Flying higher – together

Most mergers and acquisitions fail because of competing visions, personnel or processes. Air France and KLM Royal Dutch Airlines, however, have become a model for making a merger successful. **Dave Del Canho** and **Joeri Engelfriet** helped the two airlines fly higher. They tell how, here.

In a recent book on the subject, it's noted that almost 70 per cent of all business mergers fail. Happily, we have been part of the successful 30 per cent: the combination of Air France and KLM Royal Dutch Airlines, the first international airline merger, has been successful since its start in May 2004. The time seems ripe for an insider's view of how the merger fared so well. Via this retrospective, we can perhaps help others to avoid falling into the traps and dead ends that befall so many other companies seeking a triumphant union.

We have – with a background in corporate strategy and business development at KLM (reporting to the CEO) – worked intensively on the strategy and merger implementation for seven years. Around the start of the new millennium, we concluded at KLM that partnering with one of the top three European network carriers (British Airways, Lufthansa or Air France) was inevitable. This was the result of the vision that globally there would be, over time, only room for three major alliances, each centred in Europe around one of the top three. This was a crucial strategic insight, considering how Sabena (bankruptcy), Swissair (same), and Alitalia (losing two million euros a day) have fared meanwhile. After 9/11, it prompted us to adopt a two-tiered strategy: improving our stand-alone position and finding a major European partner. This strategy has created value for our shareholders – who have seen the value of their stocks more than triple in five years – our customers and employees. The hardest part of implementing this strategy was of course in the merger process.

In our view, five major factors contributed to the success of the merger:

Jointly develop an explicit vision, ambition and strategy Having a common vision of the industry and the challenges it faces is important. First, it makes explaining the rationale of the deal to stakeholders on both sides easier. In addition, once the general direction is clear and shared, it facilitates discussions on further implementation. In our discussions with Air France, we soon found we had a similar vision on both the consolidation in the airline industry and on the best merger model to be adopted (using one group with a common bottom line, and two airlines each with their own hub and brand).

Once merged, the overall vision and strategy, of course, need to be further updated. The key points here are that managers from both parties have sufficient input and that the process is truly run as a joint process. This is the only way to gain widespread commitment for execution, and it allows intrinsic knowledge and best practices from both sides to be taken into account.

To demonstrate, immediately after the merger, we decided to start developing a joint strategic five-year plan, which was discussed in a strategic seminar with the top 20 executives of both airlines. The manager in charge of, for example, KLM's engineering and maintenance (E&M) developed, together with his French counterpart, their part of the strategic plan. Upon completion, they discussed it with the newly created Strategic Management Committee (SMC), the executive body of Air France-KLM during the first three years. KLM's E&M manager shared with us that this process forced him and his French colleague to sit down together to discuss and write *explicitly* their view of the business and how they needed to manage to make the merger successful.

The strategic seminar concept was such a success that it is repeated annually. Making the vision, ambition and strategy explicit is important in any organization, but it is even more so in a cross-border merger that allows more room for ambiguity and confusion.

Integrate only where a clear business rationale exists and consider a step-wise approach Excessive focus on organization destroys many mergers. While top management is busy drawing the new org chart, people in both organizations worry about their own position, delay decisions, fret and gossip – and are distracted from serving customers well and running the day-to-day business efficiently. When the new chart becomes known (or when rumours run rampant), people dissatisfied with their new position start to leave. Focusing too much on organizational issues can easily paralyze an organization and put the whole merger process at risk. There is a better way.

It is said that organization must follow strategy. In M&A cases, this means organization must follow synergies, the strategic rationale of any merger. As organizational change has inherent risk not only regarding people but also in terms of broken processes, it should only be pursued if there is a clear business case. Depending on the merger, in many business areas a large part of the synergies can also be captured without integration – especially purchasing and revenue synergies. At Air France-KLM, we have always kept a focus on synergies much more than on organizational structures. At the start, we installed 14 committees (one for every business area), headed by the two respective managers of Air France and KLM responsible for synergy implementation and reporting to the SMC.

As you might expect, in some areas, integration is required to encourage optimal synergy realization. One example: we decided to integrate the cargo commercial organization. Given the nature of this area (with a small number of large customers, less importance of brand and less dependence on a particular hub to fly from), the benefits clearly outweighed the risks. A step-wise approach, first integrating some areas and steering other areas in a more coordinated way, has many benefits. For →

→ example, we have used the lessons learned in bringing the cargo commercial areas together when integrating other areas at a later stage. Apart from learning, this step-wise approach allows benchmarking, understanding and aligning business processes, overcoming cultural differences over time, building trust – and all this without excessive distraction over organizational issues.

Please note that we are not saying that fast integration is never the way to go. If the synergies are predominantly based on efficiency gains (such as a result of full-time employees reduction), one must integrate with haste. But, in that case, there is a clear business rationale. Top management should always carefully consider where the rationale for integration lies. In those areas where immediate integration is not necessary for most synergies to be realized, a more step-by-step approach should be considered while making clear to all involved what process is being followed (so as to not seem capricious or too hasty). A promise of no involuntary job losses for several years, as we have done, can also help in smoothing integration.

