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Aligning Identity and Integration Method for M&A Success

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Introduction

Every year companies spend over \$4 trillion on mergers and acquisitions (M&As) in spite of the fact that between 70% to 90% of these M&As fail. Both practitioners and scholars are puzzled by these intriguing statistic and have tried to identify the causes of M&A failures. Factors such as inaccurate assessment of financial and operational synergies, lack of clarity in the execution of the integration process, negotiation errors, lack of backup plans, and cultural issues are only a few of the long list of reasons that may lead to such high rate of failure. Evidently, some of these factors have been analyzed more than the others and a lack of promising evidence has generated strong sentiments for giving additional attention to the causes that are not as heavily explored. For instance, while many studies highlight the importance of financial, accounting, and value-creating synergies in post-acquisition performance, others have noted that a lot more work is needed in evaluating the role of behavioral factors such as understanding cultural and identity changes in post-acquisition success.

Firms commonly use mergers and acquisitions (M&As) to fuel organizational growth, profits, market power, and international expansion. The size and the number of M&As have increased since the 1980s, and have continued to grow since 2000 (Lakshman, 2011). Perhaps due to the importance of M&As among scholars and practitioners alike, there is vibrant discussion around the variables that actually help post-acquisition performance (Bouchikhi and Kimberly, 2012; Hitt et al., 1998; King et al., 2004). Interestingly, while a strong body of research highlights the

importance of financial, accounting, and value-creating synergies in post-acquisition performance (e.g., Franks et al., 1991; Halebian and Finkelstein, 1999; Hayward, 2002; Lubatkin, et al., 1997), many scholars point out the significance of behavioral factors such as organizational culture and identities in evaluating post-acquisition results in M&As (e.g., Bouchikhi and Kimberly, 2012; Drori et al., 2013; Weber & Drori, 2011). As Weber and Drori (2011: 77) note, “most studies, although essential to the understanding of mergers, leave important aspects, such as behavioral issues and organizational identity or identification, relatively unexplored.” Indeed, while financial and operational due diligence is clearly on the forefront of M&A research, work is needed to understand how merging the different *identities* of the two companies affects the performance of the new entity (Bouchikhi and Kimberly, 2012). Scholars suggest that previous research has paid only cursory attention to the integration of identities, e.g., creating a new logo or adopting a new name for the combining firms. The deeper identity issues that connect individuals psychologically remain unattended (Bouchikhi and Kimberly, 2012; Drori et al., 2013).

Inspired by these calls, this paper explores the concept of organizational identity (OI) to propose a framework of M&A performance based on cross-level identity dynamics. OI refers to the central, distinctive, and relatively enduring characteristics of an organization (Albert & Whetten, 1990). OI has gained attention in the M&A research by addressing gaps left by studies that focus on financial and operational variables (e.g., Amiot et al., 2013; Bouchikhi and Kimberly, 2012; Weber and Drori, 2011). OI is about “who are we as a firm”, it probes organizational values and goals, and provides organizational members with a sense of stability (Dutton and Dukerich, 1991). These beliefs may become altered during an M&A since one or both the organizations undergo rigorous transformation as they combine to develop into a new entity. As we propose later, the similarity or dissimilarity in the identities of the two firms (the acquiring (parent) and

acquired firms is one of the dimensions that influences performance of the newly combined entity. Consider, for instance, the challenges that exist in the integration of identities between Verizon and AOL in their recently proposed merger. While value creation as a post-acquisition goal is no doubt important, it is just as critical that it fully integrate the businesses and merge cultures and identities (Bradt, 2015). This is no small task, as the organizational identities of Verizon and AOL are quite different: Verizon is an engineering-based, telecom firm, while AOL is closer to the customer with an emphasis on the creative and the B2C sale. In the absence of a careful consideration given to the identity differences and ways to integrated these, psychological and cognitive disengagement by employees is likely or worse employees may harbor open hostility toward the combined entity.

The second issue—the integration of identities—or the manner in which the two firms manage the new M&A identity, is dependent upon how the employees of the two combining firms are brought together for behavioral integration. It is well documented that a significant amount of pre-M&A anxiety and post-M&A friction exists between employees of the two firms coming together (Ullrich et al., 2005). Without an identity-based continuity, perceptions of uncertainty and feelings of threat can impact employee work routines and jeopardize post M&A performance (Hogg and Terry, 2000). We propose that conditions under which M&As are likely to reduce the anxiety and offer identity continuity will enhance the chances of integration. Conversely, when employees perceive a significant threat to their pre-merger identity, they may engage in roles and behaviors that directly or indirectly impede efforts of integration (Amiot et al., 2012).

