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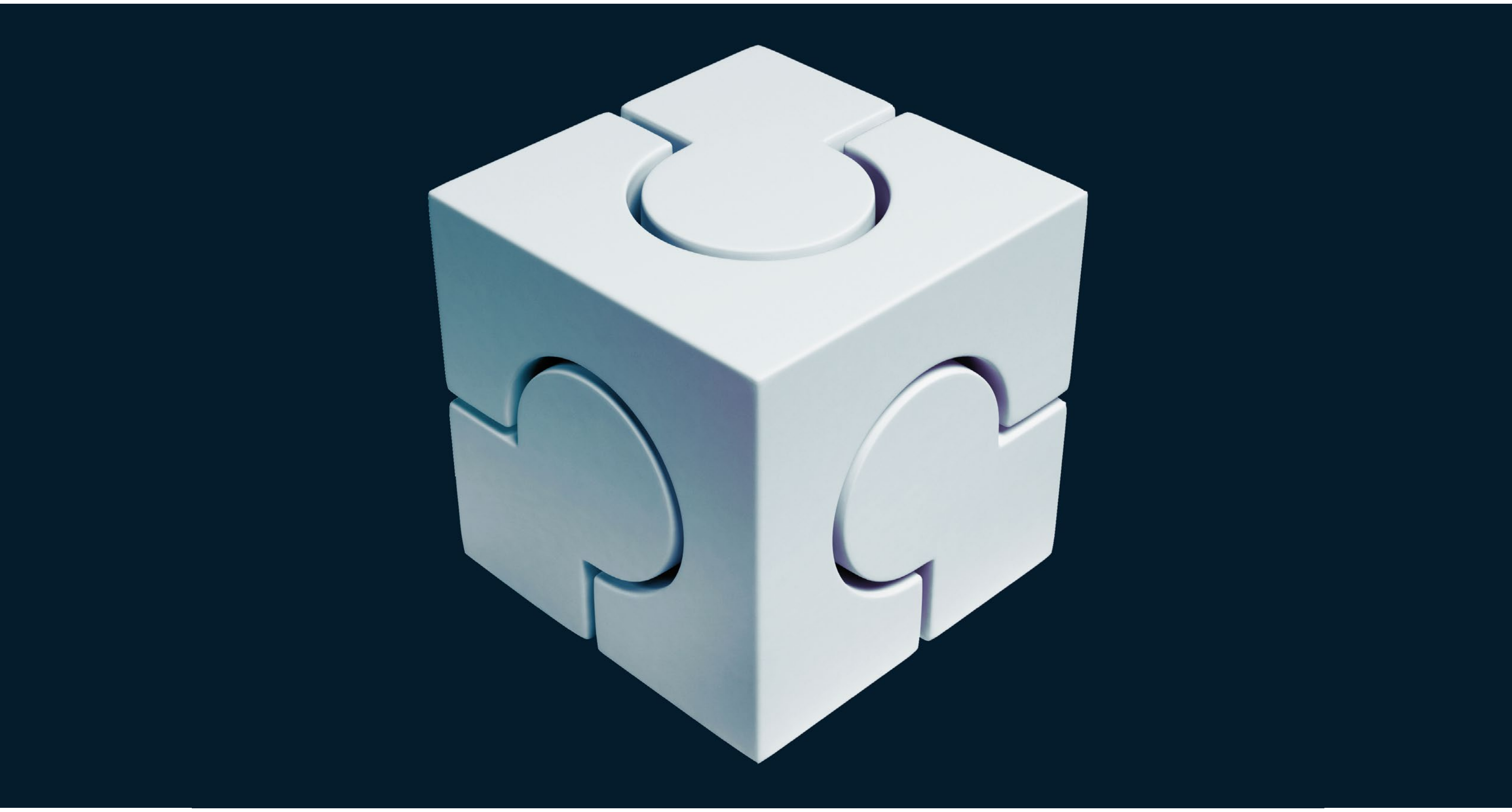
Organization Practice

# Realizing the value of your merger with the right operating model

Substantial changes to an operating model are often necessary to achieve an organization's strategic objectives and deliver the promised value of a merger. Making these changes requires a thoughtful, leader-driven process to navigate the unique constraints and risks of the endeavor.