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Adopt a targeted approach to create trust, respect and working together Both the joint explicit strategy process and the integration philosophy we used helped to create trust and respect, probably the main drivers for merger success. Besides encouraging shared trust in purpose (for example, the united vision and merger rationale), we also tried to boost trust in process (for example, the strategy process and the integration process). Obviously, having trust in people is crucial in creating their trust in the process and the executives managing that process. Thus, trust must start from the top. If the CEOs and their top teams don't trust and respect each other, there is little hope that the people below will. The top team must create and promote an atmosphere of working together. And they must be very consistent in their messages and keep their promises; unkept promises from either side are the best recipe to destroy trust.

In every merger, there will always be many differences between the parties involved. You don't reconcile these by imposing new ways on both sides; instead, give people an understanding of each other and tools to work together. This brings to mind the story of the KLM manager who requested that the SMC adopt a rule saying that all emails in the group had to be answered within 24 hours. This was not a simple request. In KLM, email is widely used and people expect emails to be answered quickly. In Air France the situation is different: if you need something, you call someone's cell phone. Wisely, the rule was not adopted; instead, the colleagues of the manager who made the proposal gave him practical tips on how to work together so as to encourage good feelings (and efficiency) on both sides: by sending an email and then giving a call, or sending an email to the person's secretary requesting her to print the mail and deliver it to her boss. In an M&A situation, it's far better to bridge differences instead of imposing new ways of working.

To give people the skills and means to bridge their differences, we developed an explicit programme consisting of five elements: *culture bridging sessions* (both seminars and team sessions), *people development* (training and selection), *incentive-setting* using group objectives, *monitoring of employee perception and satisfaction* and a *manager exchange programme.* This was supported by aligned communication and top management modelling the right example. The programme as a whole contributed significantly to the spirit of working together and the success of the combination. It served to excite people for the success of the entire group. One example: based on their experience, the managers in the exchange programme decided to produce a "working together manual". This booklet contained practical guidelines for managers of joint teams and their employees and is now widely used throughout the combination.

Create a joint team leading the combination in all aspects The stakes and risks of a merger process are of such magnitude that the process has to be managed from the top. The SMC, with Air France and KLM equally represented, met bi-weekly in Paris and Amsterdam, thus ensuring sufficient top-management attention, group spirit and commitment. But just an executive committee meeting every two weeks is not enough. There must be a dedicated team just below the top managing the merger process on a daily basis, preparing decisions that are fair to both companies, establishing a functioning liaison between the two organizations. Such a team is ideally composed of people from both groups, working with all managers and experts on both sides and with direct contact to the CEOs.

After the assessment and deal phase, our office was paired with Air France counterparts to form such a team. Participating in the SMC, we were charged with planning, initiating, monitoring and issue solving on all aspects of the combination: organizational matters; ways of working together; further development of joint ambition, vision, strategy and values; monitoring progress financially and in terms of employee and customer satisfaction; people aspects; and communications. Next to a direct link with the CEO, it is important that this multi-disciplinary team consists of people who are able to work with others across the organization and across cultures. From the start, we decided to see each other face-to-face at least once a week. Here again, the main success factors are trust and respect, setting an example for the rest of the organization. This means being open to each other by asking, explaining and calling each other several times a day on a multitude of issues. Sending only emails just won't do the job.

Adopt an explicit multi-stakeholder approach

Merger processes can only be successful and create sustainable value if the interests of all stakeholders are consistently taken into account (and not just the interests of shareholders). The lessons described above all contribute to this; but, if you are serious about multi-stakeholder value creation, you must go further and explicitly plan, execute and monitor it. Naturally, in all of the phases of a merger (from strategic assessment to negotiation to implementation), there must be frequent dialogue with all stakeholders. But a true multi-stakeholder approach means even more.

In the strategic assessment before agreeing to merge, the different options must be evaluated according to stakeholder benefits. A useful method of evaluation is a value tree, where the first branching represents the different stakeholders. Explicit assessment of, for example, the pros and cons for employees of a deal means not only a potentially better (and more feasible) merger but also makes explaining the deal far easier. Therefore, in the negotiation phase, the interests of all stakeholders must be stated and secured. In the case of Air France-KLM, for example, we negotiated guarantees on fair representation ("best person on the job"), fair growth for both hubs (important for employees and national governments) and keeping the KLM brand (important for employees, customers and governments).

In the implementation phase, monitoring all stakeholders is paramount. Monitors for tracking synergies, employee satisfaction, and customer perception are all critical management tools. This way, issues can objectively be identified and dealt with as soon as possible. Consider: half a year after the integration of the cargo business – led by a KLM manager – satisfaction among Air France employees started to decline. This resulted from changes in the way of working, in which French workers began feeling they had to do things "the Dutch way". Moreover, the use of English as the working language complicated matters. A task force of top cargo managers immediately started tackling such issues, among others, through many sessions. They listened to these concerns and *jointly* solved the different problems – also by offering more language courses to facilitate communications. Morale recovered rapidly.

Working together is critical in any business, and even more so in a merger. By adopting a joint, consistent and explicit approach geared toward sustainable multi-stakeholder value creation, the Air France-KLM combination has been very successful. Flying higher can only be done together. ■

Resources

Scott Moeller and Chris Brady, *Intelligent M&A: Navigating the Mergers and Acquisitions Minefield,* John Wiley & Sons, 2007.

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