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ABSTRACT

"Synergy" is among the most frequently used buzzwords in business today, employed to rationalize mergers, acquisitions, and restructurings. This paper first examines the common use of the term 'synergy'. It then discusses the actual meaning and cites situations in which the term is commonly misused. Despite consistent promises of post-merger synergies, merged firms frequently underperform their pre-merger predecessors, deliver lower dividends to shareholders, and create few productivity gains. Multiple studies concur that mergers rarely deliver the scale of synergies promised by their architects. The paper concludes with guidance both for dealing with promises of synergy and for creating potential synergies within one's own company.

SYNERGY AND THE CEO

Whether CEOs are born with the aptitude or learn it along the way, their vocabularies invariably include a variety of inspiring terms rarely uttered by lesser mortals. Thus equipped, these super managers are enabled to stand before reporters, analysts, and shareholders and paint glowing pictures of amazing possibilities, in some cases even as their firms face imminent doom. The unique dialect of CEO-Speak has not gone unnoticed; Suzanne Bates wrote an entire book on the topic, summing it up succinctly: "There is nothing on [a CEO's] busy schedule from morning to night but talking and listening. That's the job requirement. That's what CEOs do" (Bates, 2005, p. 4). Most of them do it quite well.

In feast or famine, prosperity or bankruptcy, the inside front cover of a firm's annual report invariably features a portrait of a confident-looking, well-dressed executive, along with a beautifully worded description of how well the firm is performing. CEOs are notorious for their page one success stories, regardless of what the financials say a few pages later. In 2005 the level of CEO obfuscation reached such heights that *Slate's* Daniel Gross created a recurring feature entitled "The CEO-English Phrasebook: What your boss means when he talks like that" in which he interpreted such cryptic pronouncements as "managing for cash," which could be loosely translated into "the firm will be sold as soon as a sufficiently gullible buyer can be located".

Of all the weapons in the CEO's verbal arsenal, none is more frequently deployed than the all-purpose term "synergy." *Synergy* is one of those words which everybody seems to use, but few people ever bother to define; in particular when CEOs step before the microphone to justify an acquisition or a merger, we can know with virtual certainty that they will utter, perhaps several times, that magical term. Don't believe it? Just Google the name of any Fortune 500 CEO and the term *synergy* and you will quickly find that wherever a CEO goes, discussions of synergy are rarely far behind.

When Daimler and Chrysler consummated what is now considered one of the greatest disasters in merger history, prominent among the rationale given by the deal's authors was the achievement of vast synergies between the two already enormous firms. Nine years later, as Daimler execs paid to unload Chrysler and returned to Germany hoping to forget the entire debacle, commentators wisely intoned that the merger had failed because it never achieved adequate synergies. What that statement actually means nobody knows, but at least it sounds authoritative.

DEFINING "SYNERGY"

Despite its modern sound, the term *synergy* first appeared in the 1600's. The word's Greek root literally means 'cooperation' or working together; however, implicit in the modern term is a combination of the two entities which is somehow greater than the sum of the separate parts. In teaching my Strategic Management students, I define Synergy as something on the order of 1+1=3, meaning that after the joining of the two parts we possess a surplus resulting from our efforts. This definition is consistent with what CEOs often promise when promoting acquisitions or mergers, and with good reason: after all, if I merge a $1 billion firm with another $1 billion firm and after enormous effort and expense I preside over a $2 billion firm, what have I really achieved?

Synergistic effects are, I believe, fairly common; however I suspect that they occur much more frequently at the lower levels of companies. Imagine, for example a meeting in which managers from two different divisions realize that they are actually pursuing similar goals in very different product lines, and that one possesses expertise in production technology while the other has mastered the intricacies of distribution and customer support. Beyond the simple sharing of knowledge and cooperation which might occur (an important outcome, but not truly synergistic) we can conceive of future efforts in which these two managers jointly produce truly innovative solutions which benefit both product lines, and which might in fact spawn entirely new products or extensions of existing lines. In such a case we observe *synergy*, unique and novel results which would never had occurred had the two managers not combined their efforts.

A second, even less spectacular example of synergy occurs when two firms join forces primarily for the purpose of producing a larger organization. In such a case the two $1 billion firms might well be able to retain the contracts they already held, but also gain an additional contract which was too large for either of them to tackle alone. In such a case we might argue that the combined entity does enjoy opportunities which were impossible for the two separate firms to consider, suggesting that synergistic effects have occurred.