*by Caitlin Hewes, Rebecca Kaetzler, Kameron Kordestani, and Olivier Rigaud*





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**A merger provides** an exceptional moment for executives to reflect on the performance of a company's operating model—the organization of structures, processes, and people in service of value creation. Substantial changes to an operating model are often necessary to achieve the strategic objectives and deliver the promised value of a merger. Making these important changes is not something that top teams can or should delegate.

Mergers have a bias for speed, leading to the temptation to cut corners during operating model redesign. For example, top teams might focus on structure with the hope that future leaders will attend to processes and people. In our experience, this is generally a mistake and can lead to serious change management challenges during the transition process.

Conducting an operating model redesign during a merger also presents some unique constraints and risks:

— Success depends on building a new executive-leadership team that aligns on a vision, agrees on the path to get there, and commits to modeling the new company's ways of working.

— Heightened anxiety and jockeying for position in the executive ranks increases the pressure for a CEO to get the top-team selection and alignment right.

— Transitioning from two existing operating models to a new, combined operating model requires thoughtful transition planning and increased attention to change management—underdeveloped skills in most organizations.

— Despite pressure to deliver value quickly, teams often need to use an interim operating model for some time after a deal closes before transitioning to an end-state model—and the interim model needs to be functional enough to start delivering on deal rationale.

— Workforces are typically anxious during a redesign, and a desire for information and clarity may decrease productivity during the process.

— Regulatory and legal considerations restrict what organizations can do, design, communicate, and implement.

This article looks at the approach to designing operating models during mergers, including how to think about an overall operating model for a new company, the process to design and implement it, and key factors for success.

## Defining the operating model

An operating model has three elements: structure, process, and people (Exhibit 1). Our research confirms what most leaders intuitively know—many companies tend to focus on one subset of structure: organization structure, or "boxes and lines."[1] It also confirms that this tendency is exactly what leaders should avoid. Addressing a holistic set of design levers across all three elements is essential to getting operating model design right and capturing the value promised to investors and employees.

### Structure

A broad understanding of structure ensures that a new, postmerger organization is clear on not only who reports to whom but also primary value-creation streams, governance structures (how decisions will be made), scope of important roles, how functions will support business lines, and where the company will conduct business.[2]

### Process

Companies are living organisms and often organically develop unique ways to get things done—methods that may not be appropriate for a

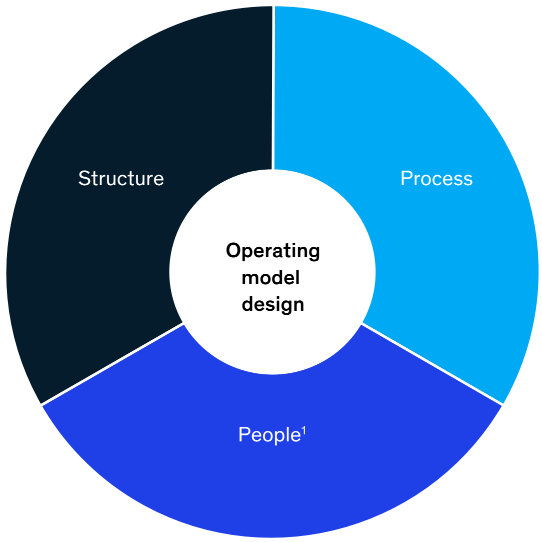
[1] McKinsey Organizational Redesign Survey, 2015.
[2] For more on effective decision making, see Aaron De Smet, Gregor Jost, and Leigh Weiss, "Three keys to faster, better decisions," *McKinsey Quarterly*, May 2019, McKinsey.com; Iskandar Aminov, Aaron De Smet, and Dan Lovallo, "Good decisions don't have to be slow ones," *McKinsey Quarterly*, May 2019, McKinsey.com; and Aaron De Smet, Gregor Jost, and Leigh Weiss, "Want a better decision? Plan a better meeting," *McKinsey Quarterly*, May 2019, McKinsey.com.

