M&A Views

Deloitte M&A Views podcast: Importance of organizational culture in M&A

Greg: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions. I'm Greg Jarrett. Today, we'll discuss the importance of organizational culture in M&A. Today, we're joined by Ami Rich and Matt Usdin, both principals with Deloitte Consulting LLP. Ami, let's start by defining organizational culture. Just what is it, and how does it impact M&A?

Ami Rich: When we describe organizational culture, we're talking about the way work gets done within the organization, and that's the sum total of both visible and invisible actions, things like the organizational beliefs, things that are taken for granted, assumptions that are held close within this organization, as well as on the more visible side, the behaviors, what employees are doing, what are the processes and the incentives that reward action and inaction by employees. It's also a reflection of values, stated values that you might share within the organization and externally to your customers and market.

Each of those is reflected in a variety of different ways, from the stories that get told and retold within the organization, stories of success, stories of failure, the rituals and routines that go on, little things like how do we check in/out or what we value, what do leaders value, and then, finally, the processes and the systems that reward behaviors. This could be incentive schemes. This could be how we record time, but all of those things, including the network and informal networks, those are all a part of the culture, and they shape how the work gets done within the organization.

In M&A, this matters because you've got potentially two different companies coming together and are working in very different ways, and the stories that have shaped who they are and how they work together, are different, and they need to be honored as you think about how the companies can and should come together.

Greg: If I were to say there's a lot going on in today's deal environment, I'd be named the king of understatement. There's just so much happening right now. Can you point to a few instances of why organizational cultures should be prioritized when making a deal? Did Deloitte's 2020 Global Human Capital Trends Survey provide insights?

Ami Rich: Absolutely. One in three companies surveyed* identified that cultural integration issues are a primary cause of the failure to achieve the stated objective of a transaction, and we've seen 43% of deals being delayed, terminated even, or experiencing some kind of negative impact due to cultural issues. But more importantly than that, I think it's that you want to create a sense of belonging, and in Deloitte's recent Global Human Capital Trends report, it highlighted the importance of creating a sense of belonging. Seventy-nine percent of organizations who participated in the survey said that fostering a sense of belonging for the workforce is very important and will be important over the next 12 to 18 months. You can imagine that in a deal environment, that sense of belonging, especially when you're coming potentially from a different organization, is incredibly important if you care about retaining the talent that came with the deal.

Greg: Matt, it seems like there is a need for a chief officer of culture on both sides of any deal right now to figure out where they are. How does culture raise its head? How does it come to life in a deal?

Matt Usdin: Culture comes to life in every deal from the moment a deal's contemplated through the entirety of the deal life cycle through to completion of the integration and realization of deal value. And we see culture come to life in a couple of really important ways in the M&A environment. One is every company has a unique culture, and so there are gonna be similarities between the buyer and an acquired company. There are gonna be differences between the buyer and the acquired company, and leveraging similarities and bridging differences is really critical to getting success in a deal, and culture comes to life when those similarities and differences can be recognized, acknowledged, and managed.

The second thing that I would offer is that the primary cultural similarities and differences that really impact deals are those that impact the speeds of value. How quickly can an organization pull off the synergies that it expects? And the places where you see that come out in a really pronounced way are in decision making. How companies make decisions are often gonna be very different. Speed, the amount of people involved in decision making, the formality and hierarchy of the processes are often very different and are very noticeable very early in integration planning, and so decision making is one area that comes to life very quickly. And the second is collaboration and how folks work together, and you see this often when big companies buy smaller companies, and big companies show up with hundreds of people in their integration meetings, and small companies show up with three people, and the expectation is often very different, and that also comes to life throughout the deal life cycle in a very meaningful way.

Greg: It seems, Matt, that well before you even consider two companies, two organizations joining forces, they'd be looking closely at their cultures, and that would be a dominant predictor on just how things were going to turn out. Is there, indeed, a phase when active culture management is particularly important?

Matt Usdin: I think you hit it, Greg, that very early in the deal life cycle, it's really important to start getting an understanding of culture. If you go back 10 or 15 years, people gave that lip service, organizations gave that lip service, but they actually didn't start looking at culture till well into the integration planning phase of a deal. We're seeing more and more now many of our clients, both corporations, as well as private equity investors, starting to look at culture in the due diligence phase of a deal for a variety of reasons.

