A Contrarian View of Synergy: Successful Merger and Acquisition Activity Based on the Military Tactics of Coin

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Merger and acquisition (M&A) activity is a research area where consensus has yet to be reached. What is clear is that at least half of all M&A activity is viewed as unsuccessful. One of the most-cited reasons for M&A activity is the concept of synergy. A contrarian perspective is presented that contends synergy is unrealizable without one firm dominating the other and imposing its management control. We propose that the most effective method of realizing intended benefits of mergers and acquisitions is the utilization of counterinsurgency (COIN) tactics as employed by the United States military and others.

Introduction

The academic literature houses a rather large inventory of both theoretical and empirical studies regarding the benefits and detriments of merger and acquisition activity. Multiple reasons are postulated as to why mergers and acquisitions are undertaken. One of the most debated antecedents, however, has been the pursuit of synergy. While many have extolled the virtues of synergistic company mergers, this paper proposes that synergy is in fact unrealizable without one firm dominating the other and imposing its management control. We propose that the most effective method of realizing intended benefits of mergers and acquisitions (hereafter referred to as acquisitions) is the utilization of counterinsurgency tactics (COIN) as employed by the United States military and others.

The reasons top management teams posit for pursuing acquisitions are as myriad as top management teams themselves. Haleblian, Devers, McNamara, Carpenter, and Davison (2009) provide a comprehensive list of examples, including the creation of value through increased market power (Battacharyya & Nain, 2011), efficiency, resource redeployment, or market discipline as it relates to ineffective managers; managerial self-interest as it relates to compensation (Agrawal & Walking, 1994), hubris, or defense tactics; environmental factors such as uncertainty (Folta, 1998) and regulation, imitation and resource dependence, and network ties

(Haunschild & Beckman, 1993); and firm characteristics like past experience with acquisitions activity or a firm's strategy and position (Graebner & Eisenhardt, 2004). In the case of related acquisitions, however, there has been an overriding belief in the potential of synergy (Chatterjee, 2007), particularly the benefits of economies of scale and operating efficiencies (cost synergy), revenue growth (revenue synergy), or both.

The obvious problem most firms encounter when acquiring another for synergistic purposes is integration (Chatterjee, 2007). The result of many synergy-based acquisitions is poor performance by the acquired firm post-acquisition (Datta, 1991) as opposed to pre-acquisition. Many firms acquired through related acquisitions have causually-ambiguous internal, complex business operations (Chatterjee, 2007) that have been developed over a long period of time, contributing greatly to difficult integration issues post-acquisition. New leadership for acquired firms is obviously provided by managers of the acquiring firm (Walsh & Elwood, 1991), but to achieve long term positive returns through acquisition activity a new model is proposed that utilizes some of the tenets of counterinsurgency.

Academic researchers in strategic management have often sourced military science when creating new theoretical models. One area of military science that has risen in prominence in recent years is counterinsurgency or COIN. COIN research (Kilcullen, 2006; McNeil, 2009) has as one of its origins the classical French military scholar David Galula who analyzed France's activities in Algeria (2006). More recently David Kilcullen's (2006) twenty-eight fundamentals of successful COIN have become highly regarded. Kilcullen's work has been seen as a model for the dominant form of warfare in the coming decade, influencing greatly the US Army Field Manual on Counterinsurgency. Kilcullen's (2006) work will serve as the COIN model for this paper.

The COIN model is viewed through a lens that reveals similar issues between problems encountered by occupying military forces and firms acquiring others. COIN emphasizes the need to win the hearts, minds, and acquiescence of the population. Acquisition research emphasizes the need of the dominant firm to overcome people problems with the acquired firm if antecedents are to be achieved. While all of Kilcullen's (2006) points are not applicable to acquisition integration, several are relevant to overcoming these people problems.

Following a literature review of COIN and acquisition activity, failed COIN efforts and failed synergy acquisition attempts will be discussed. The proposed model utilizing COIN techniques for acquisition activity will then be presented, followed by a summary and conclusion.