Exhibit 1

**Defining an operating model requires more than 'boxes and lines'—defining the governance, processes, and key talent considerations will be critical.**

(xx) Focus area during integration

- **'Boxes and lines'** (primary and secondary axes of organization structure)
- **Roles and responsibilities** (profit-and-loss ownership and role of corporate center)
- **Governance** (decision rights and committee structure)
- **Boundaries and location** (headquarters location and footprint)




- **Process design** (cross-cutting design)
- **Linkages** (formal mechanisms to link across functions)
- **Performance management** (metrics and targets measuring performance)
- **Systems and technology** (end-state architecture)

- **Workforce size** (synergies)
- **Talent and skills** (retaining and selecting talent)
- **Culture** (working norms and value-management practices)
- **Informal networks** (key influencers supporting change management)

[1] Dedicated talent and culture streams usually cover an operating model's "people" element.
Source: McKinsey analysis

new, postmerger company. As any operator will remind us, processes are the way work gets done in an organization. Clear, robust processes will be essential in a new company delivering distinctive value. Yet despite the criticality of process design, we often see this step start too late in the planning process, likely because of understandable apprehension around individual roles (and boxes and lines). Leaders we work with often wish they had begun designing core cross-functional processes well before the close of a merger. As one executive reflected, "Until you design how the processes will work, you don't really know how the company will operate with the new org structure."

### People

The dimensions of people and culture are of utmost importance when building a combined organization. We recommend managing them through dedicated workstreams for culture and talent, working in close collaboration with the workstream for operating model design.[3]

## Designing the operating model for the new company

In most successful integrations, the C-suite plays a heavy role early in the design of the top-level organization structure and governance for the new

[3] For more on culture in mergers, see Oliver Engert, Becky Kaetzler, Kameron Kordestani, and Andy MacLean, "Organizational culture in mergers: Addressing the unseen forces," March 2019, McKinsey.com.

organization. Once there is a defined blueprint for the operating model, integration teams take on the heavy task of creating the more detailed end-state designs for each organizational unit and the core cross-functional processes. Given the pace at which integrations move, full implementation of the end-state design is unlikely to occur on day one (deal close).

Unlike classical organization design, in which a company moves directly from the current state to the end state, organization design during a merger is unique because it often requires interim steps that can be different in various parts of the organization. Depending on what issues the integration encounters, this usually means leadership must work quickly to align on not only an end-state model for the new company but at least one interim model. Each of the steps in this process have specific elements that require attention to achieve success (Exhibit 2).

**Step one: Align on design principles and establish the baseline**

When designing an operating model, in any context, we believe that clearly establishing the expected deliverable is critical. An operating model design is one of the most powerful tools in a leader's tool kit to shape a new company that will produce the promised value. Leaders should align on a clear set of design principles that will shape the objectives, outcomes, and guardrails for the end-state design (see sidebar "What are design principles?"). This will help integration teams design the new operating model for an outcome, and not just "design to design."

The combined company's CEO should lead the development of the operating model's design principles in line with the combined company's strategic objectives. The principles—and development methods for them—can vary, depending on capacity and context. For example, in an integration with a much smaller entity, a new company's CEO may choose to add just one or two principles to the acquiring company's existing operating model. This will allow the integration team to preserve value and move as efficiently as possible, with minimal disruption to the broader organization. In an acquisition of a company for unique capabilities or talent (such as in R&D), the acquiring organization's leaders may choose principles to ring-fence and nurture that important organizational unit.

