

The Barriers and Bonds of Organizational  
Learning in Cross Border Mergers & Acquisitions

Danna Greenberg, Babson College  
Henry W. Lane, Northeastern University  
Keith Bahde, Benedictine University

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Acquisitions**

Danna Greenberg  
Assistant Professor  
Babson College  
Babson Park, MA 02457-0310

Henry W. Lane  
Darla and Frederick Brodsky Trustee Professor in International Business  
Northeastern University  
College of Business Administration  
313 Hayden Hall  
Boston, MA 02115-5000

Keith Bahde  
Benedictine University  
5700 College Road  
Lisle, IL 60532

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# **The Barriers and Bonds of Organizational Learning in Cross Border Mergers & Acquisitions**

## ***Introduction***

We live in a time of significant economic change. Increasing interdependence of markets for goods and services is a reality. Trade liberalization has opened borders and regional economic integration continues to take place. Deregulation and privatization have also contributed to increased international investment. Companies find themselves competing against foreign competition in their home markets, while simultaneously looking for new markets in other countries. Many companies are coping with this phenomenon of ‘globalization’ by expanding their geographic reach and “globalizing” as well. This often means that more capital and greater size are necessary to operate in the global marketplace.

The result of all this is the consolidation of industries and more alliances and more mergers and acquisitions are occurring between large established companies seeking complementary competencies but also large companies acquiring small companies. Consolidation is taking place within and across national borders. Some visible examples include Pharmacia-Upjohn followed by Pharmacia-Monsanto, and then Pfizer-Pharmacia, DaimlerChrysler, and Lycos-Terra Networks, which is majority-owned by Telefonica S. A. of Spain and BP – Amoco just to name a few.<sup>1</sup> There are scores of smaller deals that don't make

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<sup>1</sup> For a list of the top (value) 50 cross-border M & A deals during 1987-1999 see World Investment Report: Cross-border Mergers and Acquisitions, 2000. United Nations Conference on Trade and Development, New York and Geneva, 2000; pp. 110-111.

the headlines. The 2000 UN World Investment Report<sup>2</sup> provides the following snapshot of this phenomenon:

- In the decade of the 1990's, most of the growth in international production took place through cross-border M & A's rather than through greenfield investment.
- The value of completed cross-border M & A's rose from less than \$100 billion in 1987 to \$720 billion in 1999.
- The total number of all M & A's (domestic and cross-border) increased 42 percent annually between 1980 and 1999.

This increase in M & A activity is driven by corporations' need to gain access to highly skilled knowledge workers, R & D capabilities, and new products and processes; and to gain access quickly for competitive reasons. M & As are a useful tactic for speeding entry to market and/or quickly obtaining a larger percentage of the market share a firm currently serves (Hitt, Hoskisson, Ireland, & Harrison, 1991).

As strategically justified as a merger or acquisition may be, however, companies are painfully learning this process is not easy and that success is not guaranteed. The finance and industrial organization literatures support the perception that large numbers of M & As "fail" in the sense that they do not increase shareholder value or profitability.<sup>3</sup> Depending on the particular financial or accounting measures tracked, researchers have found that between 50% - 80% of M & As fail to create significant shareholder value or generate their promised strategic and financial goals (Ashkenas & Francis, 2000; Hitt et. al, 1991; Sirower, 1997; Ravenscraft &

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<sup>2</sup> World Investment Report: Cross-border Mergers and Acquisitions, 2000. op cit. pp. xix-xx.

<sup>3</sup> World Investment Report: Cross-border Mergers and Acquisitions, 2000. op cit. p. 139.

Scherer, 1987). Of the 107 largest cross-border M & As completed between 1996-1998, 83% of the acquisitions did not lead to any increases in shareholder value.<sup>4</sup>

The reality is that choosing the "right" partner or target for strategic fit is not the end of the M & A process - it is only the beginning. Academics and practitioners have found that the problems in combining firms often have less to do with strategic fit and more to do with execution during the various phases of the acquisition process. It is in the *acquisition decision-making and integration processes* that the problems and failures occur. Insufficient attention is given to execution of the strategy, management of the integrated employees, and differences in organizational and national culture. Research by AT Kearney<sup>5</sup> supports this view, as they found that the primary reasons for failures among bank mergers in the United States were as follow:

- Cultural differences 35%
- Poor planning and execution 20%
- Unrealistic targets 13%
- Inadequate due diligence 11%
- De-motivating employees 10%
- Defection 8%

The individual experiences of industry leaders who have had extensive M&A experience further reinforces the perspective that insufficient attention is given to the organizational issues associated with integration management. When Helmut Maucher was Chairperson of Nestlé S. A., a company with substantial M & A experience, he wrote:

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<sup>4</sup> KPMG report, 1999.

<sup>5</sup> Op. Cit.

“If implemented properly M & As are an important and efficient strategic instrument for enhancing the competitiveness of a company... M & As do not automatically generate success. Management should give its undivided attention to aspects of the actual integration process itself during the period when all contractual and financial aspects have been taken care of. These aspects include, *inter alia*, motivating the new employees, ensuring equal opportunity for all, and achieving a two-way transfer of knowledge – all aspects that are much more difficult to deal with than, for example, handling a property transfer.”<sup>6</sup>

As the number of cross-border M & As have increased, problems related to differences in organizational cultures have been further compounded by national cultural differences. A report by Towers Perrin states:

"The global nature of business today has increased vastly the level of complexity of people-related problems. As more and more companies make acquisitions outside their headquarters countries, differences in company cultures are now compounded by differences in country cultures - in languages and customs..."<sup>7</sup>

Madura, Vasconcellos and Kish (1991) also report that national differences as they manifest themselves in organizational culture, language, and organizational practices significantly increase the difficulties of succeeding in cross-border acquisitions. Differences in national culture have led different people in other countries to develop their own philosophies on how to best manage people and organizations (Laurent, 1986). Because of these differences,

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<sup>6</sup> Mergers and Acquisitions as a Means of Restructuring and Repositioning in the Global Market – Business, Macroeconomic and Political Aspects, Helmut O. Maucher. *Transnational Corporations*, Vol. 7 No. 3, December 1998. United Nations Conference on Trade and Development, Division on Investment, Technology and Enterprise Development. Geneva, 1998.

