This paper examines the process of mergers and acquisitions from the combined perspectives of leadership and decision-making/moral hazards. In particular, we examine the roles and intentions of senior managers in M&A activities based on leadership theories, and then use this framework in evaluating the human resource impacts of mergers and acquisitions. Existing literature suggests disconnects between the espoused values and guiding principles of mergers and acquisitions with the actual impacts of these deals. More specifically, there are often clear gaps between pronouncements prior to M&A transactions and the subsequent reality in terms of financial returns, human resource impacts, market share effects, and industry realignment. This paper then applies this conceptual framework in reviewing two major M&A deals in differing industries. We also explore the moral hazard and decision traps of M&A transactions in regards to shareholder benefits, consumer benefits, and senior management compensation packages.

**Key words:** mergers and acquisitions (M&A), moral hazard, senior management, leadership.

**Context**

Paradoxically, most organizations refer to senior management as Senior Leadership. The irony of this label is that in large organizations, particularly those that actively pursue mergers and acquisitions as a primary strategy for growth, senior management often exhibit behaviors that directly contradict major principles of good leadership. This contrast between the leadership label and actual behaviors can be analyzed from a variety of perspectives. Incentive structures, competing interests, narrowly defined objectives, and decision complexity are all fruitful approaches into understanding and analyzing senior management actions in mergers and acquisitions.

In this paper we will explore the people side of mergers and acquisitions through the lenses of leadership and decision-making. We will first outline four core principles...
of leadership and explore how M&A activities, by default, can undermine adherence to leadership principles. Underlying these discussions and conceptual framework will be a focus on decision–making, and the unavoidable moral hazards impacting M&A deals and activities. We then follow up with two short case analyses of high–profile M&A arrangements illustrating these points.

Our goal in this paper is twofold. First, we want to clearly outline the complicated and unavoidable difficulties associated with large M&A deals. Given the abundant press on failed M&A activities, we hope to shed some light on why so many deals take place when their success rate is low and ability to achieve desired and stated goals is elusive. Second, by highlighting two specific cases of M&A deals, we hope to highlight both positive and not–so–positive efforts that can help senior management truly act in line with the label Senior Leadership.

**Leadership Conceptual Framework**

Choosing a framework for understanding and analyzing leadership is a daunting task. Given the overwhelming volume of literature available under the topic of leadership, distilling this body of work into four core principles is fraught with limitations. However, for the purposes of this paper, we propose the following core elements of leadership as a framework for analyzing leadership regarding M&A activities. This framework is in part distilled from Kouzes and Posner’s most recent book on leadership, *The Truth about Leadership*, in which they outline core “truths” of leadership that seem to be consistent over time and across settings.

1. Value clarity and consistency,
2. Integrity through transparency and honesty (trust and ethics),
3. Inclusiveness and pursuit of the common good, and

While each of these core truths entails multiple terms and concepts, we think it is important to understand each as multi–faceted and complex. Thus, a simple list of four terms would not provide sufficient context for further analysis. Additionally, each of these domains is not independent of the others. They are, in essence, inter–dependent and inter–related. Below we review each of these concepts with application to the context of M&A activities, and the behaviors and actions of senior managers during these activities.

*Value clarity and consistency* – Review of the literature would suggest that many failed mergers and acquisitions were the result of incongruent or clashing cultures. Clearly, the values that drive organizational culture vary tremendously, and failure to account for these value differences in finalizing M&A deals can lead to disastrous results. Employ-
ees in just about any organization that has taken part in a major merger/acquisition will attest to ongoing reference to “legacy employees and procedures” and complications in blending organizational cultures. As discussed in more detail below, the Daimler–Chrysler merger provides a grand illustration in point.

The second author witnessed the limiting nature of conflicting values and cultures as a researcher investigating training and change implementation in two hospitals in the southeastern United States nearly ten years ago. The two hospitals, literally across the street from one another, could not have differed more in their values and culture. One had very strong religious roots and governance. Their core values guided not only which services could and could not be provided, but also the nature of care and support provided to patients. The second hospital was guided by benchmarks for national rankings and “world-class diagnostics and procedures.” Given their proximity, the merger of the two systems provided promise for increased efficiencies and decreased costs. In reality, the merger never produced the desired results. Years after the systems were combined, seasoned employees at both still referred to “the other side of the street” in noting continued differences in how decisions were made and care was delivered.

