

Cultural issues in mergers and acquisitions



Companies today are combining in record numbers. Executives pursue mergers, acquisitions, and joint ventures as a means to create value by (1) acquiring technologies, products, and market access, (2) creating economies of scale, and (3) establishing global brand presence. There is an underlying belief that most markets can provide revenues to three large suppliers; when more than three exist the urge to merge is irresistible.

That said, the business world seems littered with integrated companies that have lost value for shareholders. The question that inevitably arises is: "What forces are powerful enough to counteract the value-creating energy of economies of scale or global market presence?" Culture has emerged as one of the dominant barriers to effective integrations. In one study, culture was found to be the cause of 30 percent of failed integrations.¹ Companies with different cultures find it difficult, if not often impossible, to make decisions quickly and correctly or to operate effectively.

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What is "culture"?

Culture consists of the long-standing, largely implicit shared values, beliefs, and assumptions that influence behavior, attitudes, and meaning in a company (or society).

This definition has several important implications:

Culture is implicit. People who share in a culture find their culture challenging to recognize. The most insightful cultural observers often are outsiders, because cultural givens are not implicit to them.

Culture influences how people behave and how people understand their own actions. As a result, culturally influenced beliefs and actions feel right to people, even while their implicit underpinnings make it difficult for those people to understand why they act the way they do or why other ways of acting might also be appropriate.

Culture is resilient. Its elements are long-standing, not a matter of fads. The resilience of culture is supported by culture being implicit. It is difficult for people to recognize their own culture and how it exerts an influence on them. The staying power of culture is that it feels right to people; new cultural values that are imposed on people seldom replace their underlying values and beliefs in the long run.

¹ Isaac Dixon, "Culture Management and Mergers and Acquisitions," Society for Human Resource Management case study, March 2005.

What does this mean for integrating two companies?

If people acted solely on the basis of rational calculations — the model of behavior preferred by economists — mergers would be effective — or not — based on the soundness of their economic underpinnings. But participants in mergers are human and driven both by their shared culture and individual personalities. Cultural influences have the potential to be broad and far reaching:

Culture affects	Resulting in
Decision-making style (for example: consensus contrasted with top-down)	<ul style="list-style-type: none">• Effective integration requires rapid decision-making.• Different decision-making styles can lead to slow decision-making, failure to make decisions, or failure to implement decisions.
Leadership style (for example: dictatorial or consultative, clear or diffuse)	<ul style="list-style-type: none">• A shift in leadership style can generate turnover among employees who object to the change. This is especially true for top talent, who are usually the most mobile employees.• Loss of top talent can quickly undermine value in an integration by draining intellectual capital and market contacts.
Ability to change (willingness to risk new things, compared with focus on maintaining current state and meeting current goals)	<ul style="list-style-type: none">• Unwillingness to implement new strategies.• Unwillingness to work through the inevitable difficulties in creating a new company.
How people work together (for example: based on formal structure and role definitions or based on informal relationships)	<ul style="list-style-type: none">• Merged companies will create interfaces between functions that come from each legacy company, or new functions that integrate people from both legacy companies. If the cultural assumptions of the legacy companies are inconsistent, then processes and handoffs may break down with each company's employees becoming frustrated by their colleagues' failure to understand or even recognize how work should be done.
Beliefs regarding personal "success" (for example: organizations that focus on individual "stars," or on teamwork, or where people rise through connections with senior practitioners)	<ul style="list-style-type: none">• Again, these differences can lead to breakdowns in getting work done. If people who believe they have to achieve goals as a team integrate with people whose notion of "success" emphasizes individual performance, the resulting situation is often characterized by personal dislike and lack of support for getting the job done.

How to harness culture to promote an effective integration

Culture usually is a soft concept; it is a set of implicit influences that people cannot account for completely or accurately. Premerger due diligence will ferret out things that are measurable, with an emphasis on financial data. Culture surveys and assessment tools can be used to measure culture, but these can be time consuming to complete, and the heat of deal-making usually precludes the luxury of an extended effort to assess soft variables. Even if a culture assessment is performed during due diligence, it is difficult to imagine a joint venture or merger being called off because due diligence revealed that the cultures of the two legacy companies were incompatible.

Given that culture will seldom stop a proposed transaction, it becomes the responsibility of the people managing the deal to stop culture from undermining their desired goals. The most widely used approach to managing the cultural issues is to define a set of desirable cultural attributes (a typical set being: customer-focused, innovative, entrepreneurial, decisive, team-oriented, respectful of others) and then to exhort employees to adopt these attributes in their daily behavior. Companies are replete with posters, screen savers, coffee mugs, and mouse pads that remind employees of desirable attributes. This method is not supported by many "success" stories. The attributes are usually generic and employees struggle to bridge the gap between broad principles that are easy to agree with and the specific, culture-driven ways that things get done in companies.

