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Safeguarding M&A deal value
Managing culture clash

The culture-performance connection

Company culture can have a significant impact on company performance. Indeed, decades of research support a direct link between culture and indicators of financial and nonfinancial performance.[1] While the exact formula relating culture and performance has proved elusive, it is clear that companies should consider culture as one of the key levers they can pull to sustain and improve performance. By effectively understanding and shaping their culture, companies can drive business strategy and achieve their operational and financial objectives.

Performance is always a top-of-mind issue for executives; even more so during a merger and/or acquisition (M&A) because M&A transactions are subject to increased investor scrutiny. Moreover, M&A introduces an element of uncertainty and potential volatility into financial results, even for consistently profitable companies. As a result, there is an imperative for executives to carefully manage their company's culture throughout a transaction.

Failure to address culture during M&A deals can impact a company's performance in subtle ways. Delayed integration due to cultural inhibitors can lead to opportunity costs or breakup fees if the deal stagnates or gets called off. Productivity and innovation can decline if employees begin to question if the culture they "signed up for" will change. Employees of the acquired company may experience a sense of alienation when confronted with the perceived dominant culture of the buyer, leading to turnover. The departure of key talent with unique, high-value skill sets can erode profit margins as hiring managers scramble to fill gaps.

The bottom line is that culture is inextricably linked to performance, especially in an M&A context. The question is not if—but how—companies should manage culture to safeguard the value of an M&A deal.

Managing culture clash

While business leaders generally recognize the importance of assessing and managing culture during M&A, many apparently do not feel equipped to make culture-related strategic decisions. According to one study, 54 percent of leaders believe that neglecting to audit non-financial assets such as organizational culture increases the danger of making the wrong acquisition; however, only 27 percent of them made cultural compatibility a priority during due diligence.[2]

Yet, it doesn't have to be this way. By recognizing cultural differences and applying a structured, objective approach to work through the barriers created by misaligned cultures, merging entities may mitigate the risks of a culture clash on the way to a successful, value-generating integration.

Cultural issues may derail integration planning

A mismatch in the values and resulting behaviors that companies consider core to their existence can create challenges during integration planning and, possibly, deep-six integration efforts. Consider the case of an American company that decided to acquire one of its Japanese competitors. The integration process was expected to be fairly straightforward. Executives at the acquiring company were used to setting and achieving targets fluidly by making quick decisions and rapidly iterating on those decisions. Substantial, cyclical restructuring of large swathes of the workforce typically was part of the process.

Executives at the Japanese target had a very different approach to decision-making. They believed it was important to carefully build consensus to achieve buy-in and alignment across the organization. During integration planning, some key decisions sat on the table for more than a year while all stakeholders engaged in the discussion.

In addition, Japanese company executives' understanding of the employer-employee relationship differed. To them, a corporation existed first and foremost to employ people. Many employees expected to work at the company for their entire career, with an average tenure of over 25 years. Leaders believed that reductions in force were simply not an option.

Together, these cultural factors—the magnitude of which was not fully appreciated during due diligence—combined to prolong, complicate, and frustrate integration planning efforts. Ultimately, the failure to consider culture hindered the companies' ability to preserve the transaction's short- and long-term value.

Culture: A key to effective integration

A merger or acquisition is founded on an *investment thesis*—a definitive statement of how the deal will create value for the buyer. It's often backed by projected revenue synergies and cost savings to justify the deal to investors. Whether the goal is to consolidate power in an existing market or to enter a new line of business, the investment thesis becomes the backbone of the deal's integration strategy.

However, if the strategy does not culturally resonate with the people who are expected to make it a reality, integration may falter. Effective strategies often inspire employees to go above and beyond, forging emotional connections that motivate people to "go the extra mile" throughout the deal life cycle.