<sup>7</sup> *Seven Steps to a successful Merger or Acquisition*, Towers Perrin, Company Report.

there is a diversity of human resource practices in organizations (i.e. planning and staffing, performance evaluation and compensation, and job design) (Schneider, 1988). Since organizational culture is directly influenced by national culture (Schneider, 1988), merging cross-border organizations are even more likely to have diverse organizational cultures and, hence, an even greater potential for culture clash. These differences may cause organizational members to become even more resistant to the changes that occur following a cross-border M & A.

In this article, we suggest that learning and the two-way transfer of knowledge, or the lack thereof, may be a key factor contributing to the high failure rate among M & As, in general, and cross-border M & As specifically. In most discussions of learning and M & A, researchers have primarily referred to either:

- *knowledge transfer* that occurs during the post-acquisition phase as the newly formed company attempts to create new products, processes, and services that propel the new organization to achieving anticipated synergies, or
- *lessons learned* from previous M & A activities and a firm's ability to apply this learning to improve its management of future M & As.

In addition, prior research has been very *outcome driven* focusing on the knowledge necessary for new product and service development or synergy realization rather than as a basic *process* that is itself an important component of M & A activity. We believe, however, that learning in M & As is also fundamentally about the exchange that must occur between individuals, groups, and organizations as the acquisition process unfolds. If the merging organizations are not designed to support learning in the early phases of the acquisition process, particularly in the due diligence and integration phases, then the strategic learning that supports

value creation in the later phases is not likely to occur nor is it likely that organizational members will be able to learn from this specific M & A experience.

Thus, to understand the role that learning plays in the success of an M&A, we present a model that focuses on the learning process as a critical part of acquisitions. Our intention is not to add another perspective to the already numerous perspectives of M&A or to challenge the already existing learning or knowledge transfer perspective. Instead, in our re-conceptualization we focus on investigating the question “Why don’t organizations seem to learn throughout the M&A process?” To address this question, we believe that identifying the potential barriers and bonds to learning in the M & A process offers significant value in helping to understand why information is not obtained, learning does not occur, and anticipated M&A synergies are not achieved. We conclude with the presentation of a simple heuristic derived from *barriers and bonds theory* that should increase the information and knowledge flows in M & As and the learning that occurs throughout the M&A process.

### ***Mergers & Acquisitions from a Process Perspective***

Although research on acquisitions has been conducted from many perspectives such as financial, strategic, and organizational, in this article we rely on the process perspective to the study of M & As<sup>8</sup>. The process perspective combines elements of the strategic and organizational behavioral perspectives that frame acquisitions as a series of linked phases each of which has an impact on the subsequent phases and on the final outcome of the M & A. This perspective posits that to fully understand acquisition value creation, one must study the actions

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<sup>8</sup> For more detailed discussions of these different perspectives see Bahde, 2001; Haspeslagh & Jemison, 1991; Larsson, 1989.

that lead up to the acquisition decision along with the integration and management activities that follow the decision (Jemison & Sitkin, 1986). Although there may be a well-identified strategic and organizational fit underlying an acquisition, organizational members play an important role in the realization of the potential value following the acquisition. Hence, integration process management will strongly influence value realization (Haspeslagh & Jemison, 1991).

The acquisition process can be divided into three general phases: pre-combination, combination, and post-combination (Marks & Mirvis, 1998). We discuss these three phases of in more detail as they provide the basis for later exploration of the barriers and bonds to the M&A learning process.

### *Pre-Combination Phase*

The pre-combination phase denotes the time period before the acquisition closes in which potential acquisitions are identified, due diligence is conducted, and final deals are negotiated. In larger firms, M & A activity is typically planned and initiated by a specialized business development group. These M & A specialists have the training, background, and experience needed to conduct the complex process of evaluating M&A targets (Bentley, 1996). The business development team reviews M&A opportunities that are brought to it, proactively seeks out opportunities, and does a review of the candidates for strategic fit, synergy potential, and financial performance.

Once an M & A target is identified, due diligence begins. The driving force during due diligence is on avoiding an “acquisition disaster” that could occur if key liabilities went unnoticed until after the deal was finalized (Begley & Yount, 1994). Many merger problems can

be traced directly to a lack of sufficient information about the acquired company and to potential integration problems that were ignored or minimized until after the deal closed (Boland, 1970).

During the due diligence period, a small team of financial and legal specialists and business development advisors scrutinize accounting data and investigate potential legal liability associated with environmental, employee benefits, and other issues. A range of financial analysis tools are also employed to establish the economic value of the target firm based on the existing assets, future investment requirements, and the future earnings potential all of which may be heavily influenced by synergies expected from the combination of firms (Bielinski, 1992, 1993; Shralow, 1985). The challenge during the due diligence process is to find a way to collect and analyze a vast amount of data pertaining to complex operational and financial issues under highly confidential conditions and accelerated timetables.

Many authors have argued that there is a need for an expanded due diligence process that places greater emphasis on some of the less quantifiable, intangible aspects of a firm (Harvey & Lusch, 1995). The evaluation of a target firm is a complex process which, when done comprehensively, should encompass the entire spectrum of firm functions. Additional functions that might be investigated include human resources, employee benefits, information technology and customer relationships. A few authors have also proposed that an assessment of cultural issues needs to be added to the due diligence process (e.g., Ignatius, 1995; Marks, 1999). The goal, according to Marks (1999) is not to exclude firms that have somewhat disparate cultures from consideration as M & A targets, but to develop an awareness of the cultural differences and to begin to plan integrative efforts to bridge such differences. There is no doubt that cultural differences might exist between combining firms, especially in cross-border transactions and that these issues need to be considered during the due diligence process.