## What are design principles?

**Design principles are:**

— enterprise-wide rules that define the future-state design in line with an organization's ambitions

— commitments to enable employees to make complex decisions and to increase accountability

— guardrails for what is part of design scope and what is not

— specific, measurable (both quantitative and qualitative), actionable, relevant, and time-bound expectations

— aspirations for structural points (such as spans and layers) and ways of doing the work

— the rationale behind an initiative's worthiness

**Design principles are not:**

— dollar-value goals for the organization

— prescriptive requirements for all future organizational choices

— a one-time exercise with unchanging output

— a "final answer"

— specific initiatives

Exhibit 2

## Several deliverables are critical to consider in the approach to operating model design.

**Overview of key deliverables**

| | **Build baseline and align priorities** | **Develop preliminary end-state design** | **Design day-1/interim models and plans** (Day 1) | **Integrate, stabilize, and transform** |
|---|---|---|---|---|
| **Central team (in integration-management office)** | • Organization-design principles in line with deal rationale and strategy | • Operating model options for key decision points, with inspiration from companies within and outside industry<br>• Draft end-state operating model, including level-1 and -2 structures, top-level governance, and select cross-functional processes | • Day-1/interim operating models that define key cross-functional processes<br>• Consolidated plan for transition from day 1 to end state<br>• Change management plan for key operating model changes | • Final end-state model<br>• Governance/monitoring approach to support transition |
| **Integration teams** | • Operating model baseline of each company | • Draft end-state operating model for team's scope (in coordination with respective leadership) | • Day-1/interim operating models for team's scope<br>• Plan for transition from day 1 to end state<br>• Change management plan<br>• End-state operating model with more details | • Final end-state model for team's scope |

Source: McKinsey analysis

In an integration of two large companies with a focus on full-scale transformation, the new company's leaders may choose principles to double down on centralization and scaling of efficiencies.

While leaders are deciding on design principles, the integration team should build the baseline understanding of each company's current operating model and distinctiveness to understand where the organizations are coming from. For example, take two engineering organizations that look the same on the surface, with the same number of full-time equivalents, locations in the same region, and similar products for similar markets. One organization uses rigorous, highly documented, stage-gated product-development processes, and the other operates in an agile model with a fail-fast methodology. Obtaining accurate and complete baselines of each organization across all operating model elements would allow the companies to uncover these types of differences.

Given the speed at which mergers move, leaders should be prepared to make decisions with less-than-complete information, relying as necessary on the deal analysis and due diligence to fill in informational gaps. The baselining work can extend into step two of the process described earlier, but alignment on the top-level structure is essential to proceeding to step two. By the time teams are ready to move to step two, they should have a concrete understanding of what each company brings to the merger, the balance of capabilities required to capture maximum value, and how the future company will fulfill the promise of the deal rationale.

### Step two: Develop the preliminary end-state design

After aligning on the design principles and understanding the current operating models, merging companies can transition to defining the end-state operating model. While all organization design levers have a role in shaping how a company creates value, because it shapes the main value streams of a business, no lever has more "architecting" influence than boxes and lines.

It is vital for leaders to be open to meaningful change. The new company will likely be an organization that neither organization's leaders have experienced. Therefore, relying only on what worked before or "how we do it in my organization" is unlikely to be helpful. Thus, it is important to lean on the design principles and a strong fact base to determine what is right for the new organization—that may mean maintaining structures and processes from the original organizations in some instances and developing new ones in other instances.

Consequently, leaders should pay special attention throughout to what is being communicated when, how, and to whom as companies need to manage communication with external stakeholders, from investors to suppliers to customers, to avoid business disruption.[4] As an organization navigates building and deploying a new design, it should recall that mergers affect nearly all employees in differing ways. People are understandably eager to digest the decisions that companies are making and how those decisions will affect them, particularly if head-count cuts are on the table. Mergers involve not only employees and structures within the company but also their broader networks and the value-creation ecosystem of which the company is a part.

