarding the key people retention issue, as a dedicated support especially to senior executives. Peter F. Drucker set forth the rules for successful acquisitions which one of those, states that well structured incentives and rewards must be held out to the management of both firms to help make the merger work.[120] Anslinger and Copeland identified that successful acquires who substantially outperformed benchmarks such as S&P 500 and the Morgan Stanley capital international index by almost 50% during a recent 10 year period are those who employ principle of using strong incentives and compensation systems.[121]

The author considers the use of exemplary leadership model by James M. Kouzes in managing the transition as part of managing the planned change process over the other models such as fifth disciplines model of learning organizations, adaptive work model from Ronald A. Heifetz, leading change model from John P. Kotter because the model is fully comprehensive approach which cover all important aspect needed in coping with M&A change such as articulating the vision, engaging bonds within employees, removing obstacles of information sharing logjam, and building employees' empowerment by

[119] Greame K. Deans, Fritz Kroeger, and Stefan Ziesel, op cit, p. 114
[120] J. Fred Weston, op cit, p. 645
[121] J. Fred Weston, op cit, pp. 643-644

promoting the benefit and cherishing the accomplishment. The author finds that the practices inside the 10 commitments of leadership have some similar points with other models as mentioned above, but the exemplary leadership of James M. Kouzes is simply to apply in real life and can cover the lack of other models related to practices inside them. For example: in fifth discipline, it misses the practices of how important to model the way by celebrating small wins. Those other models are also a good approach but their detailed descriptions miss some points of how to manage the transition in post M&A integration process, and the model that the author uses in this thesis is considered as a complete and thoughtful basis for a leader to guide the change process and also to guide the employees on achieving the concerned achievements. Throughout the study done in forging this model, it has been discovered that ordinary people who guide others along pioneering journeys follow rather similar paths with the practices inside the model.[122]

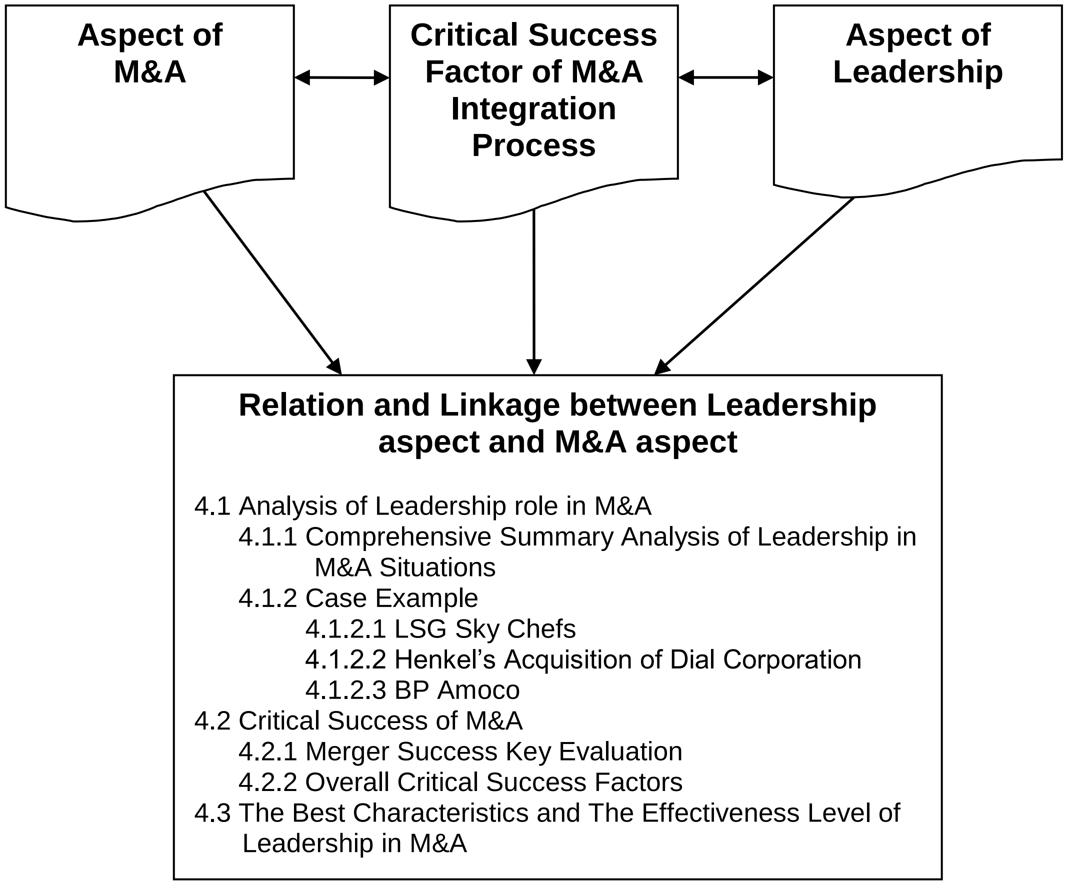
And after managing the transition process as a third step of the planned change management, it goes to *the last step of* managing planned change which is measure result and maintain change which can be employed by some method to accommodate a change measurement from employees such as financial success measures and cultural integration success measures from survey, questioners, and other satisfaction measure.