### *Combination Phase*

The combination phase begins after the negotiations are complete and the acquisition has been announced. One of the key challenges is to efficiently hand off responsibility for acquisition management from the business development team to the integration teams that will have responsibility for planning and executing the integration strategy. This hand-off is often problematic since important information gathered during due diligence that is likely to affect the integration process often is not passed forward to the team that will be overseeing the combination phase. Furthermore, there may be added problems if the operations personnel fail to buy into the strategy that underlies the acquisition.

Despite these issues, the integration teams will need to establish a comprehensive plan for the integration activities (Bower, 2001). Depending upon the strategic justification for the merger as well as the specific integration approach being utilized (i.e. preservation, symbiosis, absorption), the integration plans will need to be tailored accordingly. In any plan some of the key issues that will need to be addressed include integration of information systems, manufacturing processes, human resource practices, and organizational structures.

Although it may be clear what needs to be done during the combination phase this period of actual execution is the most challenging phase of the acquisition process. Politics, cultural differences, and individual stress and uncertainty make integrating two organizations highly problematic (Marks & Mirvis, 1998). Disruptive turnover of key employees; uncertainty and insecurity that afflicts employees of firms involved in M & A; the disruption of identity and work processes; and the potential for cultural conflicts all make it difficult for the integrated organization to move forward during this phase. This situation is further exacerbated in cross-

border mergers. Employees are often more apprehensive when they are being acquired or are acquiring a cross-border firm as there is greater uncertainty regarding the differences between the firms and how the newly integrated organization will manage across these differences. If these challenges are not successfully managed during the integration process, it is highly unlikely that information will flow easily in the newly merged organization and as a result it is not likely the organization will achieve the anticipated synergies.

### *Post-Combination Phase*

There is no definitive time frame on when the acquisition moves into the post-combination phase since it is dependent on how successful and quickly the combination occurs. In best-case scenarios, the post-combination phase begins a few months after the acquisition announcement and in worst-case scenarios this phase begins a few years after the acquisition announcement. In the post-combination phase, the new organization is expected to move forward and begin to find ways to capitalize on the synergies that were identified during the pre-combination or combination phase. The newly combined organization should now be focused on becoming more than a “the sum of its parts.” Unfortunately, problems that occurred during the pre-combination phase and the combination phase often prevent the integrated organization from every achieving anticipated synergies. Thus, from a process perspective each of these phases along with the organizational, strategic, and financial issues must be managed to influence ultimate value creation.

Reflecting back on the three phases, we can see the outline of the learning and knowledge transfer process emerging. Different groups (M & A specialists, financial and legal specialists, integration teams) are interacting with different parts of different organizations in different

countries and with people of different backgrounds, languages and cultures and engaged, hopefully, in the full and accurate two way transfer of information and knowledge. This is not an easy or straightforward process and one, which we believe, should be understood in finer detail.

### ***Learning and Knowledge Transfer in Mergers & Acquisitions***

Most discussions of learning and knowledge transfer in M & As have primarily involved outcomes as they relate to knowledge transfer in the post-combination phase or to lessons learned from past M & A experiences. Researchers have focused on knowledge transfer following an acquisition since knowledge transfer is critical to synergy realization. We believe there are significant theoretical and practical differences between knowledge transfer and learning, but we reference the knowledge transfer literature since there is limited existing research that is directly relevant to M & As as a learning *process* that is distinct from knowledge transfer. In a second stream of research, researchers have focused more on learning; however, this research focuses on lessons learned from prior M & A activities in order to improve management of future M & A dealings. Both of these streams of research are discussed in more detail below.

#### ***Knowledge transfer***

As the earlier quote from Helmut Maucher, former chairperson of Nestlé S.A. indicated, to realize synergy from an M & A there has to be the two-way transfer of knowledge between combining firms. Knowledge transfer has increased in importance as a growing number of firms have been using M & As as a strategy for gaining access to innovative technology and processes. In many industries, technological change is occurring so rapidly that no single firm has been able to develop the required knowledge or technology in house. Rather, firms such as Cisco have made M & A a core competency and have pursued a strategy of purchasing and integrating

technology (Carey, 2000) as opposed to pursuing a strategy of strategic alliances, joint ventures, and other forms of collaborative learning partnerships. Vermeulen & Barkema (2001) suggest that a combination of internal technology development and acquisition is preferred, as “acquisitions may broaden a firm’s knowledge base and decrease inertia.” (p. 457).

One of the factors making knowledge transfer particularly challenging following an M & A relates to the *type* of knowledge being transferred. Much of the knowledge associated with product development and other organizational procedures is *tacit* rather than codified (Singh & Zollo, 1998). Tacit knowledge is not documented. It resides in the understandings and memories of organizational members. Codified knowledge, in contrast, resides in documents and models. Further, Hakanson (1995) notes that much knowledge is context-dependent and, as a result, may lose value in cultures or settings in which it was not developed unless certain bridging functions are performed. This point is echoed by Leroy & Ramanantsoa (1997), who note that M & As provide both opportunities for and barriers to organizational learning. We will explore the barriers and facilitators to learning in more depth in the next section.

The second key challenge to knowledge transfer relates to the *nature* of the acquisition process itself. In order for organizational members to engage in knowledge transfer activities they need to feel a sense of belonging and trust with their colleagues. In short, a social community needs to be created among the organizational members. This is inherently difficult following an M&A. Following an acquisition, employees often feel a sense of insecurity and alienation, which leads them to engage in disruptive, non-compliant behaviors<sup>9</sup>. Fear of change and the unknown and differences between cultures can prevent the integrated organization from ever creating a new cooperative relationship. The challenge of creating a social community in

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<sup>9</sup> Nahavandi & Malekzadeh, 1994.

cross-border M & As is further complicated by the fact that organizational members differ in their languages, national cultures, and institutional and social contexts.