Emotional connections catalyze and sustain integration

While many leaders recognize the critical role that culture plays during post-deal integration, the actual mechanics of transforming culture are much less widely understood. However, emotions may hold the key. As Deloitte observed in a recent report: "Emotional connections are especially important for getting people to change their behaviors because habits are tough to break with reason alone ... Rational appeals, monetary incentives, and changes to the performance management system are certainly important. However, leaders should also inspire employees toward the social value they will create with this new strategy—how they can help solve new kinds of problems for people. When employees have purpose and an emotional stake in the company's success, they will typically push through a new strategy despite obstacles."[3]

In an M&A context, this likely means that it is more important than ever for leaders to make sure their integration strategy resonates emotionally with the employees who will bring it to life. This starts with storytelling. For a health plan, for example, it might mean framing the integration as an opportunity to improve the health and well-being of more members at lower cost. It is important to define a deal narrative that employees will want to support. Purely rational deal objectives like increasing efficiency to deliver greater returns to shareholders are unlikely to motivate and inspire, no matter how many times leaders trumpet them. A powerful deal narrative that draws on emotional connections can help to transform the natural emotional response to a merger announcement—a mixture of excitement and trepidation—into a commitment to a higher purpose.

Global deals: Unprecedented complexity and cultural variability

Today's cross-border deals present tough choices for leaders, even those who make culture a priority. In a review of complex global organizations, James Heskett observes, "In many cases, a 'one company' culture is very difficult, and may be uneconomic, to achieve. A common set of values may be the most that a global organization can hope to achieve. But the same value may be interpreted in different ways depending on local assumptions … what does it mean to managers on an everyday basis in similar jobs around the world? How do they interpret it in practice?"[4]

It can be difficult to manage cultural nuances in deals that span multiple countries or regions. During integration planning, deal teams should account for both companies' geographic and cultural variabilities, and use them to develop integration strategies to bridge any gaps. However, integrating company cultures is not the same as integrating business processes—it is not possible to simply select best practices and rationalize workflows. Organizational culture spans borders and functional boundaries, and is of profound importance to employees and leaders alike. Cultural integration should be handled with care, given the volume of simultaneous changes occurring during a deal. Leaders need to take into account both companies' distinct cultures and subcultures, which likely have developed organically over time, and select positive aspects from each to incorporate in the new company's culture.

When two companies merge, the most apparent cultural differences typically are at the corporate level, where shared beliefs about the company's mission, collective values, and work processes are common foundations of organizational culture. In the health plan example, the buyer might frame its mission as a commitment to be as efficient as possible to reduce costs for members; the target, meanwhile, might place a premium on innovation and integrated care to improve health outcomes for members. While both companies have a similar focus on the customer, they pull different cultural levers to achieve their goals of efficiency and innovation. Cultural variability also may be observed in regional and country-level nuances and norms. Commonly accepted beliefs about how business is conducted can play a major role in global mergers and acquisitions. Attitudes about the social impact of restructuring and how decisions should be made are among common cultural differences that can directly affect an integration team's ability to deliver on a deal's projected value.

Geographic boundaries are not the only hallmarks of cultural divides in modern organizations. Differences may also exist within organizational subcultures–functions, subsidiaries, and prior acquisitions. In a health plan example, one company may have an Information Technology (IT) function where the top priority is innovation while the other company's IT department is primarily focused on mitigating cybersecurity risks. Failure to recognize and manage influential subcultures can undermine integration efforts and, ultimately, the ability to achieve synergy targets.

Global deal's communication breakdown

As cross-border M&A becomes more common, business leaders will need to account for the cultural realities of where, why, and how the deal participants do business. A merger involving two American companies illustrates the challenges of managing culture in a global deal. Regional and country-level cultural nuances were not initially considered to be limiting factors in this deal, as both companies were headquartered in the United States. However, the target company had a significant workforce population in Germany, while the acquiring company did not. As integration work began, country-level differences in business norms and attitudes began to undermine the cultural integration of what appeared to be two American companies with similar interests. For example, some of the target's German employees felt that from the time the deal was announced the buyer's CEO had an overly bold leadership and communication style. The CEO quickly earned a reputation for being brash, which delegitimized his role in leading the integration process and hindered the two companies' ability to work together to realize deal value.

The CEO's style was just a symptom of a fundamental cultural issue: American and German workers tend to communicate and collaborate in different ways. Recognizing this, the deal team developed cultural interventions for both organizations' leaders and integration team members. By educating them about the differing work styles, cultural norms, and employee perceptions, the team was able to help the companies establish a foundation for cultural understanding and integration. This enabled everyone to work together more effectively and created a tangible financial impact by averting a prolonged integration process.

