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Pipeline Construction Update

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Making Money While Merging

By Kevin Owyang

Faced with conflicting objectives, it is essential to blend traditional management doctrines with newer management techniques and concepts to provide a balanced solution. One effective method has been to use soft management concepts to drive hard-dollar results.

Senior managers of unregulated energy companies often find themselves with three conflicting objectives. They must build an organization that can quickly and dynamically adjust to the evolving marketplace, gain the support of a corporate parent accustomed to a more predictable, regulated marketplace, and manage through the uncertainty and turbulence presented by the consolidation of the energy industry as a whole. If executed poorly, the simultaneous pursuit of all objectives can limit the progress of any.

Traditional management doctrines, the foundation of General Motors' (GM) organizational structure earlier this century, were based on departmentalization and compartmentalization in order to promote command and control. Increasing global competition, however, required GM to move to a more team-based structure, most noticeable in its Saturn subsidiary. Today, the team-based structure is used extensively by corporations whose marketplace is constantly evolving (e.g., Intel, Microsoft and unregulated energy companies).

Energy deregulation brings the continuous change for which team-based structures are most appropriate. Teams succeed when they use the diverse capabilities of members from a variety of departments. The presumption is that each team member understands clearly not only his department but also others. In a long-standing company such as GM, functions have been ingrained within the culture; however at many unregulated energy companies,

Managing Mergers

How does a company still in its infancy survive during the acquisition of its parent? KN Services' unregulated energy marketing organization had ample opportunity to test that issue in the past year. It started 2½ years ago by completely restructuring the management. KN then acquired Interenergy and merged with MidCon Gas Services. This summer's transitions were merely the latest period of acquisition uncertainty.

The adaptability of the team-based structure can be successfully applied not only when being acquired, but also when making an acquisition. For example, the KN teams that managed the attempted integration with Sempra included former MidCon Corp. employees who came to KN as a result of the MidCon Corp. acquisition in 1998.

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Sempra Energy announced on Feb. 22, 1999, the purchase of KN Energy for $1.8 billion. The acquisition was canceled June 21, 1999. Just a few weeks later, KN Energy and Kinder Morgan signed an agreement and plan of merger to combine the two companies in an exchange of about 41.5 million shares of KN Energy stock in return for all outstanding shares of Kinder Morgan Inc. The combined entity will be known as Kinder Morgan Inc. They expect to close the transaction in the fourth quarter 1999.

The use of soft management concepts to drive hard-dollar results was considered by insiders as "challenging." Success and survival, especially in the most challenging times, were attributed to the use of the regional profit/loss team-based structures. They were also credited with holding power and control within the teams and thus minimizing feelings of loss of control.

such strong cultures do not exist. Senior managers of energy companies must be mindful of employees who are new to the industry. Typically, these companies are young and often consist of individuals from energy and nonenergy industries, so employees are unclear about one another's roles. Therefore, unregulated energy companies must ensure that employees understand the entire business if they hope to build an effective team-based solution.

Managing a company *during the acquisition process of its parent can be a lengthy, difficult and disruptive undertaking.*

Among sellers and purchasers of gas or power, the term "marketing" can mean sales, design, packaging, market research, advertising, customer service, promotions, trading, risk management or asset optimization. Often, a marketer in one company may fill a much different role and have different responsibilities than a marketer at a competitor. To resolve the confusion, one could redefine the supply-side terminology and departments in traditional manufacturing terms.

The use of traditional management nomenclature provides a simple platform that can be used to explain functions both to the corporate parent and to the individuals within the organization (Table 1). Comfort is found by corporate in assimilation of the business to well-understood manufacturing and selling functions, and by individuals in definition of expectations, goals and objectives.

ADDRESSING CHALLENGES

With basic functions departmentalized, cross-functional teams address more broad-ranging issues, specifically new product design and development, asset acquisition and divestiture, and process innovation (Table 2). On paper the program looks quite simple. In practice, however, maintaining stable teams of diverse individuals can be quite challenging. For example, if senior management has assembled a strong team of department heads by recruiting from a variety of energy and nonenergy companies, then those department heads have only one thing in common—past success in their specific area of expertise. But the characteristics of what makes one successful in one function is very different from what makes one successful in another. Consequently, individuals form different notions about the importance of certain characteristics based on their own success.

Often, these differences are expressed as a lack of appreciation for the value of other functions. The misunderstanding can become quite extreme. For example, I've heard traders refer to sales people as "people you can get for a dime-a-dozen who drive around in Buick Le Sabres with a set of golf clubs in the trunk." Similarly, I have heard sales people refer to traders as "money-hungry devils who are no different from ticket scalpers." To bridge this gap, both leaders and team members must have "emotional intelligence"—a collection of skills that allows people to work effectively in teams, says Daniel Goleman. Goleman defines emotional intelligence in "What Makes a Leader" in the Nov/Dec 1998 issue of the *Harvard Business Review* as a composite of self-awareness, self-regulation, motivation, empathy and social skill.

For example, a leading integrated energy company hired an experienced nonenergy executive to manage sales of natural gas and electricity (i.e., energy commodities). The company consisted of many subsidiaries that provided everything from energy commodities to energy audits and electronic metering. Each subsidiary operated fairly autonomously and had responsibility for its own sales and marketing. None of these companies, however, had a robust selling function.

Using soft management *concepts to drive hard-dollar returns does more than result in profitability. It results in the long term viability of a firm—even through the turbulent times of merger and acquisition.*

The new sales executive knew that integrating all the selling functions into one department would maximize efficiency and effectiveness. She also knew, however, that if she attempted to force her authority upon the subsidiaries, she would encounter strong resistance and ultimately fail.