[122] James M. Kouzes and Barry Z. Posner, op cit, p. 8

Chapter 4

Analysis and Relation of Leadership and M&A Aspect

Figure 4.1 Analytical Framework of Relation and Linkage between Leadership Aspect and M&A Aspect



4. 1 Analysis of Leadership Role in M&A

4.1.1 Comprehensive Summary Analysis of Leadership in M&A Situation

Based on an illustration and an analysis from chapter 2 and from chapter 3, the author suggests and proposes several relations of leadership role in M&A. In the beginning, the author suggests the consideration of leadership role in post M&A integration in terms of managing the main change problems. Post M&A integration is related to major change effort and transformation process. Based on empirical evidences of M&A, as described in chapter 2, the soft factors issues become major reasons and critical concerns to the high number of failures in recent M&A transactions. The author suggests that leadership can be a key to manage the soft factors issues during post M&A integration. Leadership might work to iron out the differences related to HR issues and to extract the full value of M&A. Leadership will help in building a sense of urgency to drive the change, establishing a direction for some strategic decisions, creating a sense of togetherness and aligning people to work on the change, and also building enthusiasm to deal with barriers of change.

The author also suggests that there should be a balance between management and leadership in M&A situations. The solidified combination between management and leadership impacts in faster achievement of newly merged companies goals. Leadership can anchor the change stick with the newly merged culture and can alter the corporate inertia during the change process.

From analysis of leadership theories, the author concludes that the contingency, transactional, transformational, and participative leadership will effectively be used to produce an effective decision making based on some situational aspects and also in terms of inspiring, motivating, and achieving established M&A objectives.

To have successful post M&A integration, there are several factors that should be managed regarding the soft factors issues; the merged companies have to create a new vision with new shared values, manage the retention problem, create an effective communication strategy, and create functional capabilities with an effective organizational structure. To help in building those concerns effectively, the author suggests the use of a due diligence process as a systemic screening and a strategic evaluation of short term and long term synergy value potential partner. As part of comprehensive due diligence, HR due diligence should be also regarded important as a starting phase to address the soft factors issues of potential merging companies such as sketching out the strength and openness level of the partner's culture. The HR due diligence can also be used to evaluate the readiness and compatibility level of potential management partner.

Successful post M&A integration relates to a workable change process that encourages leadership to institute the significant organizational change. The author considers the use of a planned change process based on figure 3.3 as steps which incorporate leadership with post M&A integration process and manage the detailed issues inside that process. In one detailed of planned change process which is managing the transition process, the author marks this phase as a crucial phase because in this phase the major transformation process is being executed and involves all elements of companies. In the transition phase, a multi step process, which can overwhelm all soft factors issues during post M&A integration, has to be implemented. The author proposes a model of exemplary leadership from James M. Kouzes to manage the transition process and act as a workable change management plan for post M&A integration. The main consideration is that the model is a fully comprehensive approach of leadership practices such as challenging the process, inspiring a shared vision, enabling others to act, modeling the way, and encouraging the hearts which cover all important aspects needed in coping with M&A change.

4.1.2 Case Example

To see that leadership gives an important contribution in M&A situations, the author gives some case examples from industries' experiences which successfully employ leadership as one of the key factors in their M&A strategy.