The difficulties in the blending of values and cultures cannot be understated, particularly for organizations that have long histories. Complications arise from many facets of organizational culture, from espoused values in guiding documents to reward structures to the importance of quality, efficiency, and seniority. Given that most of these factors are hard to quantify or clarify, it is understandable that most M&A activities are driven by, and justified by, financial and quantitative measures.

For senior management, trying to identify the impacts of major M&A activities on the emergent values of the blended organization is virtually impossible. While a charismatic founder of an organization can have tremendous impact on the values and culture of an organization, this impact wanes when either the founder is no longer present or the organization grows through M&A activity. Indeed, it might be postulated that the ability to clarify a lucid set of values is inversely proportional to the number of M&A endeavors an organization undertakes. Thus, while it may be easy to criticize senior managers for lack of value clarity and consistency during and after M&A deals, the complexities in doing so must also be noted.

**Integrity through transparency and honesty (trust and ethics)** – The very “secretive” nature of many M&A negotiations, on one level understandable and potentially necessary, directly contradict notions of transparency and openness. Perhaps more than any other construct, the complexities of M&A activities in regards to integrity through transparency and honesty are difficult to clarify. The impact on employees, markets, and competitors of senior managers announcing “we have just started the process of talking with
XYZ about a possible merger” is uncertain at best. However, keeping these constituents uninformed also has uncertain impacts.

Perhaps the biggest disconnect in this regard for employees affected by, and observers of M&A transactions, is the lack of transparency regarding personal gain. What is never stated is the very clear truth for senior managers that: “This deal will help to line our pockets almost immediately so that we won’t have to worry if we never realize the gains we are promising. Once we close this deal, we will either look to foster more deals to make us even wealthier, or leverage the success of this deal to move elsewhere to continue this pattern.” Harsh words for sure, but M&A activities often wreak of self-interest, often in the name of benefitting others or maximizing shareholder wealth.

On a related note, the reader should also understand that often some of the biggest winners in M&A deals are not the companies directly involved, but the consulting and legal firms that help make them happen. As noted in *Bloomberg Business Week* (May 2–8, 2011), the law firm with the highest profit per partner (at over $4.3 million) is “known for mergers and acquisitions.” The article also noted that other “top-five performers … chiefly rode Wall Street’s deal–making resurgence” (p. 16).

We are not trying to imply that senior managers and their legal team are being dishonest, at least directly or intentionally. What is clear is that they divulge information selectively to their own benefit, not necessarily for the benefit of the organization’s constituents. And, as mentioned earlier, this points to the inter-related nature of the leadership framework—connecting the integrity and inclusiveness constructs (discussed below).

Of course, the solution to this lack of transparency is elusive. As noted above, a certain amount of secrecy and cautious disclosure is probably prudent regarding M&A negotiations and announcements. And, complete disclosure regarding the personal benefits of such transactions is improbable at best, if senior managers truly wish to earn the label of senior leadership, the transparency and candor regarding M&A activities must err on the side of openness.

*Inclusiveness and pursuit of the common good* – There is no doubt that most senior managers try to tout the vast benefits of the M&A deals they pursue. It is almost a canned speech that such deals will “provide value to our shareholders, provide our customers with greater choice and service, and reduce redundancies to ensure greater strength and sustainability for both organizations.” Evidence suggests otherwise in the vast majority of cases. So, why the big promises of mutual benefits with limited delivery of those broad benefits?

Most M&A activities are driven by two clear incentive structures for senior managers. First, increases in stock value benefit themselves directly, and benefit them indirectly as their mutually benefitted Board of Directors reinforces their actions. Second, the increased market share and cost savings that can result from such deals provide oppor-
tunities for growth in revenues and profits that would take much longer through more organic means. By default, major M&A deals create organizations with broader markets and customer bases. And, as evidence would suggest, most major M&A deals also realize some level of cost savings through reduction in redundancies and economics of scale.

