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The secret ingredient of successful big deals: Organizational health

Creating value from a merger is not easy. Acquirers that get it right start with an overlooked advantage: a healthy organization.

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For years, McKinsey research has shown that a programmatic approach to M&A generates the most value in deal making. The least successful approach? Large (greater than 30 percent of an acquirer's market capitalization), infrequent deals.[1]

That said, the variance is high, and major acquisitions can work to your advantage—particularly if your organization is healthy. Our latest research finds that acquisitions by healthy companies tend to perform better than do those by less healthy ones. We've also identified three critical behaviors (selecting the right people, maintaining a strong external focus, and running a tight ship internally) that typify healthy organizations and are tightly connected with the creation of deal value. In this article,

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[1] Based on an evaluation of M&A programs (as opposed to individual transactions) over varying ten-year periods.

we'll lay out those research findings and then illustrate them with examples of healthy acquirers in action.

Organizational health and the big deal

For almost two decades, our Organizational Health Index (OHI) has been monitoring health across a hundred countries and well over a thousand companies, aggregating the views of millions of employees and managers on management practices that drive nine key organizational dimensions—or "outcomes," as we call them. We assign scores to each practice and outcome, allowing a company to see how it compares with others in the database. Time after time, companies with a healthy culture dramatically outperform their peers. In fact, publicly traded companies in the top OHI quartile generate three times the total returns to shareholders achieved by those in the bottom quartile.[2]

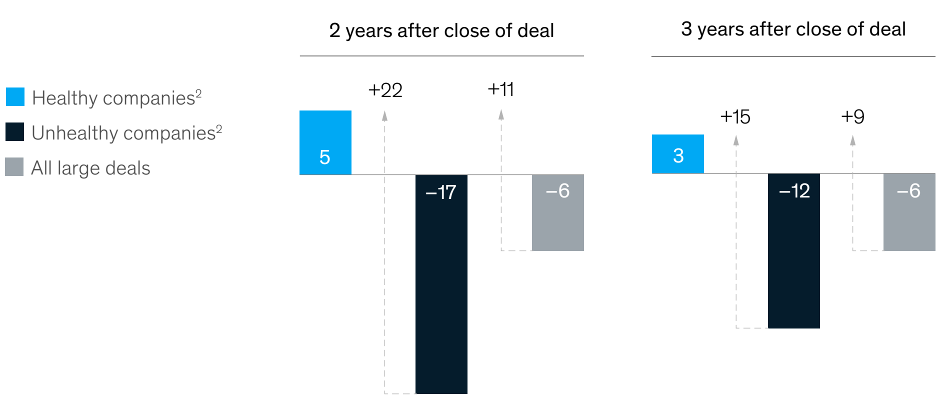
The numbers suggest that organizational health matters immensely in the M&A context too. Our research finds a strong correlation between the preclose organizational health of the acquirer and the postclose financial performance of the newly combined company. Acquirers in the top half by OHI score gain, on average, 5 percent in excess total returns to shareholders (TRS) compared with industry peers after two years, while the change in excess TRS of unhealthy companies is –17 percent over the same period (Exhibit 1).

[2] Based on McKinsey's Organizational Health Index data collected over more than 15 years. The index aggregates the views of employees and managers on the daily cultural behaviors they observe across a set of 37 management practices.

Exhibit 1

Unhealthy acquirers destroy value, while healthy acquirers create value and tilt the odds toward success.

Median change in excess total returns to shareholders,[1] %



[1]Measured using companies' excess total returns to shareholders compared with their industry peers, to isolate effects from those of broader industry trends. Gaps are measured in percentage points.
[2]Healthy companies defined as those with Organizational Health Index scores within top 2 quartiles; unhealthy companies defined as those within bottom 2 quartiles.
Source: Organizational Health Index by McKinsey

The behaviors that matter most

Since deals in which an acquirer is adding more than 30 percent of its market capitalization are almost axiomatically transformational, the stakes are high indeed. They're also getting higher. In 2018, the upsurge in large deals raised the total value of announced deals globally by 17 percent. So it's understandable that would-be acquirers invest substantially in target scanning and number crunching as part of their due diligence. Yet most don't match that effort when it comes to *self*-diligence. Leaders considering a large acquisition, our findings suggest, should first assess their organization's own health to better gauge whether or not to take the merger plunge.

When considering whether your own organization measures up, it's important to recognize that there is no single blueprint for organizational health. Distinct sets of approaches work best for specific situations. That said, three behaviors that are typical of heathy organizations also are strongly correlated with the creation of deal value. We're not suggesting that these attributes—talent management, external focus, and internal discipline—are a substitute for performing other critical M&A practices. Rather, they are more like prerequisites for getting big deals right (Exhibit 2). Healthy companies are more likely to deliver on these priorities throughout the merger process because they are an extension of characteristics that those companies display in the ordinary course of business and are part of the organizational fiber.

Exhibit 2

Three behaviors of healthy organizations are strongly correlated with the creation of deal value.