In one recent merger, the CEO decided to make fundamental changes to the structure and processes to maximize the potential value to be captured. While this approach took more effort and created more changes for the organization, it went quickly and effectively, with a dedicated integration team and significant ownership from the top team. A design that the team members believed in allowed them to communicate it clearly and confidently, which helped employees understand why the company was transforming and get on board.

One key component of building such understanding is a cascaded change story.[5] A change story is a communication that cascades from the CEO to employees and speaks about a merger in a personalized way. It helps the organization achieve two objectives: one, understand the reasons for the merger, and two, demonstrate leader-led support for the change. The integration team in our example also developed a plan for working with suppliers and customers to help them understand the basics of the transition, prepare them for known issues, and assure them of service delivery and their importance to the organization.

**Organizational blueprint: Designing the level-one and -two structures.** Level-one and -two organizational structures will define how the organization will serve its customers and generate value. What will be the main value streams? Will they group by business unit, geography, product, or some other factor? How will functions and shared services serve the value streams?

A CEO should start by defining the top two levels of the end-state organization—and the roles that will characterize it—with a small, core team of top leaders. A level-one structure often describes the organization's main value-creating streams (for example, by business line, customer segment, or geography). A level-two structure often describes how functions will serve value-creation streams and designates the second dimension (for example, geography or product line) that will help organize the level-one structure further.

The methods of organization that leaders choose for level-one and -two structures frequently are highly correlated with the value-creation thesis. For example, one chemical-industry player looking to merge with a like-size competitor believed that the key to long-term success postmerger was opening the Asian market. The company's top team first spent a substantial amount of time considering whether to organize as global business units or geographical, multiproduct regions at level one. Then it considered whether to treat Asia as one market or break it into China, Northeast Asia, and the rest of Asia. This step involved a few critical

[4] For more on internal and external communication strategies in mergers, see Oliver Engert, Becky Kaetzler, Kameron Kordestani, and Anish Koshy, "Communications in mergers: The glue that holds everything together," January 2019, McKinsey.com.
[5] Oliver Engert, Becky Kaetzler, Kameron Kordestani, and Andy MacLean, "Organizational culture in mergers: Addressing the unseen forces," March 2019, McKinsey.com.

elements: establishing nonnegotiable features based on the agreed-upon design principles, reviewing external examples based on trends observed in other players within and outside the industry, and looking at both successes and main pain points of each merging organization. Through this process, the company established the foundational aspects for value creation to allow the integration team to develop the appropriate design.

**Detailed approach to structure design.** Functional- and business-unit-integration teams begin their detailed, end-state operating model design (spanning structure, governance, and processes) upon completion of the design for the top two structure levels.[6] They typically work with their level-one leaders[7] (once announced) in designing the full, end-state operating models for their functions or units. The high-level design principles communicated by the CEO and the operating model baselines and comparative analysis previously completed by the team guide their work. Detailed design usually extends into step three of the approach, depending on the timing required because full, detailed design of all organization levels is rarely complete until after day one.

With pressure from all sides to complete a design as quickly as possible, it is tempting simply to choose a model option from external examples and assume the new company can achieve the same success. This assumption is usually untrue given that the new company is unlikely to have the same processes, resources, culture, and other defining features as the external example did. We recommend taking examples from other companies under advisement when designing structure but making a thoughtful decision based on the new company's strategic objectives, deal rationale, and pain points.

During detailed design, an integration team should work with the top team to recommend the functional knowledge and expertise the company should preserve at the core, the functional knowledge and expertise the business units should own, and the centralized expertise and shared services a center should offer—and how these arrangements will work (for example, via charge-back or dedicated support). The details will evolve during the interim state, but the basic architecture should be part of the discussion when designing an end-state organization.