One is they've realized that deal value and the ability to get to target outcomes as quickly as possible is often contingent in part on culture, and so understanding the culture early in the diligence process has become important. And the second is for the data points that Ami has referenced earlier, that many deals are finding that they don't achieve the value that's expected because of culture. And so we're seeing organizations look at culture in a much more intensive way, as early in the deal life cycle as they can in order to appropriately factor in the time to get value, in valuation models, in deal models, and the like. But on the flip, there's no wrong time to look at culture, meaning that companies should be looking at culture throughout the entirety of the deal life cycle.

Greg: Ami, It's been determined that culture is pretty important, but at the highest level, at the C-suite, how do you approach culture in this environment?

Ami Rich: Well, I think one of the most important things that you need to do up front is decide whether and then how you integrate the cultures. Depending on the deal's rationale, why you decided to buy this company, it may be that you really want to protect and isolate certain elements of the culture. So, really defining that based on why you bought the company is probably the first thing that needs to be done.

Second, aligning on the values and the behaviors that matter most for successfully working together.

Third, I think about making sure you understand the starting point. So, what Matt was describing earlier, it's the similarities and the differences. We typically recommend a combination of both qualitative and quantitative assessments to make sure that you understand it. The quantitative would be some sort of culture diagnostic, like Deloitte's CulturePath Diagnostic, but those are supplemented with employee conversations or focus groups and then some leadership interviews. I like to say that the data that comes from a diagnostic, like CulturePath, is brought to life through the stories that are told by the employees and the leaders. That really helps you understand where you are versus where it is you wanna go and the behaviors that are gonna matter most.

And then the final step here is around culture activation, and that is defining the specific actions and behaviors that either need to be evolved or, honestly, stay the same and encouraged, do more of this, and then developing the plans to really implement that. To build on something Matt was saying before, culture doesn't change overnight. You're on an 18-month to two-year journey to really drive sustained culture change, but I would argue more broadly, companies need to be actively managing their culture and questioning whether the behaviors that matter today to help make the deal a success are the same behaviors that matter two years from now, and if not, again, look at evolving the culture then. It's an active idea that needs to be managed at all times.

Greg: Let me ask both of you this next question. I'll address it to you first, Matt. Now, have you seen a lot of clients successfully or unsuccessfully manage culture in a deal, and what'd it look like? What did they do right? What did they do wrong?

Matt Usdin: The first thing I would say to that is clients that do it well actually actively manage culture, just like they would any other work stream on a big integration program, meaning they treat culture like they would treat finance or IT or commercial or any of the other efforts they have going on with integration, which means they actually define what they're trying to do, they come up with a plan, and they monitor an execution of the plan and outcomes against that, and when companies do that, they do that well. When companies are ineffective in doing this, they primarily don't do anything, and they think that the culture will just naturally evolve to something that they like the outcome of, but we know from experience in seeing this with many of our clients, that clients that don't manage culture end up with something that they don't like. Companies that do this well actually actively manage culture, and companies that don't tend to think it'll happen by itself.

Ami Rich: I totally agree, Matt. I think about it as, especially in the early stages of the deal, we're talking about trust being borrowed before it's been earned, and so having these active conversations about how work has typically been done here and acknowledging those differences exist and then aligning and agreeing on how we want to work together at least helps everybody understand that the reason we might have come at it from a different way is rooted in the way we used to do it in the past, not an unwillingness to adapt to the future.

In terms of the ineffective clients, one of the things that I would add, Matt, is how often have we seen clients understand the culture, but then fail to do anything to try to evolve it? I call that admiring the problem, but doing nothing to advance it, and that's worse, honestly, Greg, than doing nothing at all, because when you decide to understand the existing state of the culture, when you do an assessment that involves employees and leaders, you're basically making a commitment that you want to actively manage that and do the right thing to care and feed. So, stopping short at the assessment stage and then doing nothing to try to drive or evolve the culture is a big misstep that, unfortunately, a few companies have made along the way.

Matt Usdin: And, Ami, I agree with that. I think one final thought on this is that the key when you see an organization actively manage this well is to make sure it's connected to business outcomes. If this feels like a culture exercise off to the side and not core to the business outcome that's trying to be achieved in an M&A deal, then it doesn't work, and so where we find the most successes is when it's actively managed and managed to business outcomes that matter.

Greg: Thank you, Matt, and thank you, Ami. We certainly know a lot about organizational culture now. Refer to Deloitte Global Human Capital Trends Survey 2020 for even more insights. This podcast contains general information only, and Deloitte is not by means of this publication rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This podcast is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this podcast. Until next time.