However, as is often noted, these cost savings often come at the expense of two major stakeholders in M&A activities. First and foremost are the employees who work for the organizations who are laid off, relocated, or downgraded. Second, the customers of the new, larger organizations often get reduced customer service or benefits, even though the opposite is touted prior to the deal. The Delta–Northwest case, discussed in more detail below, provides illustration of both points.

After the merger/acquisition of Delta and Northwest Airlines, no fewer than 2,500 employees were laid off from Northwest’s former headquarters. While some employees were offered the option to relocate from Minneapolis to Atlanta, most were simply laid off. In addition, while the pre–merger and post–merger rhetoric was that the new Delta would be hailed for great customer service, several publications, including the *Minnesota Monthly* and *Consumer Reports*, indicate that for 2010 Delta customer service ratings were nearly at the bottom for major carriers. Given Delta’s also flat stock performance since the deal was finalized, it is still unclear if there were any benefits of this deal beyond the wealth created for those who helped craft it.

*System thinking and long–term perspectives* – Short–term focus on stock value and cost savings is understandable given the average tenure of most senior executives in M&A–happy firms. However, as most noteworthy authors on leadership will attest, true leaders think more systemically and long term. As with the above discussion, it is clear that incentive structures that reward senior managers for risky and excessive M&A activity clearly outweigh long–term impacts in many cases. Given human nature, this concern will not abate. We can, however, better clarify and understand short–term and long–term perspectives in evaluating M&A activities. The Daimler–Chrysler case is exemplary in this regard, as discussed below.

Nearly all M&A dealmakers espouse the “symbiotic relationships” that will emerge, allowing the new organization to benefit from diverse perspectives and joined resources. They tout the cost savings to be achieved, and often declare the promise of increases in revenues and profits that will benefit shareholders and employees alike.

In a presentation delivered by Archie Palane [2001], deputy–general secretary of the National Union of Mineworkers, he stated, “Where mergers and acquisitions occur workers become the first victims in terms of retrenchments, compromised industrial relations, changed working culture, and conditions of work sometimes to the worst. Although there are many valid reasons for mergers and acquisitions to take place, approaches taken in most cases are always distanced from the industrial relations or social
issues. These issues are only considered towards the end of the whole process when there are only few days left to commence with the new merged arrangement.” As should be clear, addressing the human resource elements of M&A deals is a long–term process, as noted by Shuler and Jackson in their article “HR Issues and Activities in Mergers and Acquisitions.”

**Decision–making and Moral Hazards**

As noted above, glaringly missing from all senior management declarations regarding M&A deals is the riches they themselves will earn in the process. Failure to understand this principle, and the obvious rebuttal to this claim by those who make these deals, is dismissing fundamental human motivation and behavior. As with other moral hazards, as evidenced in the press nearly every day, there are clear incentives to take risks when the risk taker does not bear the brunt of the risk entailed. Akin to a mortgage broker who can close a deal with a risky investor, earn immediate commissions, and then sell the risky mortgage in mortgage–backed securities, M&A dealmakers rarely are forced to absorb the full risk of their actions.

Cynicism aside, we are not implying that all M&A activities are driven by selfish desire for personal benefit at the expense of others. Decision–making at the top levels of any organization is complicated, and decision–making regarding major M&A activities is clearly influenced by a large, complex set of often–conflicting information, incentives and motivations. Our goal in this section is to help illustrate how difficult it is to adhere to the four elements of leadership when navigating M&A negotiations and post–deal activities.

Several studies have demonstrated that a major leading cause of suboptimal performance of mergers and acquisitions is inflated premiums paid for the M&A target. Some researchers have used premium paid as a proxy for the quality of decision–making, thus excessive premiums are correlated with poor decision–making. Certain studies suggest that high premiums are due to the overvaluation of the target. Other studies indicate CEO hubris as the cause for the inflated premiums. In these cases, once again, senior managers can engage in risk prone activities without being subject to the full risk of their actions.
Putting It All Together – Two Case Studies

Daimler – Chrysler

The merger between Chrysler Corporation and Daimler Benz was officially announced on May 7, 1998, which created the new entity DaimlerChrysler. Chrysler was founded by Walter Chrysler in 1875 and officially incorporated as Chrysler Corporation in 1925. Throughout its history, Chrysler has been the smallest of the U.S. “Big Three” automobile manufactures (behind General Motors and Ford Motor Company). Daimler started as Benz & Company in Germany in 1883, evolving to Daimler Motoren Gessellschaft AG until 1926, and renamed as Daimler-Benz AG until the merger created Daimler-Chrysler.