Synergy may sometimes be easier to identify in the creative arts. When playwrights Andrew Lloyd Webber and Tim Rice first collaborated in the 1960's, few could have imagined how their works, including *Joseph and the Amazing Technicolor Dreamcoat* and *The Phantom of the Opera* would revolutionize modern theater. In such cases it is relatively easy to envision two very creative men pushing one another forward and building upon one another's ideas as they jointly achieve creative heights which neither one would have achieved alone.

While we have now considered three very different examples of how synergy might occur, we must discuss other outcomes which are frequently, and I believe mistakenly, labeled synergy.

FAUX SYNERGIES

Numerous outcomes are labeled as *synergies*, however most of these are not truly synergistic. For example, complimentary (non-overlapping) product lines are often referred to as a synergistic mix. Before their failed merger, Daimler-Benz and Chrysler were noted for this fit, with Daimler's strengths lying in luxury cars, large trucks, and the European market, while Chrysler's operations were concentrated in mainstream cars, light trucks, and North America. While this lack of overlap meant that less trimming was required, it did not mean the two firms should automatically expect synergies to emerge from their now broadened product line, and in fact few such synergies were ever created. One might argue that a typical car buyer is unlikely to purchase additional cars regardless of how broad the product line might be.

A second mis-use of the term deals with cost savings and increased efficiency. CEOs frequently rationalize a merger by noting that the two firms operate separate facilities in major markets, suggesting that closure of half these locations will lower costs and increase profits. In this same vein the new firm will be paying one CEO rather than two, funding only one Human Resources department, and so forth. As we will see later, these cost savings often fail to materialize, but even in cases where they do, simple operational efficiencies are not truly synergistic in nature.

Complimentary operations and cost savings are only two of the more common misuses of the term *synergy*. In practice we find numerous other examples of corporate leaders or analysts mislabeling fairly pedestrian events or processes as synergy, and in other cases blaming failures on a lack of synergies. For many leaders the term seems to have become a generic marketing slogan attached to any type of improvement.

MERGER SYNERGY: A HISTORY OF NON-DELIVERY

In assessing the function and impact of synergy we most commonly hear the term used when discussing mergers and acquisitions. Given this close association between the two it seems reasonable to evaluate these types of transactions in order to assess how often and to what degree synergy does or does not occur.

While a merger or acquisition is often lauded as a bold and visionary course being charted by a daring corporate captain, the performance record of these undertakings is decidedly negative. In fact, even in the previously discussed faux-synergy areas such as cost savings, large scale mergers appear to offer surprisingly poor outcomes. In general terms, the majority of large-scale mergers are eventually judged to be failures, regardless of the metric chosen.

As previously noted, CEOs invariably tout cost savings as a motive for merging. This claim is relatively easy to sell, given the expected reductions in head count and potential economies of scale. In specific cases where location is a primary consideration, such claims may be justified; a merger involving two convenience store firms could easily result in the closure of 'duplicate' outlets with relatively little loss of income. However, in most cases such economies fail to materialize.

One recent study (Trimbath, 2002) looked at 276 takeovers involving Fortune 500 companies over a 15-year period. While the majority of the firms did experience increased efficiency, the average gain was surprisingly low. The largest improvement occurred in the Petro-Lewis takeover of 1987, which yielded an impressive 55% efficiency gain; however no other firm even approached this level of improvement. In fact only 13 of the firms (fewer than 5%) recorded efficiency gains of 10% or more, while fully 70% of the deals yielded improvements of 1% or less (and in some cases resulted in productivity losses). Realistically, most planned mergers should project efficiency gains of no more than 1 to 2%.

Proposed mergers are often expected to provide a variety of other benefits to the firm and its shareholders. But shareholders frequently experience lower post-merger returns, and ‘substantial’ shareholder returns are achieved in a minority of cases; Noe’s (2002) survey found that profits increase in as few as 20% of merged firms. In terms of operational improvement, the numbers are no less gloomy, with productivity falling an average of 50% in the months after a merger and integration, and almost half of managers in acquired firms leaving during or shortly after the merger (Noe, 2002).