4.1.2.1 LSG Sky Chefs

The first example is a cross border merger between the German company, Lufthansa Service GmbH (LSG) and US company Sky Chefs. In this example, the author wants to give a case example of a successful acquisition based on a mixed culture strategy which is based on an article from Ravin Jesuthasan and Helmuth L. Uder:[123] Sky Chefs started business as a subsidiary of American Airlines in 1943 which was sold in 1987 to a group consisting of its management and Onex Corp. LSG, as a subsidiary of Lufthansa Airlines, acquired a stake in the food service company in 1993 and by 2001, LSG purchased the whole Sky Chefs company and created the largest airline catering in the world. The integration process was started with a clear understanding of the current practices of both organizations and also cognition of existing state at other leading companies. They were primarily concerned with managing soft factors issues during and after integration by minimizing the discrepancy in structure and roles, cultures, total rewards, and measurement and alignment. The organization's strategic priorities and the culture it wanted to create became the major focus of integration activities. In area of *structure and roles*, when LSG and Sky Chefs merged, they created five organizational levels ranging from individual flight kitchens through countries, areas (aggregations of countries), regions (e.g. North and South America) and global.

[123] Kai Lucks (2005) : Ravin Jesuthasan and Helmuth L. Uder, pp. 182-190

By this structure, the functional role was linked to the geographic role. Despite internal hiring, the company also considered of doing external hiring to get a high performing management structure. The company also created an open structure where executives at each level had the opportunity to participate in decision making at the upper level. In area of *culture*, the organization highlighted the commonalities, strengths relative to the desired culture, and gaps that would need to be bridged. The communication of desired future culture was facilitated by the leaders using the media tools of public meetings, one-on-ones, and email statements. The organization tried to combine two different cultures to become one culture to support business principles and objectives. In area of *Total Rewards*, the organization early on employed a process of inventorying its current reward programs. The inventory covered the differences between current reward systems, the potential image of barriers and gaps from business merging, the operational work and measurement methodology of each company's reward system. The overall rewards philosophy to drive the integration of two companies was formulated by combining best practices information and a well understanding of desired business strategy and culture. In the area of *measurement and alignment*, LSG Sky Chefs made a framework used to create a shared understanding of the key drivers of product quality. The company expanded the framework into two key HR processes of performance management and annual incentives to certify alignment between key business drivers and individual performances.

From the illustration of LSG and Sky Chefs case example, the author wants to show that both companies successfully employed the mixed culture strategy. The companies successfully shaped the new entity's culture which accommodated best both companies' practices. The author finds that they successfully combined two different companies to become one business platform. The companies also realized the obstacles coming from soft factor issues since the beginning of the process, and the companies tried to overwhelm the issues by imparting leadership in the early phase of transaction. The role of leadership was applied by involving HR in the beginning of the process. HR here did its task in the scope of HR due diligence to asses the potential compatibility of both companies. Leadership here also played a role as a key success factor of this cross border integration by managing soft factors issues and minimizing the disruption occurring in areas of structure and roles, culture, total rewards, and measurement and alignment. Both companies tried to employ leadership as a factor to combine both differences towards to strategic value creation of transaction and establishment of new shared practices and culture, and as a basis to give a deep understanding of the current rationale of each company.

4.1.2.2 Henkel's Acquisition of The Dial Corporation

In the next example, the author wants to give a case example of a successful acquisition based on multiculture integration strategy. The example is based on the article from Lothar Steinbach, Steve Blum, and Helmut B. Buhn:[124] Henkel Group was founded in 1876 and today the company operates in more than 125 countries with net sales of 10.6 billion Euro and EBIT (before exceptional items) of 800 M Euro in 2004 by nearly 50.000 employees on the company's structure. There were several strategic challenges that Henkel faced in its laundry and home care and personal care (HPC). First, Henkel had a high dependency on the European market with higher pressure coming from increasing global competitors' and private label's market share. Second, the market where Henkel participates is a very mature market with low growth prospects and high experiences in product, service, and price competition from branded company and also private label offering products. Those reasons forced Henkel to enlarge their current product portfolio by enhancing and expanding markets and leveraging opportunities in contiguous categories. However, this has to fulfill some specific requirements. The first was to maintain Henkel as the controlled company respected to their capital structure. The second requirement was to maintain the capability of good managerial resources and a loyal management team in developing and integrating a business. Based on those requirements and geographic gap conditions, Henkel took an approach to look for an acquisition candidate for additional critical mass which may give benefits from economies of scale and fulfill key customers' requirements. The candidate for the acquisition was Dial Corporation. Dial businesses was originally the consumer products piece of a larger entity with a multitude of business scope including motor coach transportation, financial services cruise ships, industrial catering, and convention services. Although the consumer products company