The predominate approach for overcoming these differences and creating a new social community is by building connections across the organizational boundaries. One way to do this is to engage boundary spanning managers who can help build this community and facilitate knowledge transfer. Tushman & Scanlan (1981) describe the important role that *boundary spanning* managers can play in the knowledge transfer process. Boundary spanning managers typically bring a unique combination of technical and interpersonal skills, which enable them to facilitate the knowledge transfer process. A similar approach for facilitating knowledge transfer and the development of a new social community involves resource redeployment in which organizational members from the acquirer are reassigned to the target firm and vice versa. Both of these approaches enable connections to be created across differences that facilitate the building of a shared community and the transfer of knowledge. While both boundary spanners and redeployment of people are potentially valuable tools for facilitating knowledge transfer in an M & A, they may not be enough if other barriers exist as well.

### *Lessons Learned*

In addition to focusing on knowledge transfer as it relates to synergy realization via new product/service development, researchers have also examined the issue of learning but with a focus on how organizations learn from past M & A experiences in order to improve their management of and success with future M & A endeavors. Acquisition performance and synergy realization has been tied directly to an organization's experience level with M & As. Organizations that engage in an extensive number of M & As are more likely to be successful in managing acquisitions because they have developed a core competence around acquisition

management. This core competence develops as the firm learns from its past failures and successes and applies this learning to future M&A activity. This learning does not develop simply from the accumulation of experience, rather it is through the investment of time and effort in activities that enable the firm to learn directly via processes of interpreting and institutionalizing the lessons learned from previous M&A dealings. Thus, it is not enough that a firm establishes a separate department to oversee M&A activity but that department must also establish processes that facilitate its learning from prior experiences.

For example, GE Capital has built a core competency around M & A activity by creating an M & A department that is responsible for identifying and managing acquisitions and for conducting post-M & A appraisals that enable GE to learn from past mistakes and successes and build its core competency in M & A management (Ashkenas et. al., 1998). Although these activities do relate to learning following the M & A and to some extent during the M & A, they do not relate to the learning process that must occur between the two organizations.

In summary, discussions of knowledge transfer and learning relative to M & As have primarily focused on knowledge transfer that needs to occur during the post-combination phase in order to fuel synergy realization via new products/services and on learning that occurs after the M & A process is complete that leads to better management of future M & A activities. Most researchers have only hinted at the role of learning throughout the M & A process. For example, it has been suggested that the learning process needs to begin during the pre-combination phase when members of the combining firms gather information about the physical assets, financial issues and process factors that will need to be managed during the integration process (Begley & Yount, 1994). However, this research does not create a conceptual framework for a learning process in acquisitions nor does it provide insight into the

organizational factors that inhibit or facilitate learning during the M & A process or during knowledge transfer once the merger or acquisition has been completed.

### ***Recasting Mergers and Acquisitions as a Learning Process***

Our basic premise in the reconceptualization of the M & A process as a learning process is that the knowledge transfer and learning that must occur following an acquisition in order to achieve synergy realization will only occur if learning has been a fundamental consideration in the earlier stages of the M&A process. In other words, a newly merged organization probably will not learn during the post-combination phase of the M & A process if it has not been engaged in a learning process throughout the prior phases of the process.

As we think about the use of M & As to gain access quickly to proprietary knowledge for corporate competitive advantage, the challenge seems clear - communicating and moving knowledge across organizational and cultural boundaries. Developing an understanding of the other organization's people, products, processes and capabilities means acquiring and disseminating information in different systems organized by different logics of action and using this understanding to motivate people in a common direction.<sup>10 11</sup>

Acquiring and disseminating knowledge across boundaries is a dynamic process and, ideally, not a one way transfer from the acquired to the acquirer. One model that has been developed to understand the dynamics of learning is the 4I theory of organizational learning.<sup>12</sup> It identifies four processes: intuiting, interpreting, integrating and institutionalizing that occur over

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<sup>10</sup> *Managing Large Research and Development Programs*, Henry W. Lane, Rodney G. Beddows and Paul R. Lawrence. State University of New York Press, Albany, 1981.

<sup>11</sup> "The Technical Logic of Research and Development". H. W. Lane, R. G. Beddows & Paul R. Lawrence. *R&D Management*, Vol. 11, No. 1, January 1981.

<sup>12</sup> "An Organizational Learning Framework: From Intuition to Institution", Mary M. Crossan, Henry W. Lane and Roderick E. White. *Academy of Management Review*, 1999, Vo. 24, No. 3, 522-537.

three levels: individual, group, organization. In an ideal world the innovative ideas that occur to individuals are shared with others, actions are taken, and common meaning developed (interpreting and integrating). This shared understanding developed by groups becomes institutionalized in organizational processes and routines.

A tension exists between assimilating new learning (feed-forward) and exploiting, or using, previous lessons (feedback). Feed-forward processes facilitate the flow of new ideas and actions from an individual, to a group, to the organization level. Simultaneously, lessons and routines previously learned feedback from the organizational to group and individual levels, affecting how people act and think. These processes create routines and responses that become the organizational logic of a company (the way things should be done) and contribute to the development of a distinctive corporate culture. Thus, the tension is between feed-forward processes that facilitate change and innovation and feedback processes that facilitate structure and routine.

Learning requires communicating across different personal cognitive maps and organizational cultures, and integrating these maps with others in a way that develops a shared, collective understanding. This is not always easy or successful. Within firms there are barriers to communication as people try to communicate between groups and functional entities and communication choke points can develop which block the flow of information and knowledge.