As a result, she chose the following strategy. She got the subsidiaries to train her sales force in the various product offerings. During each sales call to a commodity customer, she would attempt to create a sales lead for the other subsidiaries. She knew over time that her sales expertise would bring results and that, as a consequence, she would become the de facto head of the integrated sales function for the entire company—all this without wasting time fighting her peers for control. In this way, she leveraged her emotional intelligence to efficiently achieve an objective that would benefit the whole team.

Inevitably, the competitive nature of executives will lead to friction among departments. Thus, it is important to emphasize the overriding goal: Senior management creates an environment of cross-functionality and teamwork in order to achieve objectives. This goal, however, creates two additional requirements: that senior management have strong team-building skills and that compensation be based upon this common goal.

Table 1. Departmental Roles And Objectives

DEPARTMENT	ROLE/OBJECTIVES
All	Senior management creates an environment of cross-functionality and teamwork in order to achieve objectives by groups: sales, product marketing, trading/risk management and operations.
Product Marketing	Target the most profitable market segments. Design, package and position products for delivery to market segments. (Products are bundles of energy commodity and energy-related services.)
Origination (Sales and Supply)	Increase market share in targeted market segments. Deliver products to the market through the most efficient channels. Manage customer service to maximize customer retention.
Trading/ Risk Management	Deliver energy commodity to customers. Engineer and manufacture energy commodity products. Extract optionality of, manage and optimize the commodity risk positions of the sales/marketing portfolio and the unregulated asset portfolio. Leverage our market knowledge to actively participate in the determination of unregulated asset development, acquisition and divestiture.
Asset Operations	Operate the physical plant safely and in environmental compliance. Maximize operational flexibility, minimize costs and maximize efficiency.

TEAM POWER

Some companies have created environments that contrast sharply with the traditional management tenets of command and control. While certain individuals have budget ownership, a number of their peers contribute to profitability. Ultimate control, however, is not held by an individual simply because he has budget ownership. Rather, control and power are held within the regional profit/loss teams. The teams then allocate responsibility to the most qualified individuals—that is, to the individuals who have used their emotional intelligence to gain the team's respect for their expertise.

Over time, recurring disagreements can destabilize the teams. To successfully balance and reset the teams, senior management must have a high emotional intelligence.

Because power and control are held within the teams, operational and short-term development projects can be handled without involving senior management. This allows senior managers to focus on broad-ranging and longer-term projects such as merger evaluation and integration projects.

LAYERING CHALLENGES

Managing a company during the acquisition process of its parent can be a lengthy, difficult and disruptive undertaking. The process starts with the initial round of due diligence. During this round, several potential acquirers meet with a small group of executives and have access to large amounts of proprietary information. Despite the strict confidentiality of these meetings, rumors spread regarding the names of potential acquirers. Rumors themselves can be disruptive to business because they cause employees to focus more on future job security and less on finding future business opportunities.

Once a suitable acquisition partner is found, the next step is to announce the merger. The actual close of the merger, however, may not occur until several months later. Although certain legal requirements prevent the two companies from acting as one, the acquirer needs to ensure that the acquired company does not engage in substantially different business practices. As a result, large expenditures of capital and the conclusion of other large transactions typically require the approval of the acquirer.

For managers and employees of the acquired company, this interim period, also known as the merger integration period, is particularly difficult. Day-to-day decisions that used to be made independently now require the approval of a future parent. As a result, fundamental tenets such as strategic focus and the underlying business plan become clearer to the future parent. Before long, they too are subject to the reaffirmation of the parent. This new and sometimes tedious approval process strains both employees and managers of the acquired company and, unless managed effectively, can create friction with the future parent before the merger is ever completed.

When people do not feel in control of their future, they become fearful and angry. They fear the uncertainty of their future employment and they become angry with the corporate executives that led them to be acquired. All in all, they grieve over the death of their company.

The response to these emotions can be very disruptive to business. The frustration of the approval process can result in apathetic managers. In some cases, managers passively wait for guidance from the future parent rather than actively pursue new initiatives. Decisions can get postponed. The lack of direction negatively affects employees. Some employees resign—sometimes to pursue better opportunities, sometimes merely to escape. Managers find themselves having to run the same business with fewer employees. Frustration and apathy mount. Morale can drop precipitously.

Table 2. Strategic Corporate Teams

TEAM	MEMBERS
Regional Profit/Loss	Trading/Risk Management Origination Product Marketing
Asset/Acquisition, Business Development	Asset Operations Product Marketing Trading/Risk Management
Product Innovation	Risk Management Product Marketing Origination
Process Innovation	Origination Trading Risk Management Asset Operations

Effective teams use the knowledge and understanding of their business to gain an emotional advantage and maintain profitability.

GAINING CONFIDENCE

In a team-based structure, senior management does not dictate actions to employees. Hence, employees make decisions traditionally reserved for senior managers, which directly benefits employee morale. The confidence and experience gained from high-level decision making easily translates into future employability within the industry, whether with the current company or another company. The autonomy instills a sense of ownership and pride in the company that translates into loyalty to the company. Taken together, the team-based structure makes employees more capable of dealing with an uncertain future.

Effective teams use the knowledge and understanding of their business to gain an emotional advantage and maintain profitability. To them, it is not just the acquirer that is in a position to decide whether to keep them employed. Effective teams understand that they, too, are in a position to decide whether or not they will stay with the acquirer. The senior management team then uses its emotional intelligence to determine when and how best to reiterate financial success to the acquirer without causing friction.

Using soft management concepts to drive hard-dollar returns does more than result in profitability. It results in the long term viability of a firm—even through the turbulent times of merger and acquisition. With the energy industry continuing the trend of consolidation, the application of these soft management concepts becomes ever more important to industry executives. ■

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