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[124] Kai Lucks, op cit : Lothar Steinbach, Steve Blum, and Helmut B. Buhn, pp. 97-110

enjoyed some early successes following the spin off from their financial service business, attempts to expand into new markets and new categories ruinous their financial resources. The company's condition continuously deteriorated until August 2000 and forced the management board to make sweeping management changes. The new management concluded that in order to survive and ensure the best interest of shareholders in long term, Dial had to gain greater scale and be a part of larger organization and that time Dial was emotionally prepared to be acquired. Although Dial-Henkel transaction demonstrated the differences in nationalities and business models, the acquisition had a strategy to exploit the growth business opportunities from both companies. The acquisition strategy also considered the importance of people involvement in change by communicating the strategy over time to the employees and to encourage them to actively manage the changes. The companies also took advantage of the good business relationship and personal contact which had been established since 2000 in terms of making a detailed candidate's screening phase. In the integration phase, after closing the transaction the CEO of Henkel tried to give their personal endorsement of company's combination and came to Dial Headquarters to welcome all Dial employees to Henkel. The company also tried to begin constructive dialogue and built a working relationship between both companies, and mediate also resolve any issues or conflicting problems coming from misinterpretation of acquirer requests by dispatching a senior manager from Henkel headquarters who had been part of the acquirer's acquisition evaluation team to work with a senior Dial manager. The companies tried to maintain the current work performance of Dial by avoiding dedicated acquisition integration staffing at this stage of the process, and every effort was made to minimize any unnecessary demands on Dial personnel. The new identity of transition was marked by adding the Henkel logo to all major facilities, business cards and letterheads. The clear lines of responsibility for both the operations and the integration of the acquisition were established which included responsibility for Dial's overall business performance which was assigned to Dial's CEO prior to the acquisition and the employees who had been retained during the acquisition process, and responsibility for planning and executing the integration process was done by a Henkel executive who had been part of acquirer's acquisition evaluation team. The operating standpoint including reporting relationship was not changed before both organizations have a better understanding between each other. The learning process was created by assigning key functional teams where each team performed integration tasks. Each team had leaders from both companies that were responsible for coordinating the teams' performance in achieving their objectives. The new Board of Director consisted of senior Henkel and Dial executives who had a responsibility to facilitate operating and integration issues, and also create communications at the highest level of both organizations. The board quarterly meetings were scheduled to enforce at both companies' headquarters or by videoconference. The companies set a Code of Cooperation which consisted of operating responsibilities and integration process as basis for the mutual understanding. In this Code it was acknowledged that the sales driven business model of Dial and their company's structure had to be retained. On the other hand, Henkel's task was to provide the financial and technical capabilities and new technologies to launch new projects. General objectives of the integration process were to create a knowledge sharing process and internal benchmarking to maintain Dial's strengths and to apply them for other businesses or areas of the Henkel Group, to build a suitable organizational structures and company's resources in terms of launching new projects, and to retain the existing Dial senior management during the transition period (approximately 2 years after closing). The integration process during the transition phase was to be based on mutual respect and consideration for any cultural differences. The cultural differences between the USA and Germany only had little impact in the overall transition process because Dial's and Henkel's strategies were complementary to each other. The success contribution of this acquisition resided on the corporate culture similarity of both organizations. Dial's corporate culture is based on the principle of people working together with mutual respect for each other, and Henkel's corporate culture is based on the principle of unique and powerful family heritage as is embraced in company's vision.

Based on the illustration of Dial and Henkel acquisition, it is evidence that both companies were successful to do the M&A transaction and employed the multiculture integration strategy. Each company retained its own culture and its business strengths also overall business. From the illustration above, it is shown that Dial and Henkel saw other business strengths as long standing and identifiable models which may give a competitive advantage to the new company. The diversity was seen as a potential benefit and enriching opportunities for both companies.