Literature Review

The commonly accepted definition of synergy, a Greek word that means working together, is that "the whole is greater than the sum of the parts." Examining synergy in the context of business, when the combination of two or more business units leads to superior effectiveness and efficiency than was achieved prior to their conjoining, synergy has been accomplished (Barragato & Markelevich, 2008). In theory, the result is that the combined firm has created more value than the two firms could independent of each other, or put another way, 2+2=5 (Mintzberg, 1989; p. 223).
Allowing for the established empirical evidence that most firms pay a premium over market value for firms they acquire renders a strong return on investment as critical for shareholders of the acquiring firms. Without realizing a premium, the only shareholders to benefit are those of the firm being acquired. In light of this issue, a more precise definition of synergy has been operationalized by Sirower: "Synergy is the increase in performance of the combined firm over what the two firms are already expected or required to accomplish as independent firms" (1997; p. 20).

Acquisitions are extremely prevalent in the current business milieu, but this has been true for some time, particularly in the United States. Simply stated, when one firm buys another an acquisition has occurred. Synergy is most closely associated with acquisitions of firms that are somewhat related, enabling the sharing of resources and capabilities between firms. This issue of relatedness has been applied to multiple situations, including selling the same or similar products, serving similar markets, or existing in the same vertical chain (Blackburn, Lang & Johnson, 1990; Chatterjee, 1986). Such noted management theorists as Lubatkin (1983), Porter 1985), and Rumelt (1974) have posited that related acquisitions yield superior accounting results to unrelated acquisitions. Lubatkin and Chatterjee (1994) also cite lower risk for organizations with closely related businesses.

Contrary research, however, has challenged Rumelt's findings (Dubofsky & Varadarajan, 1987; Michel & Shaked, 1984; Varadarajan & Ramanujam, 1987) with research supporting superior results with unrelated diversification attempts. Regardless of which type of acquisition produces better results, a key issue for all acquiring firms is the consequence of paying large premiums (Carroll & Muim, 2008). The concept of synergy represents an increase in wealth to shareholders that could not be duplicated on their own through something as basic as portfolio diversification (Bauguess, Moeller, Schlingemann, & Zutter, 2009).

Exploring Coin

Kilcullen defines counterinsurgency as "a competition with the insurgent for the right and the ability to win the hearts, minds and acquiescence of the population" (2006; p. 29). While the employees of target firms are rarely referred to as insurgents, it is clear that acquiring firms face some of the same challenges in integrating operations as occupying military forces face. Although Kilcullen's (2006) twenty-eight points do not map corporate needs, such as the need for Combat Service Support, the key themes serve as a checklist that any acquisition team would do well to follow if they hope to succeed in their efforts. Themes include preparation, first impressions (the golden hour), continuing actions (groundhog day), and completion (getting short) are all phases that must be mastered for a successful transition.

Key points of Kilcullen's (2006) recommendations include: Know your turf (economy, history, and culture), diagnose the problems (what makes people tick, what are the issues that worry people), organize for intelligence, prepare for cross functional operations, find a "cultural advisor," have a game plan ready to execute day one, maintain a strong presence, build trusted networks, work to extend your influence, seek early victories, avoid backsliding, remember that the world (or at least other stakeholders in the industry) is watching, regularly analyze the situation and make adjustments, work to blend cultures, and, finally, keep the initiative (control the environment). Serious dangers include isolation from the local populace (McNeil, 2009), lack of security (Burton & Nagl, 2008), failure to include the local populace in planning and implementation stages, and lack of coalition building. The findings of this new research led to the updated US Army/Marines Counterinsurgency Field Manual (Nagl et. Al. 2008) which outlines the strategy and implementation techniques that have come to be known as the Petraeus doctrine.

Failures of Synergy and Coin

A McKinsey study of mergers found that out of 124 reviewed, only 30% generated synergies on the revenue side (Christofferson, McNish, &

Sias, 2004). Carroll and Mui (2008) provide some interesting examples of failed acquisitions that have been prefaced with a goal of achieving synergy. While presenting some relatively damaging evidence of colossal financial disasters based on synergy, Carroll & Mui (2008) do give a nod to some organizations that successfully achieve synergistic conditions through related acquisitions, including Cisco and General Electric. These firms tend to understand how to link businesses through corporate level core competencies, particularly managerial expertise (Rothaermel, Hitt, & Jobe, 2006), economies of scope (Makri, Hitt, & Lane, 2010), and to a certain extent economies of scale.

