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# Mergers: Back to “Happily Ever After”

by Gerald Adolph

**M**ost mergers fail. It’s an assumption repeated so often that few would dare question it. But is it true?

During the 1990s, it was indeed true — confirmed by a 2001 Booz Allen Hamilton study that found that two-thirds of all mergers fell short of expectations. In the intervening years, however, much has changed. The Internet boom and bust made their mark. New regulations brought far greater scrutiny — and accountability — to senior management and boards of direc-

America and FleetBoston or Verizon and Bell Atlantic/GTE, are on the path to “happily ever after.”

Our analysis shows that at least one of three critical factors is usually evident in mergers that pay off:

**1. Consolidation.** Many companies are shifting away from big, strategic deals that are intended to add capabilities or create new business models, but that often instead fall flat when companies prove ill-equipped to realize the synergies that they sought. In place of such deals, consolidation-oriented transactions, designed to add scale or grow existing business lines within

## Boards of directors are getting involved earlier, asking not just “why” but “how.”

tors. Merger activity has come and gone and come once again.

Today, in an altered business landscape, a close look at current merger activity suggests a different point of view. Companies no longer should expect or accept the probability of merger failure. Although our observation is, admittedly, anecdotal, we examined dozens of transactions completed since our last study, and there is no doubt that the success rate of mergers has increased significantly. Instead of the troubled marriages of Quaker Oats and Snapple, or Matsushita Electronics and the entertainment giant MCA Inc. in the 1990s, more recent couplings, such as those of Bank of

an existing business model, are gaining favor. Think Wachovia Bank and First Union or Quest Diagnostics and SmithKline Beecham Clinical Laboratories. (See “Making Acquisitions Work,” by Kenneth W. Freeman, *s+b*, Fall 2005.) Because these types of mergers essentially involve an enhancement of the company’s core business without the need for a fresh set of operational and strategic skills, they carry far lower execution risks and, therefore, have a higher success rate. In the first 10 months of 2005, 42 percent of the 50 largest deals involved companies within the same industry group. This compares with fewer than 30 percent in 1999.

## 2. Stakeholder Oversight.

Boards of directors and stakeholders have become more active in vetting the “how” of potential transactions, rather than considering only the “why.” They are getting involved earlier and are moving beyond traditional board-level issues, such as the purchase price and strategy, to such fundamental concerns as the roadblocks to successful implementation. Witness Dutch publisher VNU’s proposed \$6.3 billion merger with IMS Health Inc., a U.S.-based health-care data firm, announced in July 2005. Two large shareholders holding a combined 25 percent of the stock publicly opposed this merger even before the proxy was filed with the SEC. They argued that VNU should focus on improving the performance of its current businesses and questioned management’s ability to execute a difficult integration. By the end of November, the deal was off and VNU’s chairman and CEO, Rob van den Bergh, resigned.

**3. Premerger Planning.** In our original research, we found that more than two-thirds of mergers failed because the companies did not integrate their operations quickly and effectively to leverage the anticipated gains from the transaction. To avoid this type of failure, companies now initiate integration planning or ongoing examinations of the acquisition anywhere from two to five months before a transaction is actually closed and increasingly even before the agreement is finalized. During this time, managers from both companies may meet to assess short- and long-term performance targets; design a framework for the merged organization, including use of resources and staff allocation; draw up blueprints for

integrating corporate networks; and create benchmarks for tracking the planning process. The advantage is obvious: The economics of the merger will improve because synergy realization will be accelerated.

The economic rewards of planning early were aptly demonstrated recently by a global telecommunication services company’s \$1 billion acquisition of a U.K. fixed-line operator. Shortly after the initial due diligence was completed, a management team analyzed the deal more closely and identified three to five times more potential gains than the companies had initially found. By balancing these newly discovered opportunities with existing cost-reduction goals, the companies were able to more effectively determine the resources and integration requirements needed to capture the most substantial benefits from the acquisition.