Although both companies retained their culture and their working methodology, the multisteps of change process were also applied to help in creating the successful integration. The changes were related to how to make a newly merged company combine their positive impact to each other under the new vision, code of conduct, and business strategy. The steps of change process were based on leadership internalization. The author sees that leadership here played a role in the integration phase in terms of building effective working relationship and building a mutual understanding between both companies. They tried to employ leadership as a key to bridge their differences; they also imparted some leadership practices of effective communication and knowledge sharing.

The company also tried to create the learning process between them by adopting the key success of each company and employed them to leverage higher growth levels and maintain business position stability. In this cross-border merger, the degree of relatedness between both companies gave a greater virtue for M&A success.

Both companies treated each other as an equal business partner and built a coherency based on people and knowledge focus. The Dial financial condition made the board of directors realized about the importance of making a successful acquisition. Dial was cooperative and willing to be engaged in the whole process. This was shown in due diligence phase where Dial was openly giving any information which potentially leads to a successful transaction. That was based on the trust between them. Another reason of high participation level during the acquisition process was the consideration of potential mutual benefits, Dial needed Henkel as a financial source which could bring the company through the crisis, and on the other side, Henkel needed Dial as an adjacent source to enter the US market and also to leverage their growth strategy. In this case the laundry detergent segment, despite pursuing an organic growth, Henkel saw an acquisition as a suitable strategy to build up its product category and strengthen its home and personal care business. The improvement after M&A transaction can be seen in higher US market share position for Henkel in its product category and also in transfer of knowledge of product development for Dial.

4.1.2.3 BP Amoco

The author wants to show the successful M&A transaction based on monoculture strategy or cultural imposition. The case example is based on Lit search:[125] A merger between British Petroleum (BP) and American Oil Company (Amoco) (also Atlantic Richfield Company (ARCO) and Burmah Castrol). This was a mulltibillion dollar transaction in 1998-2000 aimed to create a new single and global company having $ 200 billion market capitalization. The vision behind the acquisition was to be a global player, to enter retail markets in the world, and fill the strategic gap in natural gas and Far East. The key success factors of this M&A transaction was BP's ability to move quickly in capturing the near term synergies and creating common values and processes. The improvement after M&A can be seen in 20% cost cutting of the combined BP-Amoco cost base. Another improvement was that in within 100 days of closing the Amoco deal, BP was successful in completing the cost cutting projects including some 10.000 layoffs and built the organizational structure especially in filling all the top management jobs. During that period, the success of transaction can be seen in rising of BP-Amoco's stock price by nearly 11%. In the change transition, the leaders consistently and visibly led the change, and cherished the process. The change transition was facilitated by open communications to all stakeholders. The integration strategy taken by the leader in this M&A transaction was by imposing BP's structure and management style on the new company. That strategy led in the resignation of some key senior executives at Amoco. However, on the other side there exist the high performing results of the merger where BP achieved the projected $2 billion in cost savings within the first year. In a year ahead of schedule, there was a 19% increase in second quarter 1999 pre exceptional profits to $ 1.36bn. Those improvements presented a definitive counterpoint to the perception that M&A activity destroys shareholder value.

Another winning approach which employed as a strategy to manage the change transition of merger BP-Amoco was that each company gained an international

[125] Michael J. Shelton-FTC Bureau Economics Roundtable, op cit : Lit search (1999), " BP-Amoco's Result a Tribute to M&A Success", p. 15

experience of cross border M&A prior to BP's acquisition. BP has integrated with Standard Oil of Ohio, while Amoco learned valuable lessons with its purchase of Canada's Dome Petroleum.[126]

Based on this case example, it is obvious that the monoculture integration strategy or cultural imposition can also lead to a value creation. That is because strong leadership was applied in the process. As mentioned in the explanation of type of cultural integration, the cultural imposition may lead to some value destruction which in this case can be seen in higher unwanted turnover at Amoco. However, on the other hand, the leader of BP tried to minimize the disruption caused by cultural imposition by instilling leadership as a basis of M&A change in area of communication, leader's support, attribute shared value, and creating a feasible shared vision. The leader also effectively communicated the vision of the change, nurturing them via the vision, and giving an appropriate support to the employees during the transition process.