For every success story, however, there are a multitude of failures. Well-known examples include Unum and Provident in the disability insurance market. Both firms assumed cost and efficiency synergies were readily available post-acquisition, as well as an easy cross reference of customers from one side of the business (individuals) to the other (companies). Six years after the deal, however, of the thirty-four separate information systems that didn't talk to each other, only four had been eliminated (Carroll & Mui, 2008). The combined company performed poorly, raised prices that disgruntled otherwise happy customers, and eventually got investigated by *60 Minutes*.

A second example from Carroll & Mui (2008) is Sears, surely chronicled in anyone's description of a poor acquisition strategy. While the Allstate Insurance acquisition was successful for decades, that business was operated separately from Sears' department stores. The idea that a stock brokerage business (Dean Witter Reynolds) and a real estate company (Coldwell Banker) were synergistic components for a department store chain seems bizarre after the fact. K-Mart followed a similar and also disastrous course with its acquisitions in the builder supply and drug store businesses. Other retailers failing to cash in on synergy acquisitions include Dillard's and J.C. Penny, Dillard's with a discount retailer (Mercantile Stores) and Penny's with five drug store chains in the 1990s. And maybe on the worst cases in history, not discounting the debacle merger between Time Warner and AOL, has to be the Quaker Oats acquisition of Snapple, purchasing the firm for $1.7 billion and unloading it three years later for $300 million.
As for COIN failures of the past, McNeil (2009) presents two clear examples, from the many available, hat illustrate the dangers of poor counterinsurgency efforts. The U.S. occupation of the Philippines under Major General Leonard Wood is an example of killing hundreds of local Moros when resistance occurred, while Brigadier General Tasker Bliss kept his occupying forces isolated itself from the populace, breeding distrust. These provincial governors were followed by General John J. Pershing whose approach to the local population was one of righting previous wrongs, such as slavery, exercising restraint against arbitrary violence, engaging the various chieftans, investing in local economic development and so forth.
Another example of failed COIN activity is cited by McNeil (2009) in Iraq, specifically the situation in Anbar Province from 2004 to 2007. Drawing on the work of Burton and Nagl (2008), McNeil (2009) describes the lack of security felt by the local populace as being the most critical issue faced by the U.S. army. Another serious issue was the fear of retribution by local tribal leaders if the insurgency outlasted the U.S. occupation. Even attempts at local economic reconstruction were failures due to instability and sectarian violence. Security at a minimal level was not achieved until the U.S. surge in 2007, coupled with successful nationwide elections, turned many of the Sunni tribe sheikhs against al Qaeda.

There is a very similar feel between these COIN examples and failed synergy efforts through acquisitions. The M&A literature regularly refers to downsized employees of acquired firms as casualties and remaining employees as survivors (Gutknecht & Keys, 1993). Of particular note is the fear expressed by the populace of firms about to be acquired and the fear of the local populace of a territory or country about to be occupied.

A New Model for Integrating Firms

Most researchers agree that the most difficult challenge in related or unrelated acquisition activity is the integration from two firms to one (Rafferty & Restburg, 2010). Indeed, no less than Michael Porter and Rosabeth Moss Kanter, both strong early proponents of synergy as the basis for acquisitions, admit that most firms fail in their synergy attempts, finding the challenge quite difficult (Kanter, 1989; Porter, 1987). Trautwein (1990) reported that available synergies were almost always cited as a justification for diversification attempts by managers. Yet, some noted researchers (Hitt, Ireland, & Hoskisson, 2011) make it clear that synergy actually increases the risk of failure for firms due to the joint interdependence between businesses that constrain an organization's flexibility to respond to changing competitive environments.