The fact that the track record for mergers is improving suggests not only that these deals will con-

tinue to play a major role in the growth strategies of many companies, but that they should. After companies reach a significant size and level of maturity, they need to consider acquisitions if they want to continue to deliver shareholder value. Indeed, multiple studies confirm that acquisitive companies outperform their less aggressive peers.

Some of these acquisitions are going to have to go beyond mere consolidation to tap new strategic possibilities. However, that needn’t be cause for alarm. As recent mergers increasingly have shown, if the transaction makes business sense for both companies, has the backing of stakeholders, and is diligently planned-for well before it is finalized, it is reasonable, for the first time in many years, to expect success. +

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# Why Managing by Facts Works

by Jeffrey Pfeffer and Robert I. Sutton

**J**ohn Lilly, formerly the CEO and founder of a Web-design firm and corporate incubator called Reactivity, recently recalled what it took to sell an idea to venture capitalists during the dot-com boom of the late 1990s. In a period of 30 weeks, his team generated 30 PowerPoint presentations as “prototypes” for a diverse group of Internet-based startups. Out of

these, a combination e-mail and Web browser was chosen as the most promising. Its PowerPoint presentation was fine-tuned and then shown to potential backers. Based primarily on this slide show — there was very little else for the venture capitalists to go on — Reactivity raised more than \$100 million for a new company (now defunct) called Zaplet.

“That approach wouldn’t work now,” said Mr. Lilly, currently vice president of business development

and operations at Mozilla Corporation. “By and large, venture capitalists only fund Web-based companies that already have proven the ability to attract customer traffic.”

Chalk one up for evidence-based management — the notion that real knowledge in the form of empirical analysis of results is the shortest path to the best business decisions. That may seem obvious, yet few companies follow that precept. Many executives make pivotal strategic choices based on nothing more than business fads or the dubi-

learn, when it was too late to do anything about it, that consumers considered Compaq products to be subpar, the opposite of what they felt about HP equipment.

If you look at the top-performing companies, there are strong hints that evidence-based management is fundamental to their high ranking. A few examples: Yahoo runs many experiments a day in which its Web site design is subtly varied to see which approach attracts the most visitors and purchases; QVC’s television shopping channel analyzes

should be measured against logical and empirical benchmarks to determine whether they are efficacious ideas or just momentarily exciting thoughts better off abandoned.

Here are two basic guidelines for a successful evidence-based management program:

First, act on the facts. Many managers don’t want to hear bad news, admit that they don’t know something, or learn from others. But with these shortcomings they’re doomed to operate without critical information. An excellent example of a company that sees the value in evidence-based management is DaVita, the kidney dialysis company whose mantra is “no brag, just facts.” Data is so important at DaVita that the company always reports quantitative information on patient outcomes, good or bad, even though it is not required to. And when an important measure, such as the number of patients who don’t show up for treatment, is not routinely collected, it is nonetheless included in company reports with the notation “not available” to encourage employees to figure out how to get the information.

Second, treat the organization as an unfinished prototype. Executives who use evidence-based management best encourage their employees to learn even as they act on what they already know. They regard their companies as a work in progress — one that constantly needs to be tested, probed, and experimented with, to be certain that it is evolving in the right direction. They never view their companies as “not broke, so why fix it?” They are confident enough to act on what is already known (even when knowledge is vague and incomplete), and humble enough to

## Empirical analysis of results is the shortest path to the best business decisions.

ous recommendations of advisors who are afraid to challenge the preconceived judgments of their bosses or the organizational status quo. Quantitative or qualitative data that measures how well the strategy is working is often the last concern. As a result, critical company decision making, relating to acquisitions, restructuring, new product launches, brand marketing, and the like, often takes place in the dark.

A classic case is Hewlett-Packard’s acquisition of Compaq for \$25 billion in 2001, a transaction that is, in part, to blame for HP’s less-than-stellar record during the last few years. HP insiders told us that the company had conducted no research on how consumers viewed Compaq products until months after then-CEO Carly Fiorina publicly announced the deal and privately warned her top management team that she didn’t want to hear any dissent pertaining to the acquisition. Ms. Fiorina was dismayed to

real-time data to determine the presentation and pitch for specific products; and Enterprise Rent-A-Car, the largest U.S. automobile rental company, sends out more than 100,000 surveys per month to monitor customer service at its outlets.

