merger meeting

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Business Must Seek Remedies For Adverse Effects of Mergers

by William C. Norris

Some mergers of small companies are beneficial, when products and services are complementary, or when expansion is necessary for competitive reasons, Mr. Norris told a recent McGraw-Hill conference on mergers. But even in necessary cases, adverse factors exist that must be minimized; and in the majority of cases, and in almost all cases of unfriendly takeovers, it is his perception that potential innovation and its making of new jobs are stifled by large mature corporations buying up smaller, newer and highly creative companies.

Drawing upon his own experience, Mr. Norris warned that the traumatic frustration of society's economic objectives inherent in the merger process, unless brought under control by business itself, might invite the imposition of Government restraints. He urged that business conduct critical self-examination and self-policing, in order to preclude that undesirable intervention.

An edited version follows, of the material Mr. Norris prepared for his remarks:

What are the most important adverse factors caused by mergers? First is employee trauma, which can start at the top of a company being acquired and extend to all other workers. Members of to ma ement may suffer career damage. Younger executives may find career paths limited. Other workers face elimination of jobs through consolidations of administrative and operating segments.

Virtually every young executive aspires to be a member of the top management body that is responsible for business strategy and the main interface between the enterprise and its stakeholders. These responsibilities mainly reside in top parent-company management and are profoundly different from those of division or subsidiary company management. This difference defines the aspirations and rewards of top management.

Losses Not Retrievable

A position in top management lost through takeover is often not retrievable because now fewer of these positions are available; and in large companies, such vacancies usually are filled from within. Further down in the company ranks, executives find not only their jobs threatened or changed, but their career paths as well.

At other levels, job jeopardy is in the forefront of employees' minds because of the potential elimination of jobs through consolidations of administrative and operational functions. This is unnecessarily nerve-racking in hostile takeovers because of lack of information or credibility of assurances about plans by the aggressor.

Even in carefully planned voluntary

mergers, there will be some unavoidable employee career injury and injustice arising from the process of forcing the two organizations together.

In addition to the financial reliance on their employers, many employees have strong community ties. The severance of these roots by an abrupt takeover cannot be mended by taking a job in another part of the country, if indeed one can be found. These social injuries are not always entirely avoidable in voluntary mergers, but the consolidating process can be better managed to minimize them.

Then there are always company commitments to employees, implied and stated, relating to job responsibilities and career paths. Employees expect them to be fulfilled, yet they understand that due to competition, adverse economic conditions and other factors not under the complete control of management, some may not be fully met.

Cold-Blooded and Unjust

However, when the management of another company engages in an unnecessary and unilateral takeover, it causes abrogation of many commitments in the target company that inflict cold-blooded and unjust social injury — cold-blooded because the aggressor company has a conflicting array of commitments to its employees and understands well the consequences of abrogation, and unjust because it could have been avoided by either achieving the takeover objectives in another way or by recognizing that the objective of "I want it and therefore I shall have it" is not necessarily a legitimate objective.

The most serious economic damage, yet the least understood, results from the destruction of job-creating resources. Technological innovation is the wellspring of new jobs. Studies have shown that smaller companies are the best innovators — they are the ones that originate a majority of the new products, processes and services that provide the new jobs. Immediately after a takeover, an innovation-stifling process sets in.

As corporations rush to put their spare cash into acquisitions, R&D and new plants suffer. Furthermore, because of rising costs of R&D, the increased risk of launching new products (both because of rising costs and because many of the easier things have already been done) and relentless stockholder pressure to increase earnings, the emphasis today in most large corporations is on further improvement of existing products and reducing labor content and materials costs — this, as opposed to the development of new products and services.

Bureaucracy Favors Mergers

The bureaucracy of many large organizations today perceives the development of new products and services as unnecessarily risky; hence they are resisted and the merger route is taken to increase earnings. In contrast, the environment in the smaller organization is entrepreneurial, where developing ideas and inventions into useful products and services and associated high risk is a way of life. This mode of operation is inherent in the beginning of the business and continues because the best security for a small company competing with giant companies is to keep advancing its technology.

After the acquisition of a smaller company, this environment changes as the acquiring organization blankets the other with its bureaucracy. The small company is confronted with layer upon layer of parent company management, which often is more adept at

blocking than making decisions, and the subsidiary company proposals for new products languish in limbo for months. Even if finally approved, there is the gauntlet to run in the large organization of those — and they are in the majority — who belittle the chances of success of new undertakings. On top of all this is the foot-dragging, road-blocking administrative processes that have to be contended with in carrying out the project.

Creative Employees Leave First

This innovation-stifling process is compounded by employee trauma from the merger because it is the more creative employees who resign first. The final result is the dispersal and ultimate loss of the entrepreneurial team, the major job-creating resources of the acquired company.

This very serious loss is borne more in the short term by society than by the stockholders of the surviving corporation. Through consolidation of administrative and operating units, productivity is increased; *i.e.* output is increased with fewer workers. In our gradually worsening employment environment, this means a net loss of jobs for society.

The innovation-stifling and job-creating-resource-destructing scenario is not built on theory or second-hand information. I personally have lived it by being cast in roles on both sides — once with the acquired company and many times as the acquiror. I hasten to add that all of my experience is with voluntary acquisitions — never with ones that were contested.

My experience as part of an acquired organization occurred in the merger of Engineering Research Associates into Remington Rand in 1952. ERA was a highly innovative, small company that was started in 1946 by a group of scientists and engineers, and it had established market leadership in large-scale electronic computers for scientific and engineering use. Growth was extremely rapid; and by 1952, the company needed additional financing. It was not possible to arrange, so ERA was sold to much larger Remington Rand.