Cases like these show that failing to address culture early and often in an M&A transaction may have disastrous results, including jeopardizing leaders' ability to meet immediate commitments to the investment community when synergy targets are missed.

Managing cultural issues throughout the deal lifecycle

While almost all executives recognize the value of managing culture in M&A deals, it is not easy to turn that understanding into a viable and actionable integration approach. Part of the challenge is that some leaders do not address culture early enough in the deal lifecycle. Many of the most successful acquisitions will identify each company's core cultural strengths and acknowledge cultural differences early on – preferably as soon as the due diligence stage, given the deal constructs.

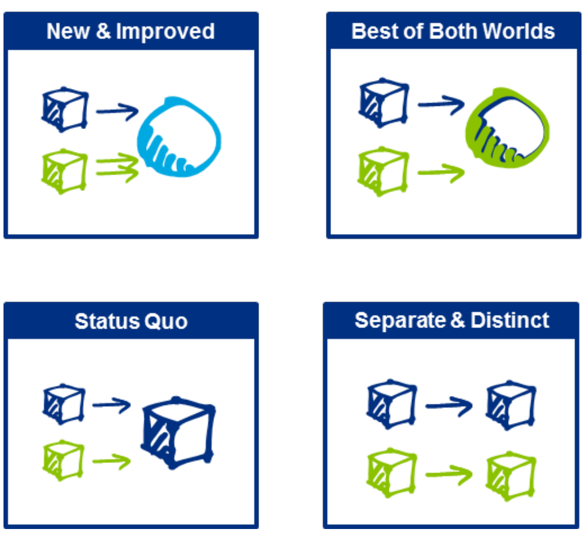
For culture change to be sustainable, issues must be managed throughout the deal's lifecycle, starting before the merger is announced, accelerating during the first 100 days of post-deal integration, and continuing even after the integration is well underway. This vigilant approach requires that the integration team develop a cultural integration strategy to enable the desired business outcomes based on the deal's investment thesis.

Pre-close preparation: Developing a cultural Integration strategy

A cultural integration strategy should align with leaders' future-state vision and support the deal's value proposition and targeted business objectives. Merging entities may choose to maintain separate and distinct cultures with little or no overlap; synthesize an entirely new culture; combine the existing cultures by incorporating the best aspects of both; or adopt the dominant, status quo culture (Figure 1). For instance, if a holding company acquires a smaller company with the goal of bolting it onto the existing portfolio of companies, it might make sense for the buyer and target to maintain and respect their distinct cultures. Conversely, if the deal rationale is to achieve economies of scale through consolidation, the preferred strategy may be to combine cultures or adopt the dominant culture to maximize operating synergies.

In some cases, companies may decide to conduct a culture assessment before selecting an integration strategy so that they better understand the cultural attributes of each company – what each values and believes and how each behaves. This assessment can provide early input into what the high-level cultural integration strategy may be. In the vast majority of cases, however, leaders typically select the strategy based on deal due diligence. Companies that delay selecting a cultural integration strategy and implementation plan risk undermining the potential long-term value of the deal.

Figure 1: Cultural integration options



First 100 days: Assessing cultural variability and opportunity areas

It is critical that cultural integration teams develop an objective understanding of the cultural variability that exists both *between* and *within* consolidating companies so that cultural interventions can be targeted when and where they will be most effective. Cultural assessments use qualitative activities, such as interviews and focus groups, and quantitative diagnostic tools to provide the information needed to understand and act on cultural variability.

Deploying a diagnostic tool such as Deloitte's CulturePath™ facilitates an objective assessment of the organizations' current state and helps define culture in tangible and measurable terms. A diagnostic tool analyzes core indices that are foundational to organizational culture and differentiating indices that can ultimately drive differentiated business performance.[5] In the first 100 days after deal close (or before close, if possible), it is important to identify where each company falls on the spectrum of core and differentiating indices to make the decisions needed to achieve business synergy targets.

The ability to leverage differentiating indices of culture can be a critical enabler of cost and revenue synergies, especially during the first 100 days. For example, an organization with a courageous, committed culture may face adversity more confidently, overcome resistance to aggressive synergy targets more easily, and be less reluctant to make tough decisions such as headcount reduction. An organization with an inclusive culture may be more open to accept all ideas, no matter how out-of-the-box, to identify potential synergies that could increase the overall deal value.