From our research, we are convinced that when companies base decisions on evidence, they enjoy a competitive advantage. And even when little or no data is available, there are things executives can do that allow them to rely more on evidence and logic and less on guesswork, fear, faith, or hope. For example, qualitative data, such as that gathered on field trips to retail sites for the purpose of testing existing assumptions, can be an extremely powerful form of useful evidence for quick analysis.

By emphasizing the importance of evidence and knowledge, we do not mean to dismiss the value of intuition and innovation. But even hunches, fresh ideas, and inventions

change course, if need be, when new information comes along. As former Intel CEO Andy Grove put it, “None of us has a real understanding of where we are heading. But decisions don’t wait for the picture to be clarified. So you take your shots and clean up the bad ones later.”

The most striking thing about evidence-based management is that it forces executives to be curious, not passive, and to be receptive, not closed, to new information. The difference between an executive who embraces evidence-based management and one who can’t see the value in it is invoked in the joke about the two economists walking down the street who spot a \$20 bill on the sidewalk. The first says, “Look, a \$20 bill. Let’s pick it up.” The second replies, “It can’t possibly

be a \$20 bill. If a \$20 bill were lying on the sidewalk, someone would have picked it up by now.” +

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these systems have so far failed to spark much interest in the United States and Europe. The reasons reveal a great deal about the prospects for innovative financial services, and about the underlying nature of infrastructure change.

One problem is that in the U.S., credit and debit cards processed over established POS networks are already entrenched, accounting for 70 percent of retail transactions. Moreover, U.S. and European consumers tend to be conservative about electronic payments; they do not yet perceive the handset to be a secure way to pay. The use of mobile phones as de facto identity authentication devices makes some people uncomfortable. And in the U.S., where mobile phone companies charge for incoming calls, customers may perceive bank messages as an irritant that “nickel-and-dimes them to death,” as one expert put it.

But the experiences of companies that have developed m-payment systems in Japan and Korea suggest that all of these issues are resolvable. At heart, m-payment systems have foundered in the U.S. and Europe because proposed programs have lacked sufficient cross-industry cooperation from banks, credit card issuers, and telecommunications companies. For example, the biggest European m-payment initiative yet was Simpay, a project developed by some of the largest wireless carriers in the European Union — including Orange, Vodafone, T-Mobile, and Telefónica Móviles — but with no partners from the financial-services industry. When T-Mobile backed out, the project was scuttled because it could no longer promise seamless transactions on virtually every major European cellular net-

## Dueling Technologies at the Point of Sale

by **Olaf Acker, Niklas Dieterich,  
and Christopher Schmitz**

**A**re the United States and Europe destined to be economic also-rans to countries that have learned to use cellular telephones in place of cash or credit cards? Commonly known as mobile payment or m-payment, cell phone-based payment systems have evolved in recent years. Initially, a voice connection or a text message was required to initiate and settle a transaction, but today’s m-payment customers simply wave their phones over a sensor to complete a purchase on the spot.

M-payments are big businesses in Japan and Korea, used for mil-

lions of transactions a month at restaurants, cinemas, convenience stores, and elsewhere. M-payments have a lot to offer consumers and companies: easier and faster check-out, lower transaction and operational costs, and built-in passwords that ensure security.

Mobile phones can also support innovative security measures like virtual credit cards, in which customers use randomly generated credit card numbers for each purchase to avoid identity theft. Unlike credit cards, mobile phones can also tell consumers at the point of sale (POS) how much money they have available to debit or borrow.

But although they could transform the purchasing experience,

work, its main advantage over proprietary payment models.