Within days after the takeover, the large-company bureaucracy began to engulf ERA. This caused a few of the most rugged with short fuses to resign. Those of more temperate makeup waited to give the bureaucracy a chance. During the ensuing five years, however, many of the best innovators left. I did in 1957, to start Control Data.

This is not meant to be critical of Remington Rand or any other large company. It is simply that the bureaucracy in large companies drives away the innovators. I have seen it happen at Control Data as we grew, and I learned that it is unavoidable.

By 1957 the investment environment had changed, and the launching of Control Data, the first publicly-financed start-up in the computer industry, helped to usher in the wave of small high-technology companies that were able to start up in the '60s by selling low-priced stock to the public.

Survival Required Acquisitions

Survival in the business of developing and marketing large computers in an industry already dominated by corporate giants required Control Data to grow rapidly. Acquisition of other small companies was an important part of the strategy to assemble the needed resources. A number of acquisitions of small companies turned out extremely well — some far beyond expectations.

The reason was that the small-company environment was maintained in

Control Data. But the day came when growth had changed our environment to that of a big company. Then acquisitions began to fall short of objectives and some of the most creative people we had acquired began to leave.

In spite of all kinds of creative approaches to organization and procedures, we were simply unable to maintain an environment satisfactory to many of the more innovative people. Recently a study of all acquisitions made by Control Data over a 22-year period showed that less than 15% of those identified at the time of acquisition as members of the innovative team were still employees.

My cycles of experiences convinced me that there had to be a better way than mergers to get the sought-for benefits in many cases.

The better way is cooperation through license agreement, joint projects or joint ventures Through this approach, the legitimate objectives of a merger can be gained while preserving the innovative, job-creating resources and either eliminating or lessening other undesirable effects.

Policy on Social Justice

One of the policies pertaining to a takeover of Control Data is called our policy on social justice, whereby better protection is provided for employees, stockholders and other stakeholders against the injustices that result from mergers, and especially from hostile takeovers. Control Data stockholders last year were requested to approve this policy as an amendment to company by-laws making it mandatory that the directors consider all social factors, not just price, in an attempted takeover. Interestingly, more than 95% of the individual stockholder votes were in favor.

One important element in Control Data's policy on acquisitions is that business opportunities be developed primarily from within. Exceptions can be made, but only when the company that is proposed to be acquired wants to be acquired, and fills a need of Control Data that could not otherwise be accomplished internally.

The policy also requires that in the event of a contemplated acquisition, at the earliest stage in the development of the acquisition plan, a social impact analysis be made. Adverse social impact that cannot reasonably be corrected is cause for rejection.

Criterion of Service

With that background in place, I would like to propose an innovative approach to merger legislation based on the best criterion for judging the merits of any merger, which is simply: "Does it serve the best interests of society?"

Obviously, there are many important considerations, including competition, effects on jobs and careers of employees, effects on productivity and innovation, effects on stockholders and communities.

These can be assessed by requiring a pre-merger social impact analysis similar to the one used by Control Data. Actually, this would only be an extension of the present Federal Trade Commission's pre-merger notification procedure. The main difference is that its scope of the present procedure is one-dimensional, dealing only with competition, whereas what I propose embraces other effects that need to be considered.

Who is to judge the merits of a proposed merger? It could be the FTC, Department of Justice, or the stockholders of the merging firms.

I favor the stockholders. Given the

information and a structured procedure, my experience convinces me that stockholders would act in a responsible manner.

An important provision would be that any interested Government agency, organization, or group, including employees, could file advocacy material so that stockholders would be fully informed.

Practical Way to Avoid Excess

I believe the proposed approach would address the matter of avoiding excessive bigness in the most practical way.

It is difficult to accept that bigness *per se* is bad, because of extensive differences among industries. For example, in the light of foreign competition, maybe our steel companies should be even larger.

However, I don't know anyone who wants to wake up some day and face the fact of concentration of virtually all business in a relatively small number of giant corporations.

The approach would also eliminate forced takeovers, which I believe are clearly not in the best interest of society, and thus would attract considerable support from the corporate community that might not otherwise support the legislation.

Most corporate executives do not believe in forced takeovers, and in fact would rather not engage in them. Yet being hired hands and fearful of incurring the displeasure of board members or the investment community, they are reluctant to speak out against forced takeovers. Also, I believe executives are concerned that speaking out might suggest their own vulnerability to takeover.

Nowhere else in the world is there a society that allows private enterprise nearly as much freedom in the use of its resources as does the US. Therefore, corporate resources must be used in creative and constructive ways that avoid harm to societal interests. To do otherwise is to assure eventual significant reductions in freedom of action. Any unduly restrictive regulation or business activity today can almost unfailingly be traced to a failure of business itself to police its own activities.

Ominous European Examples

Constraints on business already in place in European countries will surely be adopted in the US unless change is made voluntarily. For example, corporate mergers require Government approval in most of those countries. Plant consolidations that result in reduced employment are very difficult and costly to achieve because of laws requiring compensation of full salary for up to two years for layoffs.

If public concern in the US over the social trauma of takeovers does not bring constraints, the increasing economic damage from unemployment certainly should. As unemployment persists and slowly rises, the time will come when the public will understand how difficult and critically important it is to preserve existing jobs and to create new ones. By that time, it will be clear that all reasonable effort must be made to avoid the loss of job-creating resources. Then society will overreact with too-stringent controls on takeovers and business consolidations.

There is a great opportunity now for an innovative approach to the problems of mergers. However, there should be better articulation of the adverse impacts of mergers, both voluntary and involuntary, because what is obvious to some of us is simply not widely perceived. □□□

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