Cultural diagnostic tools like CulturePath™ help empower leaders by providing the cultural data points they need to identify unanticipated risk and opportunity areas. They also allow leaders to get to the heart of what is needed to make an M&A deal successful and lay a foundation for differentiated performance in the future.

Culture assessments are not solely for identifying risks or differences. They also may be used to identify the underlying strengths of the existing cultures so leaders can preserve, reinforce, and leverage them for competitive advantage.

Finally, diagnostics can be used to measure results and reassess cultural fit over time. Starting with a baseline at the beginning of a merger, diagnostics can be deployed in multiple iterations to understand if cultural reinforcement mechanisms are successfully bringing the two cultures into alignment. The results of the assessment should be used to develop short- and long-term integration action plans and prioritize the focus for ongoing cultural implementation.

Year one and beyond: Sustaining the new culture

Sustaining a changed or new company culture is not a one-time project that ends at Day 100; it requires ongoing action plan execution and reinforcement during year one and beyond. Based on the results of the cultural diagnostic assessment, the integration team should develop short- and long-term plans to drive alignment to the combined company's end-state vision. Effective culture plans typically include quick-win projects as well as long-term strategies that provide the infrastructure and processes to drive and sustain the desired behaviors. Similarly, effective culture plans are targeted. Tools like CulturePath™ allow leaders to identify which divergent groups should be focused on and which aligned groups can serve as role models. Like any major initiative, these culture plans require strong and visible executive sponsorship.

Implementing high-impact quick wins often signals that cultural integration is a business priority, helps address key issues quickly, and provides momentum for the transition. Efforts could include adopting revised cultural symbols such as logos, badges, and uniforms; redesigning the workspace; or migrating to a common e-mail format. Longer-term cultural interventions start with executive leadership and focus on systematic communications and actions to reinforce key behaviors of the desired culture. To illustrate this point, if a culture of courage is desired, leaders from both companies should consider modeling this behavior by demonstrating courage throughout the course of the deal. The degree to which leaders from the acquired company demonstrate courage and maintain focus on business as usual will go a long way towards calming target employees' nerves. Similarly, if the combined company does not perform financially as expected after deal close, how leaders respond may prove to be a watershed moment for the new company.

At the employee level, it is important to create goals, metrics, and performance management processes to incentivize desired behaviors that may help sustain the cultural change over time. Systemic reinforcements can be ingrained in the company's talent infrastructure, including hiring strategies, performance management system, training programs, and compensation and benefits schemes. For instance, if a culture of ownership and accountability is desired, then it is important to build these qualities into the competencies required for recognition and promotion. Consider, too, a company that is focused on promoting product cross-selling in the new entity's first quarter to signal strength to investors. A sales incentive plan can be structured to reward teams that collaborate to close deals, rather than reward individuals with commissions that could increase competition.

By embedding cultural reinforcements into enterprise-wide value events and processes, it is possible to influence a greater number of employees in a meaningful way and reinforce desired behaviors across countries, sites, and functions.

Use culture to take integration to the next level

Companies should skillfully manage the cultural aspects of global and regional M&A to meet immediate commitments to the investment community and build a sustainable foundation for the future. By addressing culture early in the deal lifecycle, consolidating companies have a greater chance of realizing the transaction's anticipated value.

Early alignment with the desired future-state cultural vision and integration strategy, and smooth translation of the vision into action plans can better enable companies to safeguard the short- and long-term value of their deals. The ultimate goal is for a new company to emerge from the integration process with a high-performing, sustainable culture with employees who are committed to growing and succeeding against the organization's strategic priorities. This is no easy task, especially in the context of a global deal. However, it is something that leaders should and need to do—and do well—to deliver on promised deal value.

End Notes

1. Sackmann SA, 2010. "Culture and performance." In: Ashkanasy N, Wilderon C and Peterson M (eds) Handbook of Organizational Culture and Climate. Thousand Oaks, CA: SAGE, 196.

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4. Heskett, James. The Culture Cycle: How to Shape the Unseen Force That Transforms Performance. Chapter 10. Upper Saddle River, NJ: FT Press, 2012

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