Using these two dimensions, we specifically argue that performance of an M&A depends on the alignment of two factors:

1. The similarity of OIs of the two merging firms

2. The manner in which they are integrated

Previous work on post-acquisition performance

Researchers have examined many variables to assess post-acquisition performance. These include (but clearly are not limited to) whether the acquirer was a conglomerate (e.g., Agrawal et al., 1992; Berger and Ofek, 1995), a related firm (e.g., Hayward and Hambrick, 1997; Lubatkin, et al., 1997), had prior acquisition experience (e.g., Franks et al., 1991; Haleblan and Finkelstein, 1999; Hayward, 2002), and whether cash or equity) was used for payment (e.g., Franks et al., 1989).

Quite surprisingly, none of these variables has been found to have a consistent, significant impact in post-acquisition performance, leading King et al. (2004: 188) to suggest that “changes to both M&A theory and research methods may be needed.” In fact, significant findings support both sides of many arguments about the influence of variables on post-acquisition performance. For instance, some empirical evidence suggests that unrelated diversified firms tend to outperform the S&P500 (Ravenscraft and Scherer, 1987; Campa and Kedia, 2000), while other evidence indicates that an unrelated M&As triggers a diversification discount which lowers the performance of firms (Agrawal et al., 1992; Berger and Ofek, 1995). Likewise, a related acquisition, or one where there is similarity in products or markets between firms, is assumed to have strong positive impact on performance because it allows for an increase in efficiency through reduction of overlapping resources (Rumelt, 1974). However, researchers proposing contagion effect argue that those synergies can actually become liabilities in the event of an exogenous shock (Shaver, 2006). In sum, it has been difficult both theoretically and empirically to identify variables that predict post-acquisition performance.

A case for examining OI as a predictor of M&A performance

Given these difficulties in research seeking to predict M&A performance, scholars have suggested that non-financial motives for M&A activities should be more rigorously assessed (King et al., 2004). Specifically, Amiot et al. (2012) found that perceived similarities between two organizations' identities was strongly related to employees accepting and internalizing the expectations of the combined entity. Essentially, when employees perceive a sense of continuity of their pre-acquisition status, they are more likely to persist with the positive behaviors that are important to any organization's success and performance. On the other hand, if an M&A triggers changes that culminate in employees' perceiving threats to their identity, negative outcomes such as increased stress and cognitive rigidity may result (Roccas and Brewer, 2002).

M&As and multiple identities

Bouchikhi and Kimberly (2012) suggested many ways in which firms can achieve successful identity integration in an M&A using methods such as assimilation, federation, metamorphosis and confederation. This paper focuses on two of those integration methods: *assimilation*, which is achieved when the identity of an acquired company is dissolved into the identity of the parent firm, and *confederation*, when the different identities are kept separate and are not expected to meld, such that coordination between the identities may be limited to administrative functions that have a minimal impact on OI.

When are M&As likely to be successful?

We argue that the similarity or dissimilarity in the identities of the acquiring (parent) and acquired firms, and the method -- assimilation or confederation -- used to integrate and manage the new M&A identity (assimilation vs. confederation), will influence the performance of the newly combined entity. We explain below why this is so, pose several propositions, and add Figure 1 to illustrate.

Insert figure 1 about here

Similar identities and the use of assimilation (Quadrant 1)

Identities of two firms are similar when both organizations have similar prototypical characteristics and the decision-makers categorize their firms in a similar fashion (Anand, et al., 2013). For instance, in a study of Scottish knitwear firms researchers found that the owners categorized other Scottish garment manufacturers similar to their firms (the prototypical identity of these firms often mentioned as “premium quality, expensive garment manufacturer”) while the overseas competitors whose products were mass-produced were either ignored or disidentified with (Porac et al., 1989).

When a firm acquires another company with a very similar identity there is likely to be greater shared understanding among stakeholders (including employees of the two firms) about the expectations and objectives of the merged entity. This shared understanding among managers, employees and other stakeholders is likely to be strengthened if the parent organization uses assimilation as the integration mechanism. The similarity of identities of the two merging firms and the use of assimilation can assist in reducing the ambiguity inherent during the post-acquisition phase and help achieve a smooth transition and stability during integration (Chattopadhyay et al., 1999).

When the identities are similar, executives may rely on their pre-acquisition understanding of the stakeholders, competitors, and the interdependencies between the various constituencies which may allow them to be quick and effective in decision-making. Thus, similarity of identities may lead to very similar frames of references, similar communities of practices, and information

sources that are used by top managers for decision making helping better achieve understanding and transfer of tacit knowledge across firms; eventually leading to better performance.