Although this dynamic theory of learning primarily focuses on intra-organizational learning, the 4I model has been extended to serve as a framework for analyzing inter-organizational learning. In particular it was applied to a historical analysis of the inter-organizational learning that took place among Xerox PARC (Palo Alto Research center), Apple

Computer, IBM and Microsoft.<sup>13</sup> Meyer argued that inter-organizational learning also takes place through the processes of intuiting, interpretation, integrating and institutionalizing. The question that still remains, however, is what gets in the way of learning that derails the learning process.

If communicating across functional boundaries within an organization can be difficult, after a merger or acquisition there are potentially many more challenges in learning and developing a shared view of a dramatically changed reality. Since many aspects of our logics of action and culture are tacit, communicating them requires a process of surfacing and articulating ideas and concepts – in short making tacit knowledge explicit. Even if this is accomplished, it does not mean this information will be shared. The language and logic that form the collective mindset of the organization or national culture and the resulting investment in assets, may present a formidable fortress of physical and cognitive barriers to change, agreement, and the realization of synergies. These barriers, which exist within a single organization are that much greater when they are between firms. In a cross-border deal, the complications escalate even further.

A dynamic theory of organizational learning provides a means to understand the fundamental tensions that are inherent in learning and knowledge transfer in M & As: the tension between exploration and the possible creation of synergies or the imposition of the ways of the acquirer or stronger party. This process is depicted and summarized in Figure 1. We now explain barriers and bonds theory in more detail.

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<sup>13</sup> “Embrace and Extend: A Case of Inter-organizational Learning” John P. Meyer, Eastern Academy of Management, 2001.

## ***Barriers and Bonds in the M&A Learning Process***

One of the requirements for knowledge development and learning is communication. Therefore, it is appropriate to explore some of the key factors that help or hinder the flow of information across boundaries as we examine the inhibitors and enablers to learning during the acquisition process. In particular, we adapt Morton's (1967) identification of four factors: specialized language, space, organizational structure and motivation, which are central to the type of communication that is needed to stimulate learning and innovation. Morton argues that these factors can be used by an organization to facilitate the flow of information since

“...we can deliberately build into the system certain bonds and barriers that will either inhibit or encourage the flow of information. These barriers and bonds are used in complementary fashion; whenever we have a spatial barrier we try to have an organizational bond and vice versa. Two barriers never exist together lest information flow be impeded and two bonds never exist together lest one specialist group dominate the other”.<sup>14</sup>

In the following sections, we describe in more detail these four factors and how they can affect learning during the acquisition process.

### ***Language***

The first barrier or bond is language. In general, if organizational members do not share a common language they cannot share ideas or build on one another's ideas, and they cannot learn. Previous studies of cross-border M & As have shown that cross-national differences can lead to miscommunications and misunderstandings which further impede learning as well as to the development of positive relationships that support learning<sup>15</sup>. In cross-border M & As, lack

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<sup>14</sup> “A Systems Approach to the Innovation Process”, Jack A. Morton. Business Horizons, Summer 1967.

<sup>15</sup> R. Schoenberg. 2001. Journal of Euromarketing, 10(1): 99-114.

of a common language may stem from the merging partners having different national languages. For example, when BMW acquired Rover language problems naturally arose as organizational members at BMW whose first language was German tried to communicate with organizational members at Rover whose first language was English. When a merger involves different lines of business, such as Sears Roebuck's acquisition of Coldwell Banker and Dean Witter, language differences may also arise since different businesses rely on different logics (Prahalad & Bettis, 1986). Even when the merging partners share the same national language and are in the same line of business, there are still other types of language barriers that can exist. In these instances, language barriers may emerge from differences in organizational culture or differences in types of scientific or technical backgrounds and experience.

There are two types of language differences that can hinder communication during the acquisition process. The first is differences in the actual words used to communicate an idea. For example, a software programmer may use slightly different terminologies than a hardware programmer. A German speaking English may use different words to convey an idea than an American speaking English. The second type of language differences is differences in how words are used and how thoughts, feelings, and information is communicated. This aspect of a language barrier is more difficult to overcome because it relates to differences in tacit knowledge. As a result, organizational members may not even be able to recognize when they do not understand how a concept is being communicated. Furthermore, the organizational members from the other merging partner in the M & A may not be able to explain the subtlety of how they communicate even when asked. This could be particularly true if one of the firms was from a high context culture in which communication is more subtle and indirect.

Language barriers may prevent the transfer of information between the merging partners at various stage of the acquisition process. At the earliest stages, language may be a barrier to learning during the due diligence phase in which the acquirer conducts an extensive legal and financial investigation of the target. This process is inherently complex as the acquirer tries to juggle competing pressures of secrecy and the need for exhaustive information gathering. These competing pressures have lead to an inherently flawed process that has been highlight by numerous researchers (i.e. Boland, 1970; Haspeslagh & Jemison, 1991; Marks & Mirvis, 1998).

Some of the problems in due diligence that have been highlighted include an over-emphasis on legal and financial information and a lack of emphasis on critical factors such as human resources, operational strategies, infrastructure, and external relationships with customers and suppliers. As a result the experts who are conducting the due diligence may misunderstand the value creation potential of the acquisition along with the critical success factors that are needed to obtain that value (Marks & Mirvis, 1998). We believe that specialized language barriers may be one of the reasons underlying these misunderstandings and the lack of learning that often occurs during due diligence.

These misunderstandings may stem from the specialist groups using specialized language and not understanding the language being used by the target's human resource or technical staff to discuss the value creation potential of the M & A or they may arise because the technical experts from the acquirer simply do not understand the language being used by the technical experts from the target. Without a common language between members of the merging organizations, the acquirer cannot learn about the value creation potential of the target and whether it can mine this potential.