**Governance.** How leaders define the governance structure is one of the most critical contributions to accelerating the speed and quality of important decisions in an organization. Boxes and lines may establish the performance management of and hierarchical relationships among employees, but they do little to help an organization understand how decision making will happen. For example, the executive team should not make all decisions—some decision making should occur through a defined process or by individual roles. We recommend delegating decision-making responsibility as far into the organization as possible to maximize proximity to the work being done and thereby improve the speed and likelihood of making a high-quality decision. A top team should concern itself with defining the way that the organization will make its most important decisions (or "big-bet decisions"). The team should spend serious time in laying out the architecture of committees, decision rights, and even meeting agendas that will force the organization to apply a data-backed, high-velocity approach to decision making.

In thinking about the governance architecture of a company, it can be helpful to start by defining the appropriate level of centralization, given the desired organizational structure. Will the executive team centrally handle most of the big decisions or will individual operating units have more autonomy? Regardless of where a new company lands on that spectrum, it is helpful to lay out all major decisions and clearly define the decision rights—who decides, who participates, and who receives information. We also endorse laying out the decision-making roles of key committees. It is important to define charters for these committees early, otherwise organizations will find it difficult to make decisions at the pace

[6] "Top two levels" are the first and second levels under the CEO.
[7] "Level-one leaders" (sometimes referred to as "N-1 leaders") are those who report directly to the CEO.

required to stabilize a new organization and avoid a productivity dip. Furthermore, as designers are creating the governance structure, they should be careful to ensure that an organization's cultural priorities reinforce the governance rather than in conflict with it.[8]

Addressing governance and decision making should always happen early in the process. In the merger of two financial-services companies, integration teams experienced roadblocks because they did not have guidance on the process for making major enterprise decisions. Furthermore, there was no list of individuals with final decision rights. This made it challenging for integration teams to progress on detailed designs for process and governance for each function and business unit. Once a leadership-team member took the lead to design the governance model and get buy-in from fellow executives and the CEO, the integration teams were able to progress. The process of securing leadership-team approval for the enterprise-governance model raised several sensitive topics regarding the future viability of core product lines and geographies and how that affected the choice of leaders to include in the top team. By putting the issues on the table early and having the debates required to come to a good conclusion, the leadership team became more close knit and aligned, and that improved the productivity of other teams.

**Cross-functional processes.** In practice, realization of a new company's operating model occurs through its processes. A central team should select at least five to ten of the most important cross-functional processes to design early in order to achieve stability as quickly as possible. The integration team that "owns" a cross-functional process will typically be responsible for working across stakeholders to design the end-state process, which is subject to the approval of the CEO or integration steering committee. Upon achieving initial alignment, integration leadership should lead an exercise to "run the water through the pipes"—a simulation exercise to ensure that the new operating model really works and that interfaces and decision rights are clear and do not conflict.

Prioritized cross-functional processes should align with integration priorities and deliver on deal value. For example, two international engineering-services organizations wanted to combine their complementary end-to-end offerings on large projects to offer a new, unique value proposition. Proving they could win projects because of this joint offering was critical to the success of the merger. The leadership team prioritized defining a joint bidding process before day one. Directly after day one, it launched a task force to lead competitive biddings in which the new joint offering would be a differentiating factor.

**Step three: Design the day-one and interim-state models and plans**

As we have discussed, full implementation of a new operating model rarely occurs by day one. Organizational units move toward their end states at different paces. For example, functions like HR and finance often move to their end states more gradually because they need to retain excess capacity in the months after close to support the rest of the organization's transition (see sidebar "What about our enterprise resource planning?"). On the other hand, a sales force may transition to its end state on or immediately after day one to streamline customer points of contact. Why? A sales team in flux risks damaging the customer experience. Conversely, it is nearly impossible (and inadvisable) to align processes by day one. This is something that a day-one/interim model should plan to happen over time, as the new organization begins to cohere, to ensure that the primary value-creating levers do not break in service of speed and symmetry.