Evidence from research at a more micro-level also suggests that the use of assimilation to integrate these firms with similar organizational identities may lead to better performance. Social identity and intergroup theorists have proposed that similar identities are “easier to ‘link’ at the cognitive level” (Amiot et al., 2012: 445). Perceptions of similarity of identities also help individuals to make better adjustments to their new environments because they experience continuity of their identities (Ullrich et al., 2005). Continuity refers to “the subjective feeling that despite the social changes experienced, the characteristics of one’s in group are maintained over time” (Amiot et al., 2012: 445). Perceptions of continuity lead to greater identification with the combined entity that helps employees adjust to the new settings and minimize inter-organizational differences.

Proposition 1: The performance of an M&A is positive when the two merging firms have similar identities and they use assimilation as a method of integrating OIs.

Similar identities and the use of confederation (Quadrant 2)

When a firm acquires another company with a very similar identity but employs confederation as the integration mechanism the performance is likely to suffer. A strong rationale for combining two similar firms is that the combined entity captures synergies that were absent in the previously unconnected businesses (Sirower 1997). Synergies can manifest in the form of combining operations, managerial transfer of abilities across two firms, and the creation of umbrella brands or the ability to cross-sell the products (Shaver, 2006). The use of confederation as a means to integrate two firms suggests that the two organizations are deliberately kept apart in spite of the fact that they have similar identities, goals, values, products and services. At the

simplest level of analysis this type of integration is unlikely to achieve the synergistic effects and thus may lead to negative results.

In addition, while similarity of identities may lead employees of the merged entity to assume equal status with the parent firm, they may be in for a shock if the acquired firm is allowed to exist only as a separate entity—suggesting a stepchild treatment of new employees. Outcomes such as a breach of psychological contract, low morale, employee unrest, high employee turnover and even sabotage are likely as employees of merged entity consider themselves unimportant or being overlooked for future.

Proposition 2: The performance of an M&A is negative when the two merging firms have similar identities and they use confederation as a method of integrating OIs.

Dissimilarity of identities and the use of assimilation (Quadrant 3)

When the identities of the two firms undergoing M&A are quite dissimilar and the mode of integration is assimilation, the performance is likely to be hurt because of the complications (conflicts/power issues etc.) arising due to combining firms of dissimilar identities. During an M&A, when assimilation is used as the integrative mechanism, employees from an acquired firm with a dissimilar OI are expected to strip off their previous identities and accept the new identity of the parent organization. In the case of dissimilar OIs in M&A, identities are not easy to change or alter and the change is especially difficult if individuals perceive the change to be threatening to their distinctiveness (Amiot et al., 2012). A perception of threat to their current identity increases stress, induces rigidity and inhibits integration. Studies have found employees engaging in coping strategies such as withdrawal and even disidentification with the new entity when the threat levels are high (van Dick et al., 2006). This may be met with frustration and resistance—eventually resulting in adverse organizational outcomes.

Proposition 3: The performance of an M&A is negative when the two merging firms have dissimilar identities and they use assimilation as a method of integrating OIs.

Dissimilarity of identities and the use of confederation (Quadrant 4)

We do not expect a significant impact on organizational performance when the two firms that do not share their identities are kept apart from each other after an M&A. These kinds of acquisitions usually take place for financial reasons where the parent organization is less interested in creation of synergies, knowledge transfers, or co-branding of products.

Confederation results in organizational separation to allow the acquirer and target companies to operate as distinct business units within the combined corporation. As such, this limits opportunities for cost reductions from eliminating redundancies in the business-level firm's operations, information systems, or sales and marketing activity. It may also limit coordinated sales activities, since opportunities for cross-selling may be limited by the lack of a singular OI. Thus, post-acquisition synergies may be limited to consolidating administrative functions at the corporate level.

Proposition 4: The performance of an M&A is neutral when the two merging firms have dissimilar identities and they use confederation as a method of integrating OIs.