Two quite different business conditions are responsible for the success of m-payments in Japan and Korea. In Japan, the wireless telecommunications market is dominated by NTT DoCoMo Inc., which has used its near-monopoly position to drive mobile innovation. In 1999, DoCoMo introduced a Web-based wireless system called i-mode that offers subscribers access to nearly 100,000 Internet sites for information, entertainment, and online shopping. In short order, as many as 45 million subscribers signed up for i-mode — 50 percent of Japanese cell phone users.

The latest i-mode device, introduced in 2004, is a handset equipped with Sony's FeliCa semiconductor chips, which were initially implanted in public transit smart cards. These phones can be operated at 24,000 DoCoMo-installed m-payment sensors throughout Japan. The results are impressive: Five months into the program, at the end of 2004, DoCoMo had sold more than 1 million phones equipped with FeliCa chips. It expects to hit 7 million in the first quarter of 2006, exceeding the rate of adoption of i-mode.

DoCoMo's near-universal market reach has allowed it to essentially impose its m-payment system on tech-crazy Japanese customers who are typically open to new shopping and banking channels. And with a potentially huge customer base to tap, merchants are more than willing to work with NTT DoCoMo to implement m-payment sensors in their outlets.

In Korea, the telecommunications market is more pluralistic. The country's three biggest mobile oper-

ators — SK Telecom, KTF, and LG Telecom — are currently offering cell phones that can double as credit cards and smart cards. The telecommunications companies take the lead in promoting these systems, while credit card companies manage their financing and operations and

and work closely with established financial firms — banks, POS network operators, and credit card issuers — along with handset manufacturers and retailers to design a viable mobile payments infrastructure that reaches its own tipping point. This will require a

## Mobile phone-based payment systems succeed only when banks, credit card issuers, and telecom companies cooperate.

share a 2.5 percent cut of all m-payment transaction fees with the other companies involved. One percent goes to subsidize the cost of m-payment phones for customers and 0.3 percent goes to the wireless carriers, leaving 1.2 percent for the credit card companies.

Since the launch of its m-payment system in 2003, SK Telecom, which commands slightly more than half the wireless market in Korea, has signed up 1.5 million m-payment users, approximately 5 percent of the total Korean wireless subscriber base. In other words, by aggressively courting alliances, SK Telecom has reached the same kind of "tipping point" in its customer base — a point where so many people are connected that more and more companies and, in turn, additional customers feel compelled by market forces to join in — that DoCoMo reached through market control.

No single U.S. or European wireless company has the overwhelming market share to set up m-payment systems alone the way DoCoMo has. Instead, they will have to follow the Korean model

greater degree of standardization than has occurred in the past. For example, the pioneering Exxon-Mobil Speedpass, a proprietary system for quick, one-step POS transactions, is being eclipsed by its more inclusive open-system rival, the MasterCard PayPass.

Even with industry cooperation, it will be difficult to overcome the traditional cultural bias against using cell phones for exotic applications like financial transactions. However, young consumers in the U.S. and Europe appear to be more open than older generations to customized specialty cell phones on which they can play games, send text messages, conduct GPS location scans, listen to music, and watch videos. With this range of activities, m-payment shopping is a natural outgrowth. Moreover, as new electronic payment systems such as MasterCard PayPass present highly promoted alternatives to debit cards, m-payment cell phones may not seem so unusual.

Two forms of cultural change seem to be required at once for a new infrastructure to take hold. The producers — in this case, banks,

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mobile phone operators, credit card companies, handset suppliers, and merchants — must embrace alliances to reduce the costs of transactions and work together to achieve coordinated success. Meanwhile, consumers must see and appreciate of the increased speed, convenience, and capacities of the new system.

In short, m-payment systems will meet with little success in the U.S. and Europe unless it is demonstrated to mobile phone users that m-payments are much more attractive than other, more familiar, electronic payment approaches. In the next few years, m-payment features — safety, security, availability, speed, and convenience — will be marketed individually, most likely to target groups with young demographics, the early adopters of new mobile technologies. If these groups indeed change their habits accordingly, they will alter the financial structure of the world around them as well. +

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