One of the inherent characteristics of postmerger integration is time pressure. Many tasks have to be completed quickly. Such an environment does not afford the time for a detailed cultural diagnosis or a long-term culture change project with dubious prospects of achieving desired goals. We suggest a more focused approach, based on identifying the high-risk points in the establishment of the integrated company and working with employees to reduce the ways in which culture magnifies these risks.

The major risks vary in every integration and need to be identified on a case-by-case basis, but a list of risks that will be encountered in most transactions can be provided as a starting point for specific analysis. These "standard integration risks" include:

- Establishing a shared approach to decision-making that achieves appropriate speed and decisiveness.
- Confirming that the most value-affecting interfaces (in the supply chain) between the two legacy companies work effectively.

- Establishing an internal brand — the value to the employee of being part of this newly integrated company expressed in a way that appeals to employees from both companies. This will vary strongly depending on whether the integration is a "merger of equals" or a joint venture on one hand, or the integration of one company into another. In an unequal situation, the acquirer's culture and brand should be expected to dominate and should be presented to acquired employees in a way they will value. This is especially true when the acquiring company in a hostile takeover wants to retain acquired employees. In a merger of equals, the most realistic approach is to look to the emergence of a new culture.
- Understanding the compensation programs in each legacy company and presenting any steps to integrate them in a way that employees see as beneficial to their interests.

Mixing the cultures: HP acquires Compaq

Two hallmarks of HP's absorption of Compaq were a strong focus on business issues and an equally strong focus on providing an interactive forum for employees using the Web. Interestingly, the extended proxy fight that delayed closing the deal may have helped integration by allowing time for product roadmaps to be completed before the integration began. Thus an end-state was clearly in view when large numbers of employees started to work toward it.

The integration effort began with a two-day leadership kickoff. Expectations and rules of engagement were set firmly from the top down. Short deadlines were established to achieve clearly defined synergy targets. This forced collaboration in the interest of achieving desired goals.

An employee portal was used to drive extensive communication and interaction, including feedback. On Day One alone, that portal received 50,000 hits from employees.

Addressing culture when two companies integrate

A rigorous program with clearly stated objectives should be put in place to address cultural integration. Too often, culture is presented as a woolly and soft topic. When that happens, executives tend to slight the issue. This can generally be avoided by linking the cultural program to measurable business results. There are several steps to doing this:

1. Make culture a major component of the change management work stream.

Often the main change management task during integration is providing "communications." This focus may minimize the importance of change management, when communication becomes reporting the decisions of others, belatedly, rather than driving actual decisions. If culture is recognized as a major challenge that the change management team is responsible for, then this team assumes an essential role in achieving integration goals. The change team needs resources whose numbers and caliber are consistent with enacting a critical role.

2. Identify who "owns" corporate culture and have them report to senior management.

Choose owners from both companies to the integration to allow for representation of all views, even in a takeover. These "owners" typically will be senior Human Resources or Organizational Development practitioners. This is also an appropriate task for outside assistance, given the value of external insights in identifying culture. To drive home the importance of the issue, culture should be on the agenda of regularly scheduled (monthly/biweekly) Steering Committee meetings.

3. Insist that the cultural work focuses on the tangible and the measurable.

The Steering Committee should reject soft, vague, and poorly defined presentations of culture. Instead, culture owners should be required to discuss issues that are specific, well defined, and supported by specific examples that can be tied to business results. This is the difference between culture being addressed by general exhortations to enact "teamwork" and being addressed by analysis and interventions to increase measurable collaboration among the members of, for example, the new company's merged sales force. If the culture program focuses on whether members of the sales force are effective in selling the products of each other's companies and removing the barriers to doing so, that will be a more substantial contribution than a culture effort that creates communications to inform the sales force about the desirability of teamwork.



4. Consider the strengths of both existing cultures, not just the weaknesses.

When two companies merge, the assumption is often made that they should take the "best" of each company's culture and integrate them, much like creating a "Best Of" CD from a band's previous recordings. Would that mixing cultures were as simple as sequencing tracks on a mix CD! Corporate strengths are sometimes incompatible. Solid, more mature companies often acquire start-ups as a means of adding products to their portfolio. What they often find is that the structural controls and well defined processes that are a hallmark of predictable performance for the acquirer may be impossible to mix with the less structured ways of the start-up. A more varied integration than a simple addition of desired qualities is required.