Implications and conclusion

We have argued that the management of OI is important to successful M&A performance. The literature on OI provides us with key understanding of identity integration processes, and we extend this understanding to the literature on M&A performance. Our model suggests that when M&A players have similar identities, the future organization might yield more positive performance results if the acquired organization assimilates into the parent organization. On the

other hand, when M&A players have dissimilar identities, the future organizations could result in greater negative performance if assimilation is used to integrate the acquired firm into the parent. This is because firms that have dissimilar identities are not likely to have, to pursue, or to enjoy the expected synergies when organizations try to assimilate. To this end, testing our propositions empirically would be the next step towards scholarly contributions. Future research might also explore how the integration of identities progresses and changes during an M&A. Employees of acquired firms may experience a series of adjustments during the M&A. It is likely that their identities are strongly rooted in their original firms. However, as the prospect of the M&A solidifies, their cognitive adjustment to the loss of the prior identity and acceptance of that of the newly merged firm may differ for each of the four scenarios we have proposed. It is possible that under certain conditions the perceived loss of the previous identity could trigger holding onto it so much that employees refuse to accept the new firm, and disidentify with it. Under such conditions, deterioration in performance could be severe if it is the result of apparent disregard of the new firm by the employees.

This paper has several implications for M&A practitioners as well. First, executives might realize that there is no one-size-fits-all approach to all M&As, and identity incompatibilities could jeopardize successful integration and hinder performance. Consider Lenovo's relatively recent acquisition of the Motorola cellphone handset business, which has faced several integration issues, compared to Lenovo's acquisition of IBM's personal computers (PC) over a decade ago, which is considered a remarkable case study of successful integration (Bajarin, 2015). From an OI perspective, much of Lenovo's OI overlapped with IBM's PC unit, and they used assimilation as the integration method. The two firms shared a common brand, and their management teams worked very closely to support the design and product development of each generation of ThinkPad and to coordinate the supply and distribution chain with vendors and

customers. OI similarities contributed to shared culture, values, and strategic vision, and Lenovo retained IBM's PC brand, its product development and sales teams, and strong relationships with U.S. based corporate customers.

On the other hand, Lenovo's acquisition of Motorola highlights the dangers of signaling one identity integration strategy but using contradictory actions in implementation. Lenovo's and Motorola's OIs were dissimilar— although Lenovo's PC business was global, its cell phone business was focused on China as its primary market and was managed by Chinese executives. Motorola's headquarters was in the U.S., which was its most important market. Motorola identified itself as a premium market player, whereas Lenovo's cell phones were positioned at the mass market with low relative pricing and fairly standard features (Chu and Osawa 2017).

Given these dissimilarities, Lenovo adopted "confederation" as their identity management technique, choosing to retain Motorola's branding, logo, personnel, and leadership team. CEO Yang instructed his management team to take a "hands-off" approach, allowing Motorola's leadership autonomy on product and marketing decisions. This may have resulted in success, except the noninterventionist, confederation approach was abandoned as Lenovo changed Motorola's product lineup, design language, price points, and put Chen Xudong, a longtime Lenovo PC executive with little background in smartphones outside China, in charge of the combined company's global phone business (Chu and Osawa 2017). The results were poor: sales sank for both Lenovo and Motorola brands. Lenovo's smartphone market share in China plummeted to less than two per cent, down from about 12 per cent three years earlier, and thousands of employees were laid off, mostly at Motorola. The benefits of confederation evaporated as Lenovo became increasingly entrenched in Motorola's operations.

This paper highlights the importance of evaluating OI as an element of M&A due diligence. As the example of Lenovo shows, OIs are critical to supporting value creation in M&As. Acquirers should look for targets with similar OIs and manage OI integration to emphasize these similarities and promote assimilation of the combining firms' OIs. Forced assimilation of OIs in combining firms with differing OIs is likely to interfere with attempts to generate synergies. Confederation may mitigate post-acquisition problems, but maintaining independent OIs is likely to limit synergy realization. As in the case of Lenovo-Motorola, limited synergy realization as a result of confederation may prompt a movement towards assimilation, which exacerbates the problems of dissimilar OIs and harms performance more.

Overall, this is a timely and much needed perspective, since previous research has not fully addressed the impact of behavioral antecedents on M&A performance.

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Figure 1: Organizational Identity Management and M&A Performance Implications

Identity similarity	Similar identities	Quadrant 1: <i>The performance of an M&A is positive when the two merging firms have similar identities and they use assimilation as a method of integrating OIs.</i>	Quadrant 2: <i>The performance of an M&A is negative when the two merging firms have similar identities and they use confederation as a method of integrating OIs.</i>
	Dissimilar identities	Quadrant 3: <i>The performance of an M&A is negative when the two merging firms have dissimilar identities and they use assimilation as a method of integrating OIs.</i>	Quadrant 4: <i>The performance of an M&A is neutral when the two merging firms have dissimilar identities and they use confederation as a method of integrating OIs.</i>
		Assimilation	Federation
		Mode of Integration	