As the organization moves into the integration phase, language barriers may then hinder the merged organization's ability to successfully manage the integration process. If the merging organizations are not able to learn basic information about one another's structures and operating procedures then they will not create a realistic plan for integrating the two organizations and obtaining value from the merger.

### *Space*

Physical space can be a barrier or bond to the effective flow of information and learning. If individuals or groups are not co-located space can create a barrier to information flow. Based on prior research, we know that geographic proximity is one of the factors that should be considered when assessing the potential success of an M&A. One of the criteria Cisco uses to identify a potential acquisition target is whether the company is located in Silicon Valley or near one of Cisco's remote sites.<sup>16</sup> Relative to the learning process that must occur during the acquisition, physical proximity is particularly important as it enables informal networks and relationships to develop between the target and the acquirer's staff. This proximity can facilitate the flow of information. Although meetings and conference calls may be used as a way to communicate, these mechanisms are not as useful for building relationships between the merged organizational members. Through relationships, more sensitive and complex information can be shared between the merging organizations.

It is important to note that this barrier or bond is co-location and not just close physical proximity. Relationships will develop faster and more information will be shared when organizational members from the merging organizations are co-located. For example, when EMC acquired Data General, one of the factors that was expected to ease the acquisition process

was the close geographic proximity of the two companies (both companies were located 30 miles west of Boston, MA). However, because this geographic distance was coupled with major cultural differences (motivational barriers to be discussed in a later section), it created a chasm across which information sharing and learning did not take place. Two barriers existed together until EMC created a bond by re-locating people so that former –DG and EMC employees were in the same building and able to share information and starting learning about what the two organizations might be able to accomplish together.

### *Organizational Structure*

The third factor that has the potential to permit or prevent learning during the acquisition process is the organizational structure. Organizational structure refers to the: 1) established subunits, such as departments or divisions of the organization, (2) the management hierarchy that delineates authority, and (3) linking mechanisms such as committees and task forces that ensure that the groups work together. All three of these factors work together to create an organization's structure (Greenberg, 2002). Most acquisition research that mentions organizational structure highlights the need to create a structure following an acquisition that enables the two organizations to work together effectively to achieve the anticipated synergy (Marks & Mirvis, 1998). Yet, it is difficult to establish such a structure when existing organizational structures along with the integration management structure do not facilitate the learning that will contribute to the establishment of a new arrangement. Below we explain in more detail how organizational structure can impede such learning.

Organizational structure can inhibit or facilitate learning right from the due diligence phase. One of the central goals of the due diligence phase is to assess the “fit” between the target

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<sup>16</sup> “Cisco Systems, Inc.: Acquisition Integration for Manufacturing” Nicole Tempest. *Harvard Business School*

and the acquirer. Fit includes both strategic fit, the degree to which the merging companies' resources, goals, and strategy are complementary, and organizational fit, the degree to which the merging companies structures, operating processes, and culture are compatible (Marks & Mirvis, 1998). Depending on how the target and the acquirer are structured, learning the necessary information to assess both strategic and organizational fit may be more or less difficult.

For example, many researchers have advocated that organizations that rely on frequent acquisitions to grow and compete would benefit from having a separate subunit that oversees pre-acquisition decision-making and due diligence (Ashkenas et. al., 1998). For example, one of the strengths of Cisco's acquisition process is it has a permanent new business development department that is responsible for identifying and assessing the fit of acquisition targets<sup>17</sup>. This department is not an ad-hoc team that is created and dissolved as new acquisition candidates appear and disappear. Instead, it is a permanent group in the organizational structure that is comprised of organizational members who have prior experience with acquisition decision-making and integration. These experts are able to learn from their prior experiences and apply these lessons to their assessment of new acquisition candidates. Part of the strength of the new business development department stems from the fact that it remains well connected with the other departments at Cisco.

As due diligence begins, the project manager from the new business development group will develop cross-functional due-diligence teams which include members from marketing, engineering, and manufacturing who are chartered with assessing the strategic and organizational fit of the acquisition candidate. The functional expertise of these individuals positions them to

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*California Research Center*, January 1999.

<sup>17</sup> Cisco Systems, Inc.: Acquisition Integration for Manufacturing (A). Nicole Tempest. 1999. Harvard Business School Publishing: Cambridge, MA.

understand and learn about the target's respective functional areas in order to make an accurate assessment. Cisco's organizational structure which relies on a permanent sub-unit that is well connected to the remainder of the organization is instrumental to its ability to learn about the strategic and organizational fit between itself and its target. Presumably, if the acquisition was a cross-border deal the business development group could augment its team with experts who possess the appropriate language and cross cultural skills.

Even if the due diligence team is structured to facilitate learning there are components of the target's organizational structure that may create a barrier to learning. For example, organizations that are highly centralized may have formal or informal policies that inhibit lower level employees from communicating and sharing information. Such a policy will make it difficult for knowledge to be shared easily and quickly during due diligence. In addition, if the target organization does not have strong linking mechanisms that enable different subunits to share information with one another then it is unlikely that the representatives from the target's side will have the necessary information to enable the due diligence team to accurately assess strategic fit. This was clearly the case when AT&T acquired NCR. The capabilities that AT&T thought it was acquiring were not in fact the true capabilities of NCR. Although there were many factors that influenced this poor assessment, part of the issue was that representatives from NCR (the target) could not provide the due diligence team with accurate information to learn about the potential fit.

Finally, during due diligence it may be difficult for organizations to assess strategic and organizational fit when they have significantly different structures. When organizations have different R&D processes or innovation processes it may be more difficult for each acquisition

partner to assess the potential complementarities of their current processes if they do not fully understand each other's structure.