From these three examples that have been elucidated of LSG Sky Chefs, Dial Henkel, and BP Amoco, where each one represented the type of cultural integration strategy of monoculture, multiculture, and mixed culture, it is shown that successful integration requires leadership as a foundation to build a solid execution of post M&A integration projects in how they planned, communicated and delivered the objectives of the projects. The case examples also invigorate the author's suggestion of the important role of leadership in M&A situations. Those success stories also become one of the author's considerations in determining the critical success factor of M&A and the conclusion of relation and linkage between leadership and M&A.

[126] Graeme K. Deans, Fritz Kroeger, and Stefan Zeisel, op cit, p.143

4.2 Critical Success Factor of M&A Process

4.2.1 Merger Success Key Evaluation

There are several methods to evaluate the performance of mergers:

a. The measures to evaluate the performance of M&A are:[127]

- Stock price change at the announcement
- Stock price change over longer run (3 years typical)
- Change in operating margins over longer run (1 to 3 years typical)
- Change in productivity at the plant level over longer run (1 to 3 years)
- Analysis of subsequent divestiture
- Measure actual or expected present value using actual or expected changes in cash flows or values

b. Another measures to define the success of the merger are:[128]

- Accounting measure of profitability
- Exploiting overvalued stock ("strong currency")
- Maintaining or improving market share rank
- Implementing strategy and achieving a strategic transformation

c. There are some general success measures which are:[129]

- Increase or decrease in share price
- Increase or decrease in revenue
- Increase or decrease in operating profit and profitability
- Payback of capital costs
- Recovery of any premiums paid
- Increase or decrease in productivity levels
- Increase or decrease in market share
- Loss of key executives and key staff

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[127] Steven Kaplan-FTC Bureau Economics Roundtable (2002), pp. 3-4
[128] Pankaj Ghemawat-FTC Bureau Economics Roundtable (2002), p.2
[129] J. Robert Carleton and Claude Lineberry, op cit, p. 117

There are several terms to define the criteria of successful M&A implementation:

a. The success of a merger is defined as the change in the stock price of the company versus the industry average stock performance during the three year period after the announcement of the merger; if the stock of the combined company outperforms the industry index, the deal is considered a success; and the type of merger that is most successful when external growth through acquisition is more likely to produce.[130]
b. Research on successful M&A implementation shows that a successful transaction is where there exist a high level completion of human integration and a high level of completion of task integration.[131]
c. For an M&A to be a success, the operative word is quickly, A.T. Kearney study findings indicate that a company has just two years to make the deal work and after year two, the window of opportunity for forging merger synergies has all but closed.[132]
d. The strategic scorecard of M&A success adds value which can consist of accelerating growth and boosting margin; boosting the margin effect can be reflected from cost advantage, differentiation advantage, and enhancing industry attractiveness, forestalling risks, and generating knowledge or innovation.[133]
e. The acquisition has to increase value where actions that enhance value increase cash flow from existing assets, increase expected growth rates, increase the length of the growth period, or reduce the cost of capital.[134]

4.2.2 Overall Critical Success Factors

From the key merger evaluation criteria of success in M&A above and from analysis of aspect of M&A, analysis of aspect of leadership, also comprehensive analysis including the case example of successful M&A, the author concludes that the merger success has to carefully manage the major issues which come from soft factors. This has been intensified by empirical

[130] Graeme K. Deans, Fritz Kroeger, and Stefan Zeisel, op cit, p. 162
[131] Joseph L Bower-FTC Bureau Economics Roundtable (2002), p. 5
[132] Arthur Bert, Timothy McDonald, and Thomas Herd (2003), p. 42
[133] Pankaj Ghemawat-FTC Bureau Economics Roundtable, op cit, p. 2
[134] Aswath Damodaran, op cit, p. 697

evidence of M&A where soft factors remain as the hardest issues and become the main reason of many failures in recent M&A transactions. Therefore, the author considers that the key success factors of M&A rely on how to manage the soft factor issues. The soft factors will be integrated with hard factors as in 7s McKinsey framework. A well integrated unity of those soft and hard factors will become a main strategic framework to enhance future success of M&A.