According to Kuhlmann and Dowling (2005), the start of the DaimlerChrysler merger can be traced back to 1997. At that time, three studies conducted by Goldman Sachs and internal analysts at Daimler suggested that Daimler–Benz could not sustain profitable growth based on the existing business model. Based on this assessment, several options were considered in terms of acquisition targets and/or potential merger partners. Ultimately, Chrysler Corporation emerged as the ideal candidate [Waller, 2001].

It was reported that Juergen Schrempp, the Chairman of Daimler–Benz at the time of the merger, initially suggested the possibility of the merger to then CEO of Chrysler Corporation, Bob Eaton, at the Motor Show in Detroit in January 1998. This initial conversation and subsequent decisions were kept highly confidential. Only Chairman Schrempp, his secretary, a corporate strategy advisor, the director of corporate development, and an investment banker from Goldman Sachs were involved from Daimler. The counterpart team from Chrysler consisted of CEO Eaton, the CFO, the Treasurer, and an investment banker from Credit Suisse First Boston. It was only later that attorneys and M&A experts from both companies were hired.

The Human Resource Directors of both companies were specifically excluded from the discussions despite the enormous impact of mergers and acquisitions on employees [Vlasic, 2000]. In addition, the Boards of Directors of both companies were not informed about the on–going discussion. It would seem appropriate for Chairman Schrempp and CEO Eaton to have informed the Board of Directors of both companies as opposed to the non–disclosure [Appel and Hein, 2000], particularly in light of the leadership constructs outlined above.

After the public announcement of the merger on May 7, 1998, touted as a merger of equals, a massive Public Relations campaign was launched to highlight the wisdom of the combination. Several groups were formed consisting of employees from both companies to deal with issues such as HR, global strategy manufacturing, etc. Both Schrempp and Eaton communicated in print and pre–recorded videos to their respec-
tive employees that jobs would be secure and that the merger would lead to further job creation and opportunities.

The official internal communication to the combined 431,000 employees of the merged companies occurred on November 17, 1998 via a letter to each employee signed by both chairmen, depicting the new combined product lines along with a Swatch wristwatch.

There were several opposing voices to the merger with investors launching lawsuits based on misrepresentation of merger versus acquisition. A settlement of $300 million was paid to a class of investors while other cases were dismissed.

Ironically, the most prominent discussion post–merger was the compensation packages in both companies, specifically for senior management, given that the Chrysler package was more lucrative than that of Daimler–Benz. As such, Schrempp announced that “the German salaries will be brought in line.”

The merger failed to live up to the promises made and plans to lay off over 13,000 employees was announced in February 2007, along with closing a major assembly plant and the reduction of production at other plants. Ultimately, DaimlerChrysler sold off Chrysler to the private equity firm of Cerberus Capital on August 3, 2007, with Daimler retaining a 19.9% ownership interest. Daimler agreed to pay Cerberus $650 million to offload Chrysler and related liabilities. As such, the $36 billion spent to acquire Chrysler evaporated in less than ten years.

Lee Iacocca, former CEO of Chrysler, stated that “Eaton panicked, we were making $1 billion a quarter and had $12 billion in cash, and while he said it was a merger of equals, he sold Chrysler to Daimler–Benz, when we should have bought them.” George Peterson, president of Global Insight stated, “Due diligence? Daimler–Benz never did due diligence before it bought Chrysler, never looked into the future to see whether Chrysler could afford to be competitive with the others in the industry.” Dave Healy of Burnham Securities, in reaction to the failed merger said, “You had two companies from different countries with different languages and different styles come together, yet there were no synergies. It was simply an exercise in empire–building by Juergen Schrempp.”