Structure may also affect the learning that needs to occur during the combination phase as a new organization is established that will capitalize on anticipated and unanticipated synergies. The most important component of structure relative to learning during this phase involves the structuring of the integration team. The goal of the integration team is to manage the integration process, not the new business (Ashkenas et. al., 1998). To do this effectively the integration team must first learn about both the target and the acquirer as they create a new organizational structure which may create changes regarding financial and legal reporting processes, human resource policies, job responsibilities and even organizational structure. The integration team must then help executives and employees learn about these changes. Hence, the integration team must first learn enough information to design an effective integration process but more importantly, then, it must facilitate organizational learning in order to execute this integration process.

As the integration team is assembled, there needs to be a process for connecting the integration team to the due diligence team which may now be disbanded or partially disbanded. If due diligence is conducted well, the due diligence team not only learns about the target's financial and legal position but it also gathers information about its strategy, culture, and structure. When this information is not shared, as is true in most cases, the integration process is slow and costly and often much less effective (Ashkenas et. al., 1998). In these mergers, the failure results from the integration team not learning from and benefiting from the knowledge the due diligence team gained. Hence, in the acquisition process there needs to be a structural linkage, such as boundary spanner, between the due diligence team and the acquisition team so

that this valuable information is not lost. This linkage may be the carry-over of a person from the due diligence team to the integration team or it may be a formal debriefing process that allows the due diligence team involves both written and verbal communication between the two teams. Creating these structural linkages will ensure that the integration team learns and benefits from previously acquired knowledge.

Selection of members of the integration team will affect learning. For example, following Compaq's acquisition of Digital in 1998, the services group created an integration team and an integration process that included individuals from the services division at Compaq, Digital, and Tandem (a Compaq acquisition from 6 months prior). Organizational members from each of the merging companies were included in this process because these individuals were best positioned to share with the team their knowledge regarding their current organizational structure, processes, and expertise. By including members from all three merging partners, at least one double barrier was avoided (space and organizational structure). The team was better positioned to learn about the existing processes, create an integration process and create a new organizational structure that would best fit with capabilities. Because the different members of the integration team were also knowledgeable about their own organizational cultures and human resource systems, these members were then well positioned to help educate their respective organizations on the changes.

Finally, the integration team needs to create a structure that enables the rest of the organization not just to buy-in but to understand and then create the actual integration team. Although the integration team sets the stage it is the rest of the organization that will actually carry out the integration and establish the structure that will emerge in the new organization. Communication is one component of this process but communication alone will not facilitate the

necessary organizational learning. Instead, the integration team would benefit from focusing on creating linking mechanisms that enable other organizational members to participate in the integration process and to embark on activities that lead to quick results that show the importance of integration. These quick results are essential for helping an organization establish new patterns following an organizational change. GE Capital, for example, used this approach when it acquired a Japanese financial services company (Ashkenas et. al., 1998). It created short-term projects (100 days) for the Japanese and American employees to work on *together* thus avoiding the double barrier of structure and space and providing a common motivational goal that had a direct impact on the bottom-line. Members of the newly merged organizations were able to experience the value of integration. This experiential process will foster organizational learning much faster than one-way communication and will begin to create bonds that will transcend the barriers of space, structure, and language.

### Motivation

Understanding motivation basically means understanding the relationship between particular individuals and the situations in which they find themselves. Organizational members have beliefs about the relationship between their context, their actions, and desired outcomes. It is necessary to understand personal and organizational objectives and the relationship between the two to explore why and how learning occurs during the acquisition process. Morton (1967) suggests that when motivation is strong among organizational members, a climate is created in which organizational members want to communicate to support organizational goals. A culture of trust and social community will contribute to the increased flow of knowledge.

Positive motivation fuels the desire among organizational members to want to learn about each other with the goal of creating an integrated organization. Unfortunately, most acquisitions

do not fuel integration in this direction. Following an acquisition, organizational members are often de-motivated as they worry about the security of their jobs, their new roles, and the policies of the new organization. Rather than focusing their energy towards learning about their new partner and rebuilding a new organization, organizational members are motivated to look out for their own best interests as they try to preserve their jobs and their sphere of influence. Because of this territorial reaction to uncertainty and change, many organizational members are actually motivated not to share their knowledge with their colleagues which means learning can not take place. Administrative systems of the organization such as performance appraisal and reward systems can support or destroy this motivation to share and to learn.

National culture may be a motivational factor to consider. In domestic acquisitions, differences in organizational culture can increase the complexity of the integration process and make it more difficult for the merged company to achieve anticipated synergies. In cross-border mergers and acquisitions, national culture is added to the equation. Hofstede (1980) defined culture as "the software of the mind that distinguishes one group from another". It is a commonly-held body of beliefs and values which define the *shoulds* and the *oughts* of life for those who hold them. These beliefs influence peoples' actions.

Cultural differences often deter learning from occurring during most acquisition processes. One of the key issues that must be worked through during the acquisition process is culture clash (Buono, Bowditch, & Lewis, 1985; Shrivastava, 1986). As the two organizations learn more about each other's norms and values, a competitive "us vs. them" environment often develops as organizational members become biased towards the good of their culture and nostalgic over what they may lose as the new organization forces this culture to change (Buono

et. al., 1985; Marks & Mirvis, 1992). Organizational members often are ethnocentric - seeing their culture as superior to that of their merging partner (Hambrick & Cannella, 1993).

Culture clash, whether it is due to organizational culture or national culture, may demotivate organizational members from learning from their partner and from learning new ways to work together. Organizational members become territorial about their culture and are resistant to adopting new ways of doing things that come from the other organization's culture. Furthermore, if they see their culture as superior to that of their merging partner they are demotivated from learning about their merging partner since they are biased to seeing the knowledge and norms of their partner as inferior.