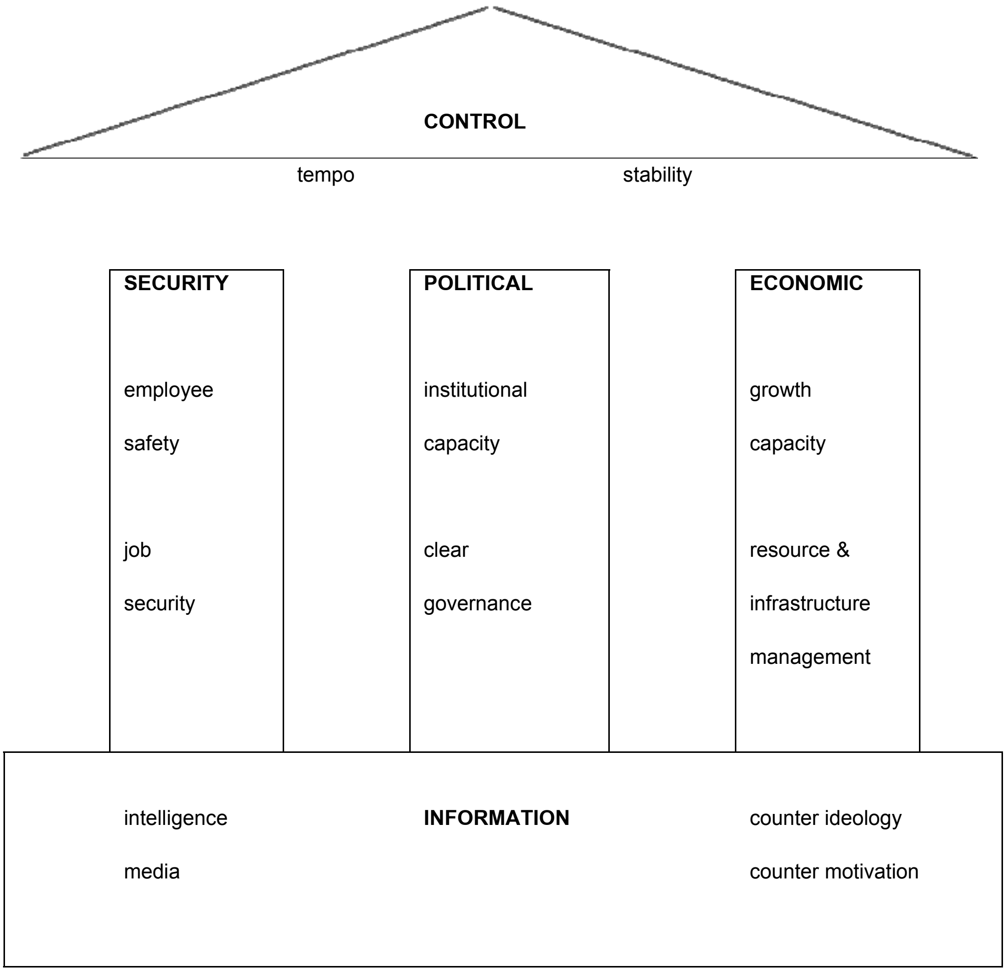
While firms continue to profess the parsimonious value of acquiring new technology, new market presence, and other innovative advantages through acquisitions rather than internal development, the failure rate of such activity is alarmingly high (Lee & Lieberman, 2010). What should be paramount in related acquisition activity, whether synergy is purported to be the primary driver or not, is that without integration no value will be achieved, regardless of premiums or market price paid. Sirower (1997) reported the results of a study by the Boston Consulting Group indicating eight out of ten acquiring firms do not perform detailed work in advance of an acquisition to determine if synergy is even possible. A study by Diamond takes this an important step further by reporting a lack of awareness of business platforms and operations of targets by acquiring firms at all levels of pre-acquisition planning, failing to recognize the risk of business platforms (Calkins, Smith, Sviokla, 2006).