To achieve that, based on overall analysis of leadership role in M&A situations, coming from analysis of chapter 2, chapter 3, and summary of analysis of leadership role in M&A also case example of successful M&A, the author proposes some critical success factors related to achieving M&A overall success which are described as:

a. *Bold and strong leadership as guidance through the M&A transition process.*

   Leadership as a key success factor will be a fundamental basis to achieve other critical success factors needed in achieving a totally successful M&A transaction. Effective leadership can help to strive for the excellence of M&A process. The author suggests that leadership should be imparted as a main key success factor which covers and acts as a key sound of other critical success factors of M&A success which they are suggested to be considered necessary in M&A transaction. The critical success factors consist of:

   - A well established plan in every phase of M&A transaction to make a smoother transition
   - High involvement of all functional elements in all companies including HR in the whole process of transactions
   - Overall consideration of due diligence activities for screening potential synergy and as a basis for risk management. HR due diligence should be also considered as an important strategic contributor
   - Development of a feasible vision as guidance through the change and also shared values platform
   - Effective internal and external communication of transaction
   - Effective cultural integration and alignment strategy
   - Low complacency and high sense of urgency in M&A change
   - A high caliber formation of new management capabilities and good management of retention issues
   - High people engagement and commitment level to the M&A change

- Development of good reward and performance system
- Employment of workable and structural change management practices
- Appointed leaders including CEO and key executives who have integrity, capability and readiness to lead the change, and also high performing team merger integration

b. *The author also suggests other key success factor despite leadership which is development and execution of an effective post M&A integration*, which also covers other critical factors of M&A success in which the author suggests to be considered important to achieve an effective transaction as described below:
   - Good integration planning process which represents fast and quick transition process.
   - Clear M&A objectives covering financial and others non-financial goals and exact determination of prioritization of those objectives.
   - Realistic and objective assessment of real valuation of company including synergy benefit and cost of integration
   - Establishment of an effective post M&A integration structure and synergy realization process
   - A smooth execution of integration using top-down approach and a technology system for knowledge sharing system, reporting requirements, and integrated communication system
   - Clarity of future contractual structure and future work relationship with external party such as supplier distributor, and so forth

From the analysis of critical success factors above, it could be proposed that leadership and effective post M&A integration are becoming the key success factors of overall M&A transaction. The author concludes that both key factors are related and complement each other, and there is a relation and linkage between them in which bold and strong leadership is needed and useful to create effective post M&A integration. Strong leadership should be implemented early on in the beginning of M&A process where the precise implementation can be formed in HR due diligence. Leadership will help to ensure the preparation including the processes, methodology, and management behavior, are ready to generate the planned integration synergies. The author also concludes for the relation and linkage between leadership and M&A that leadership should become the main consideration role after closing phase; leadership will help to mitigate the risk of dual organization and management and to keep the business of both companies performing well during the transition period from old business framework to new reengineered framework.

4.3 The Best Characteristic and The Effectiveness Level of Leadership in M&A

From the previous analysis of relation and linkage between leadership, the author derives a main conclusion that leadership has a main role in M&A process from the early phase of transaction and after closing phase in terms of building an effective transaction. The focal point of leadership implementation is laid on leader leverage capabilities. The author identifies and suggests several characteristics that leader should have to enhance M&A outcomes, which are:

- Leader should be able to persuade others to be committed and confided in M&A change and identified the alignment issues before the shift transition
- Leader should be able to manage the emotional change pattern of employees. The emotional phase relates with resistance to change, internal stress, and competition fear
- Leader should have appropriate skills and behaviors set to pursue the change process
- Leader should be able to be a knowledge source of ideas, information, and reporting person of M&A and also a role model for the change
- Leader should be able to institute the change process and naturalizing change

To manage the M&A change process, the author proposes that the characteristic of leader should be based on the ten commitments of leadership from James M. Kouzes. In those practices, the author concludes that they cover the characteristic behavior that leader should have in managing the M&A change transition. By these ten commitments of leadership model, the leader can propel the sense of urgency, trust foundation and embrace sense of accountability.

To see the effectiveness level of leadership, the author considers some measurement level of leadership effectiveness such as surveys and questionnaires, interviews to internal management and external stakeholders, HR performance measures, and organizational satisfaction measure.