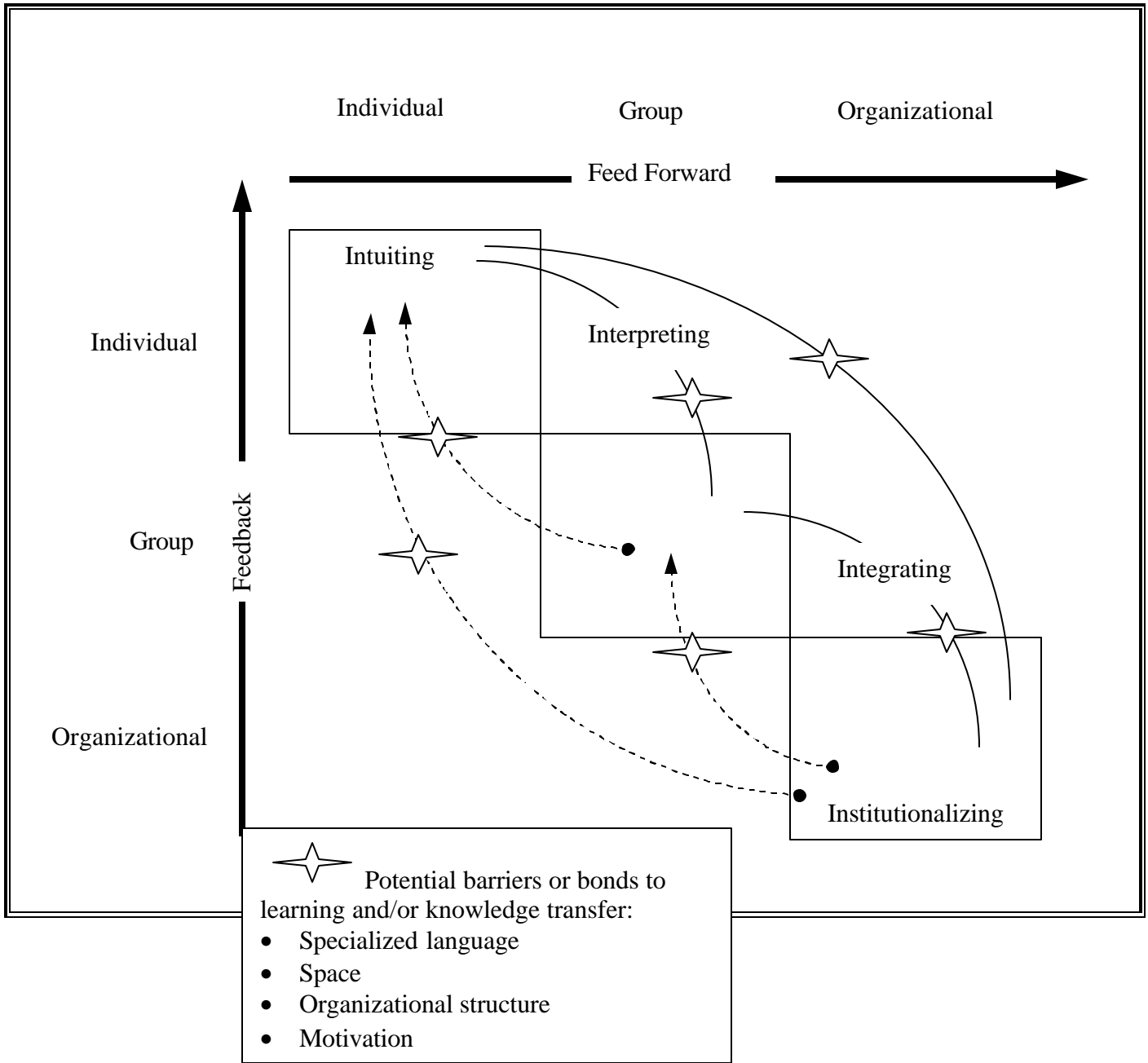
To counteract the de-motivation of organizational members towards learning and knowledge sharing following an M & A, organizations need to purposefully encourage a different type of behavior. Organizations need to find ways to motivate people to see the value in sharing their knowledge and in learning from their colleagues to create a new organization. They also need to find ways to help organizational members re-frame their views of culture and the process of cultural change. There are many ways organizations can do this. First, and foremost, it is critical that major changes regarding jobs, responsibilities, new structures, new policies, and layoffs should be made as quickly as possible following a layoff. When these changes are made quickly, a new stable order can be created which helps organizational members focus on the real work of developing the newly formed organization (Ashkenas et. al., 1998). Organizational members will worry less about their stability and will see the value in sharing their knowledge and learning from their counterparts as they work to support the new organization.

Another tactic organizations can use to motivate organizational members towards knowledge sharing and learning is to make sure the incentive systems support this learning. Existing systems that may de-motivate learning about the other organization need to be altered. When EMC acquired Data General it had a sales incentive program that “disincented” people from selling Data General products. This system prevented sales people from learning about the Data General product line and from finding innovative sales tactics to support both lines. EMC sales people only started to learn about the Data General products when this system was changed. Secondly, new performance appraisal systems and compensation systems must be created that reward behavior that supports integration between the two organizations. When the organization actively works to motivate organizational members to work together then people will be motivated to share knowledge and learn how to support the newly merged organization.

### ***Conclusion***

Success in M & A's and achievement of anticipated synergies is based on learning and the effective transfer of knowledge – preferably a two-way transfer. However, to achieve these learning outcomes, we believe learning must also occur throughout the acquisition process. Managers who are involved in the various phases of the acquisition process must pay attention to the barriers and bonds that can affect learning during this process. By identifying these barriers and bonds and managing them so that two barriers or two bonds do not exist together, firms stand a better chance of avoiding the chasms across which information cannot flow and building the synapses required to permit it. By increasing information flow and learning through the acquisition process, managers increase their chances of supporting knowledge transfer following the acquisition and of achieving anticipated synergies.

Figure 1: Modified from Crossan, Lane & White (1999, p. 532):



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