Given these varying transition speeds, a central team must develop a detailed, consolidated plan to reach the end-state operating model. It should include a day-one/interim structure, governance model, and transition plan that details the strategic decision making that is taking place across the organization.

[8] For more on organizational culture in mergers, see Oliver Engert, Becky Kaetzler, Kameron Kordestani, and Andy MacLean, "Organizational culture in mergers: Addressing the unseen forces," March 2019, McKinsey.com.

## What about our enterprise resource planning?

**The integration strategy** for enterprise resource planning (ERP) is usually a major input to the transition timeline—and affects the pace of capturing full deal value. For example, in a recent merger of two distribution companies, transitioning to the target company's ERP was central to the deal rationale. To accommodate the time required to transition without slowing value capture, the companies decided to use the following approach:

— integrating the parts of the organization that weren't ERP dependent (for example, higher-level managers and select support functions, such as legal), as early as possible

— consolidating select client-facing roles and creating "IT bridges" where necessary

— rolling out the new ERP by wave and rigorously limiting any system changes to those legally required or business critical

— transitioning business and support teams to the new model after each ERP-rollout wave

The transition phase can also provide a chance to continue testing the lower-level structures and the detailed process and governance design.

Clearly, then, change management planning is critical to the sustained success of an implementation to help employees learn how to operate after deal close and through transition. While change management often associates with making cultural transitions and blending workforces harmoniously—important considerations—the operational component is also crucial. Employees will face not only a new employer but also new hierarchies, role descriptions, and work processes.

Building a heat map of key operational changes and the employees most affected can help an integration team prioritize the areas of the businesses that require the most change management support. The heat map can help to assess the level of effort required to support an operational change by considering the degrees of difference between the new operating model and the legacy models, the number of people affected, and the impact to value capture if the change is not addressed. Remember, change management is not only about building emotional investment in the new company—it is about creating strong understanding and confidence within employees about their roles, expectations, and the new way of working.

One of the most powerful tools to pressure-test the impact of the proposed changes to the operating model is a scenario exercise (like running water through the pipes, the exercise discussed in step two). Conducting use-case sessions with teams ensures that all stakeholders know how to work in the new operating model, promoting a positive experience for key stakeholders in the period immediately following deal close. Typical outcomes from these sessions include detailed resolution plans for likely scenarios, pre- and post-close communications for internal and external stakeholders, and training plans to address awareness or capability gaps. Importantly, the workshops also facilitate alignment on roles, responsibilities, and interactions among functions for critical operational processes.

**Step four: Integrate, stabilize, and transform**
After day one, a company will continue the process of detailed organization design while beginning to move to the new operating model. This is often

an exercise even more complex than the typical reorganization because the two merging entities usually lack a shared current-state baseline and will be transitioning to the new company's design with a new set of colleagues. The largest, most complex mergers can take 18 months or longer to transition fully to an end-state operating model.

To monitor and manage progress, an organization design should embed a transition governance structure that distributes work to integrated teams but retains its role as the source of truth on progress. Although a central integration team plays a continued role in supporting transition coordination, we highly recommend establishing clear accountabilities and roles for managing the transition in business units and functions.

Additionally, it is important that a new company have defined key performance indicators to track progress so that owners of the change can understand their performances and react accordingly. Investing the time to ensure that each integration team feels accountable and responsible for fully executing their detailed integration plans builds investment in the new company, its design, and the capabilities to support it. These activities then move to business-as-usual processes and managers over time.

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Implementing a new operating model is a long journey, and day one is just the first step—and sometimes the most visible step. In our experience, key success factors include clarity on deal value; executive-leadership alignment and role modeling; implementation of interim operating models during finalization of the detailed, end-state model; definition of cross-cutting processes and decision rights beyond structure; and effective communications and change management support. With these tools you can ensure a more positive outcome not only for your integration but also for the future success of the combined company.

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