One means to help achieve this is to retain separate core capabilities where possible. For example, in the HP-Compaq merger, the merged company kept HP's strong Printer Division with minimal change, but integrated its sales force along the Compaq model, which was judged to have been more effective. Each legacy company's culture was allowed to dominate on a by-function basis. Where the cultures are different, there should be an assessment of whether the elements can be integrated. When the integration is problematic, choices to act should focus on the relationship between cultural assumptions and business results. Only address those cultural issues that are critical to the business. Make an explicit connection between both business and personal achievements and any changes in (cultural) assumptions that people are asked to adopt.

5. Implement a decision-making process that is not hampered by cultural differences.

Decision-making style is often deeply ingrained in a company's culture. However, few things have a greater impact on integration results than the ability to make speedy decisions. Customer and employee loyalty can erode quickly if a company is perceived as unable to reach decisions. Leaders of integrating companies find themselves thrust into a situation where they have to make decisions quickly. While varying decision-making styles may hamper this, the differences among decision-making styles are often less important than the difference among these styles and the decision-making style required for an effective integration. This is an urgent matter.

The leaders of the integration project must address this with the support of the culture team by:

- Identifying decision-makers for each area of the integration.
- Understanding the decision-making style of each company both in terms of what the style is and the assumptions, processes, and structures that support that style. Use this as a basis for assisting decision-makers in moving beyond their assumptions to a point where they can act effectively.
- Communicating expectations to those decision-makers, including the deadlines when decisions are required. The demand for speed can be used to force changes in how decisions are made. Specific techniques can be used to support this, such as encouraging 80/20 decision-making rather than complete certainty before a choice is made.

The three steps outlined above are a starting point for culture change in the critical area of decision-making.

In the integration of HP and Compaq, leadership had to address the tendency of engineers to base decisions on careful analysis of large bodies of data and the cultural assumption that a request for more data is a legitimate reason to delay a decision. Integration teams were introduced to the concept of "adopt and go" — a method of limiting analysis to currently available data and options. "Adopt and go" emphasizes action, not analysis. The term was heard frequently during the integration, describing the new decision-making approach that the integration teams had embraced.

6. Build the employee brand with a view toward how it will be understood by employees.

If retaining the employees is a goal of integration, then an effort must be made to secure their loyalty, just as customers' loyalty must be reinforced. When one company is acquiring another, then the emphasis should be on making the acquiring company's brand attractive, in terms of the career opportunities, rewards, and the sense of identity that it offers to acquired employees. When equals are merging, it is important to find a common point that will not be so novel as to appear alien to all employees. It should neither install one company as dominant nor fail to recognize that employees from the merging companies have different expectations. In the merger of Daaichi and Sankyo, the goal of the merger that employees were presented with initially was to become a mid-size company in the U.S. pharmaceuticals market. Employee surveys showed that this was not an effective rallying cry. An employee brand was built around "adding to the balance of life." That was reinforced by extensive communications, a campaign to identify and enroll key internal opinion leaders in the brand, and events that varied from providing "balanced" lunches to all employees on one day to massages at people's chairs on another day. This brand gained such momentum it was eventually featured in corporate advertisements.

7. Put people with culture change knowledge and experience on the teams that define the key interfaces in the new organizational model.

The organizational model defines how a merged entity will go to market and how it will integrate its back office functions. Where there are business-critical integration points (for example, sales force integration, hand-offs from R&D to manufacturing or from manufacturing to field support) and a short time available for integration, it is important to focus on the flow of work: how objects or information are passed from group to group or whether information is shared effectively. The interfaces should be designed, improved, or fixed so that they help create business value. If employees start to act in ways that lead to achieving desired goals, that can create trust and mutual respect among employees who have not worked together before. Underlying cultural beliefs should then tend to coalesce around effective and enjoyable shared behaviors. This reverses much typical thinking about culture change. Rather than trying to change the culture in the hope that behavior will follow, this approach advocates that one should change behavior and assume that culture will adjust accordingly.

One critical assumption underlying this approach is that new behaviors can help achieve employee and organizational goals and then over time "culture" will adjust to support desired, effective behaviors. If new behaviors that fail to achieve results are imposed on employees, those employees will likely cling to their old cultural beliefs all the more tenaciously.

In conclusion

Culture must be a focus in efforts to integrate companies, because when left to itself culture will often undermine value-creation. Efforts to address culture should be based on the recognition that culture is both powerful and implicit, that employees are unlikely to change their cultural beliefs in response to exhortations to adopt new cultural values, and that culture can be rigorously linked to behaviors that affect business value. The focus on business value, rather than on "soft stuff" is essential to positioning culture in a way that business leaders will agree to support it. By tying culture to value-creation and to identifying and changing specific behaviors when necessary, culture can become an effective tool for achieving postmerger integration objectives.

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