Behavior	Related organizational-health practices
Talent management Selecting the right people	**Talent acquisition**—selecting the best candidates to deliver the new vision and strategy by searching across both companies, as well as externally
External focus Keying on stakeholder communication	**Customer focus**—seeking and acting on customer feedback with tailored approaches where appropriate **Business partnerships**—collaborating with external partners to enhance performance of the newly merged company **Capturing external ideas**—bringing in best practices/methods from outside the organization to invigorate the company and spark innovation
Internal discipline Running a tight integration process	**Financial management**—maximizing economic performance and synergies through clear oversight and control of finances at all levels **Role clarity**—supporting individual accountability by creating a clear structure for roles and responsibilities **Performance transparency**—linking results to incentives and recognition; making them transparent internally to motivate employees to perform **Consequence management**—providing attractive incentives for high performers and clear consequences for underperformers

Source: Organizational Health Index by McKinsey

Talent management: Selecting the right people

Our research shows that getting the talent side right is the most important organizational-health lever in creating large-deal value. Given the pull of institutional loyalty and the press of long-standing personal relationships, decisions about employees can be particularly fraught during a merger. Effective merger integration calls for selecting the right employees from both the acquiring and acquired companies and, when necessary, from outside them. That's hard to do under any circumstances but much harder from a standing start.

In the merger context, just as in day-to-day operations, a rapid, systematic approach to talent selection is imperative. At one technology company, the integration team closely tracked the balance of candidates who would be selected from across both companies. If any area of the business was not achieving a balance that matched the relative scale of the combination, team leaders intervened. Additionally, no selections could be approved until the central team ratified them. If two candidates were deemed equally suitable for a role, the team tilted its selection to the target-company candidate, recognizing that acquirer managers likely already had a built-in unconscious bias in favor of the homegrown employee. If neither candidate was considered suitable, the team moved quickly to recruit externally. One pharmaceutical company we know also imposed a rule that unsuccessful candidates at any given level could not simply be passed on to compete for roles at the next-lowest tier. Decisions on "in" or "out" were direct and quick—and fair. By policing the policy strictly, the company was able to keep more junior, higher-potential employees from leaving the fold.

External focus: Keying on stakeholder communication

The behaviors that a company demonstrates in maintaining a strong external focus factor decidedly in large deals as well. Healthy organizations understand the importance of what their customers and partners value. If that compass fails, the complexity of fitting acquirer and target together can lead the merged organization to turn inward and critical integration decisions to be made without proper consideration for external stakeholders. Competitors will also have an easier road to attack if customer relationships are perceived as vulnerable or if brand authenticity is inadvertently diluted.

There is a huge scope for miscommunication and misinterpretation during the merger period, when, by definition, the companies undergo massive change. One acquirer we know successfully mitigated this risk by having senior leaders clearly articulate the value proposition for customers, spelling it out in a written letter, and directing account managers to make sure the message was communicated to customers in person. The considered touch of a face-to-face meeting, combined with consistent and carefully crafted messaging, reinforced the importance of external focus. Another successful acquirer closely tracked the volume of orders from existing customers from the moment the deal was announced. Any drop-off in normal volume was immediately flagged for intervention, and sales leaders were primed to zero in on the cause. The company aggressively kept in front of new challenges and successfully navigated through any merger turbulence.

Internal discipline: Running a tight integration process
Finally, it makes sense that applying behaviors essential to running a tight ship internally would pay off for companies undertaking a large deal. Internal discipline in the acquisition context starts with a standardized approach to deal screening, continues during due diligence with clear metrics on a target company's financial position, and proceeds through preclose planning and beyond as the nuances of individual contracts, customers, and commitments are made clear. To ensure that controls are enforced to their fullest effect, one acquirer moved its best financial talent to priority areas where it believed rigor was lacking—and communicated strongly what its expectations were and why it was making the changes. Another high performer made sure to identify which portion of its target's projected revenues depended upon the success of specific R&D projects. The company then ring-fenced these initiatives from being unduly disrupted by cost-savings programs and kept a close eye on their progress to ensure that accountabilities and expectations would remain clear.

Healthy companies apply the same level of rigor to the realization of synergies. A successful acquirer we know formally reviews progress on synergies, through carefully designed indicators, every two weeks. Consequences for success or failure in meeting performance goals are made clear, with direct action from the CEO when called for. Especially in large deals, even the best-laid plans can temporarily go awry. It's essential to reestablish a clear structure for roles and responsibilities without delay. With that in mind, one high-performing acquirer not only pronounces a clear set of "rules for the road" to define norms and expectations, it also implements a "buddy" mentoring program that pairs up the acquirer's personnel, who already understand existing rules, with the target company's employees, who need support as they adopt new—and more rigorous—practices. Another company publishes its sales results internally every month and circulates them to a broad audience across all its businesses to make sure that everyone is focused on the right metrics and that progress is absolutely transparent.

Conducting a transformational merger is one of the biggest bets a CEO can make. It can also be one of the most value destroying. Many would-be acquirers invest disproportionately in hard analytics and intricate projections on synergies they can realize from the target. But too often, a company will pull the trigger on a major acquisition without first conducting an honest assessment of its own capabilities. That's a mistake. If you're not confident in your organization's health—and particularly in its talent-selection capacity, its external orientation, and its bedrock of practices and controls—chances are, your deal will fall flat. In other words, before you take on the responsibility of coming together with someone else, it pays to know yourself. Q

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