It is also important to consider the use of competence performance such as 360 degree feedback to measure the leadership performance in post M&A integration to elicit the improvement for leadership implementation in managing the area of soft factors issues. 360-degree feedback is the process of eliciting input regarding the strengths and weaknesses (areas in need of focus for improvement) from overhead, direct reports, colleagues and other important persons who can speak knowledgeably.[135]

The consideration of the merged company to include the performance measures of change improvement in area of soft factors issues as a part of assessment of post M&A integration transformation phase can be also considered important. It will form in qualitative measures of how leadership addresses and facilitates in the change process. The performance measures can be seen in management behaviors in reintegration into day to day business.

It can be suggested for the consideration of implementing post M&A audit to measure the leadership performance related to people management factors in intervening M&A process using the balance scorecard concept. The balanced scorecard is a management system (not only a measurement system) that enables organizations to clarify their vision and strategy and translate them into action and provides perspectives in learning and growth business process, customer, and financial area.[136] For post M&A integration, the area related to leadership action in managing the soft factor issues in post M&A integration mostly related to area perspectives of learning and growth, customer, and internal business process. The learning and growth will be mainly associated with corporate culture improvement and learning process ability for company in adapting the post M&A integration. The internal business process will focus in how to measure post M&A integration in conforming the people knowledge company's asset. The customer perspectives will be focused on measuring the performance relationship with customer after integration process.

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[135] Timothy Bentley and Esther Kohn-Bentley (2002)
[136] Robert S. Kaplan and David P. Norton (1996), pp. 75-85

Chapter 5
Conclusion and Recommendation

5.1 Conclusion

From empirical evidences of M&A, it is identified that many M&A transactions failed because of a lack of consideration of potential soft problems. In post M&A integration, there is propensity that major considerations are in hard factors, in terms of synergy realization. To achieve a successful transaction, the attention to the hard factors is not sufficient. There should be integration between soft factors and hard factors as drawn in 7s McKinsey framework.

The hard factors in M&A are related to development strategy, standard operating procedure or code of conduct, and management structure. The soft factors are related to development of company's shared values, communication management, cultural alignment, and employees' behaviors. A precise knowledge of soft factors from each merging partner is needed to enhance the acceptance of the deal and lower potential risks during the post M&A integration execution stage.

The author concludes that leadership in M&A solidified with management can give a positive difference in M&A performance and is useful to create effective post M&A integration. The author also finds and proposes that leadership gives some positive impact in M&A in such way of:

a. Leadership will help in building a sense of urgency to drive the change, establishing directions for some strategic decisions, creating a sense of togetherness and aligning people to work on the change, and also building enthusiasm to deal with the barriers of change.

b. From the theories of leadership, the contingency, transactional, transformational, and participative leadership will effectively be used to make an effective decision making based on some situational aspect and also in terms of inspiring, motivating, and achieving established M&A objectives.

c. Leadership plays a role early on the beginning of the transaction in the due diligence phase which is used to evaluate the readiness and compatibility level of management potential partner in integration phase.

d. Leadership also plays a role as a fundamental framework for managing the change. The author proposes a workable planned change framework as a step to create useful change where in one of the detailed phase manage the transition, the author emphasizes that phase as a critical part, and to create an effective transition, the author proposes a model of exemplary leadership from James M. Kouzes of ten commitments of leadership which consists all aspects needed to cope with M&A change.

f. An effective leader with leverage capabilities and skills to pursue the change will help to foster M&A success.

g. To measure the effectiveness performance of leadership in post M&A integration, the author considers some measurement level of leadership effectiveness such as internal organizational satisfaction measure, 360 degree feedback, and balance scorecard as a useful method in post M&A audit.

5.2 Recommendation

The key finding of this thesis is that leadership in M&A is important and can give a significant impact to derive a successful transaction. However, the author suggests that leadership concerns should not become the general purpose excuse of failure. The failure itself should be taken beyond broad generalities.

If a company insists on the lack of leadership as the reason of failure, there will exist an emotional feeling of being irresponsible of the failure. That occurs because of the assumption that organizational culture can’t be managed and should be taken as an inheritance factor.

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