In discussing the state of mergers and synergy in the banking industry, one analyst at McKinsey & Co. noted that potential synergies are generally overestimated before a merger. In her assessment, synergies are actually quite rare, leading her to warn that finding good examples of synergy is very difficult, with most industries offering “only two or three good precedents” (Sias, 2005). In conclusion she offers her own acerbic label for revenue synergies: *Fool’s Gold*.

In summary, post-merger firms frequently underperform their pre-merger counterparts, pay lower returns to their shareholders, and deliver few if any productivity gains. By almost any objective measure, corporate mergers appear to be a long-shot at best. And in terms of delivering synergies, which should by definition lead to higher performance, they appear to be an abysmal failure in the vast majority of cases. In fact, based on the data at hand, it seems reasonable to predict that merging firms will more often produce *reverse synergies*, yielding returns which are measurably inferior to those delivered pre-merger. In other words, 1+1=1.

DESPERATELY SEEKING SYNERGY

Is *synergy* a real phenomenon, or is it simply a buzzword floated by CEOs in order to advance a growth agenda? Clearly, synergy can and does occur, though it is usually smaller and less flashy than its most vocal proponents claim; in many cases synergy may be the result of chance encounters or insights, rather than massive corporate restructurings. Ironically, the traumatic process of merging two firms may actually poison the close-knit working environment in which synergy tends to flourish. Given the often extraordinary difficulties encountered in merging two organizational cultures, the close working relationships needed to produce synergy may be slow to re-develop after the merger.

Given the apparent limitations of this term, how do we deal with those who use it? Perhaps more importantly, how do we encourage the development of true synergies within our own organizations? I offer three suggestions:

First, maintain a healthy skepticism whenever the term *synergy* is used. Some use it innocently, though incorrectly, to describe complimentary operations, while others use it to imply tremendous gains which are anticipated or hoped for, but which cannot be objectively predicted based on available data. In many proposed mergers the *Field of Dreams* mindset appears to predominate: “If you build it, they will come.” When confronted with unsupported projections of such synergies, be prepared to ask for justification of the proposed gains. In many cases the term represents little more than an expression of optimism, an empty promise thrown in to mask a lack of hard data or details.

Second, encourage, enable, and reward cross-pollination within your firm. Some of the most ground-breaking advances occur when individuals from different arenas collaborate, sharing their ideas, challenges, and potential solutions with one another. Ironically, many firms are structured in such a way that individuals rarely work with anyone outside their own functional groups, stifling opportunities for such interactions and in some cases producing ironic situations in which problems and their solutions simultaneously exist in different silos within the same organization. Formal restructuring and the use of project teams can help to break down these barriers, while informal rewards and activities can encourage cross-functional interactions. Initiatives such as these should normally be considered extremely long-term undertakings.

Finally, seek out opportunities to partner with other organizations. North Americans are particularly vulnerable to ‘not invented here’ syndrome, in which collaboration with outsiders is seen as a weakness. In the global market, collaboration is in many cases a precursor to doing business, as when a local partner is legally required in order for a non-native firm to bid. Today, fewer and fewer firms try to do everything themselves, seeking instead to align with partners who are experts in their own areas of operation, frequently resulting in lower costs and higher quality. Such collaborations often provide fertile ground for the development of future innovations.

CONCLUSIONS

In my Strategic Management course each semester I screen a video clip from a popular movie. In the clip, a well-dressed executive steps to a podium and asks, “Synergy. What is it?” after which he spends several minutes talking without actually saying very much, eventually leaving the audience in stunned silence as he departs. I show this clip because I believe it dramatizes the common misuse of the term; as a rationale for mergers, the data supports the contention that synergy is usually more hype than substance, especially at the corporate level. *Synergy* may well be the word that launched a thousand mergers, most of which eventually failed.

On the other hand I deeply believe in the power of collaboration, sometimes even for tasks which an individual is capable of completing alone. In my experiences collaborative processes sometimes produce end results which are an order of magnitude superior to the product an individual would have delivered. Particularly when facing ambiguous or poorly defined problems, individuals working in tandem appear far more likely to identify unexpected or unusual solutions than do individuals working alone. Companies hoping to harness synergy will need to closely examine how they motivate and reward their employees. As long as incentive systems focus solely on hard numbers and individual achievements, few employees will invest time or effort in collaboration.

Despite widespread misuse of the term, synergy remains a worthwhile objective, with potentially enormous benefits for both the individual and the organization.

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