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1 “Due diligence” is a term used for a number of concepts involving either an investigation of a business or person prior to signing a contract, or an act with a certain standard of care. It can be a legal obligation, but the term will more commonly apply to voluntary investigations. A common example of due diligence in various industries is the process through which a potential acquirer evaluates a target company or its assets for acquisition.
Delta – Northwest

Northwest Airlines (NWA) was started by Colonel Lewis Brittin on September 1, 1926, primarily to transport mail for the United States Post Office. Passenger flights followed a year later. Delta Airlines was originally started as a crop dusting enterprise, incorporated on May 30, 1924 in Macon, Georgia. The company started passenger service after being purchased by Collett E. Woolman in 1928, and subsequently renamed as Delta Air Service from the earlier name of Huff Daland Dusters [Zainaldin, 2007].

Delta was the third largest airline and Northwest was the fourth largest airline in the United States at the time of the merger announcement on April 14, 2008 (Stark et al., 2008). The merger of Delta and Northwest was approved by shareholders of both airlines on September 26, 2008. Likewise, approval was granted by a federal antitrust review board due to the peculiarity of the airline industry in terms of competitive climate. The Justice Department Antitrust Division stated that the merger “is likely to produce substantial and credible efficiencies that will benefit U.S. consumers and is not likely to substantially lessen competition” [AFA, 2008]. The European Union also granted regulatory approval for the merger given the extensive network of the newly created entity in Europe.

It is important to note that prior to the merger, both Delta and Northwest were in bankruptcy status. Delta emerged in April 2007 and Northwest in May 2007 out of the insolvent status. Previously, Delta had managed to fend off a hostile takeover attempt by US Airways in 2006 and early 2007. The merger, or more accurately stated, the acquisition of Northwest by Delta created the largest global airline in 2008.

The value and guiding principle of the senior leadership at Delta prior to the merger was captured by the declared statement of then CEO Gerald Grinstein, who refused any stock or options or cash payment post bankruptcy status. Grinstein stated that post-bankruptcy compensation should be used to fund scholarships and provide emergency hardship assistance for Delta employees and families and retirees [ATL, 2007]. This was a clear demonstration of leadership, based on the constructs outlined above.

Doug Steenland, CEO of Northwest, stated that “the merged airline would be more ‘financially stable and resilient,’ better able to meet customer needs, and better able to provide benefits to workers.” He also said, “no hubs would be closed as a result.” The pilots’ union from Delta and Northwest approved the merger deal, although there were some issues with the flight attendants given the difficulties involved in combining a union with a non-union shop.

In a commentary on Minnesota Public Radio in February 2010, Rob Harris, who owns the Carrousel Travel American Express agency in Richfield, Minnesota said,
“I think Delta really did their homework.” He said, “They looked at what worked and what didn’t. And so far, they’ve done a great job with it.”

The Delta–Northwest merger serves as an example of aligning senior management interests with those of employees and shareholders. The new CEO of Delta, Richard Anderson, has a contract that ties his compensation to the performance of the company. Likewise, a profit sharing agreement is in force to reward non–management employees when Delta generates a profit. A testament to management’s action is the profit–sharing with employees whenever the airline realizes profits. It was announced in February 2011, that Delta would payout $313 million to be distributed to employees below the general manager, director, and officer levels at Delta [Unger, 2011]. For example, the CEO’s total compensation declined about 52 percent due to losses totaling $1.2 billion in 2009. The other senior management team likewise did not receive any incentives in 2009.

Conclusion

We have presented two case studies based on Mergers and Acquisitions with particular emphasis on the leadership and decision–making components of M&As in two different industry contexts. The example of the DaimlerChrysler merger demonstrated the typical sequence of the majority of M&As with senior management reaping the most benefit from these transactions.

We also presented an example of a positive study based on the Delta–Northwest merger with evidence that the human resource aspect was given due consideration before and during the merger process. Given the difficulties in combining two distinct cultures, systems and history, Delta is still in the process of forging a single identity.

References

Senior Management’s Self–Interest in the Conduct of Mergers


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