According to Datta (1991), integration problems post-acquisition result in the acquired firm performing more poorly post acquisition than pre-acquisition. Particularly disturbing is the results of a McKinsey study where only 12% of acquiring firms managed accelerated performance three years after an acquisition (Bekier, Bogardus, & Oldham, 2000). The post-acquisition performance of organizations is historically so dismal, it has led Warren Hellman, the former president of Lehman Brothers, to remark: "So many mergers fail to deliver what they promise that there should be a presumption of failure. The burden of proof should be on showing that anything really good is likely to come out of one" (Sirower, 1997). And yet, not only do acquisitions continue to be a driving force of corporate strategy, deals in the first quarter of 2011, for example, totaled $290.8 billion, up $90 billion from a year earlier (Chon, Das, & Cimullaca, 2011). If acquiring firms do destroy shareholder value, as Sirower (1997) contends, there must be better approach to integration.

Since acquisition activity is not going away, how can the integration problems, in particular those of related acquisitions, be overcome and successful results achieved? Due to the complexity of integrating two disparate organizations, it is not surprising that the process is difficult at best. Key issues to be managed include comprehending the target's basic business operation and source of competitive advantage, melding the financial control systems and information technology assets, and delving into the corporate culture of the target firm in pursuit of real understanding. As Gutknecht and Keys (1993) also point to the importance of people issues such as maintain employee morale after the acquisition, integrating conflicting organizational values, structures, climates, and roles. Layoffs though downsizing efforts invariably occur as firms attempt to realize synergy through cost savings and as they need to increase profitability due to taking on new indebtedness. These layoffs, or downsizing activities, create negative feelings among survivors as their workload typically increases and they fear future layoffs or reprisals. This fear is also accompanied by feelings of guilt, anger, or perhaps relief by survivors (Gutknecht & Keys, 1993). Yet, the biggest issue acquiring firms face in integration may be the simple prospect of change and its effect on survivors.

One methodology for this integration is COIN. Based on his personal experience and research, Kilcullen's (2006) COIN fundamentals are most relevant when considering utilizing COIN in firm to firm acquisitions. We have modified one of Kilcullen's models, the three pillars of counterinsurgency and modified it for use in and acquisition scenario.

Figure 1. Three pillars of counterinsurgency for successful mergers and acquisitions



The model demonstrates how the principles of counterinsurgency line up to create a secure situation which will allow the dominant firm in an acquisition to incorporate the personnel and assets of the target firm into the merged organization. Information serves as the foundation of this process. Having good intelligence as to what is happening in the target organization, understanding the feelings of the employees post merger and being able to counter negative messages are all key as is controlling the message being put out by the media. The three pillars in the model, Security, Political and Economic all support the activities that take place as merged entities are brought together. Employees will crave security, clarity, and an understanding of how the merger will positively affect both the organization and their personal career. Ultimately, with a good foundation and strong pillars, the process will be capped by Control, where management can set the tempo of activities and demonstrate stability in the newly merged organization. Effective implementation of this model will make it clear to employees where they stand with the organization and will allow the organization to demonstrate to external stakeholders that the new entity is in a position to execute its intended strategy.

CONCLUSION

While synergies may be apparent on paper when strategists formulate a course of action, those synergies are rarely evident to all the stakeholders involved. This is especially true among the employees in the target organization where uncertainty is often the source of negative rumors and speculation. In this environment, the most able employees often leave the organization for what they perceive as either better or more stable opportunities. Employees without such options often become entrenched and begin a counterinsurgency as they attempt to hold on to the status quo and resist change. The US Military faces an analgous situation when confronted by insurgents. With recent actions in Iraq and Afghanistan the military has been forced to revisit counterinsurgency and update their models. The resulting strategy, known as the Petraeus doctrine has been recognized as an improvement over previous counterinsurgency efforts and led to greater success for the US military. While no model can be perfect in such a chaotic and epistemogical scenario, the updated military strategy has demonstrated improved results. As such, we have recommended that a modified version of the military model be developed to aid managers attempting to consolidate an acquisition. The model that we have described, if properly implemented, will make it clear to individuals where they stand with the organization, inform them about both their future and the future of the organization, and make it clear to external stakeholders the direction the merged organization will take.

By taking action quickly, acting decisively, and with transparency, companies will increase the probability of success. While some individuals will still be negatively affected, acting quickly and communicating transparently to the remaining members of the new organization and external stakeholders will maximize the probability that management will control the situation and have the ability to achieve the planned objectives of the newly formed organization.

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