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Where Private Business Acquisitions Go Wrong

Part III: Effective Management of Cultural Mismatch

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In previous issues of IN$IGHT, we discussed why successful private business acquisitions need clear strategic rationale and thoughtful post-merger integration (PMI). In this final article of the series, we explain why cultural mismatch is a major reason for M&A failure and share some practical suggestions for addressing this problem.

WHAT IS CULTURE AND WHY DOES IT MATTER?

There are numerous definitions for organizational culture. For our purposes, we will define culture simply as "the way we do things around here." Culture is the set of deeply-rooted values and beliefs that shape the behavior and attitudes of employees.

Ironically, we have found that it is often difficult for companies to define their own culture and how it influences their behavior. Trusted outsiders are often the best observers of culture.

It is important to realize that culture is learned. While formal training can help, new employees typically learn about culture informally through stories, language, rituals, and shared behavior.

Culture is lasting. It can and does change, but usually very slowly. Therefore, blindly imposing new cultural values on an acquired company rarely replaces underlying values and beliefs.

Why does culture matter? Historically, competitive advantage, for the most part, was a function of better assets and refined strategy. However, globalization and easy access to information has undermined these factors. Capital to build assets is now readily available and competitors can quickly replicate a successful strategy. What cannot be easily replicated is a superior performance culture.

IMPACT OF CULTURAL MISMATCH ON M&A SUCCESS

Culture can have a broad and far-reaching influence on M&A success. According to a large survey of American CEOs and CFOs, culture is one of the top factors affecting a firm's value; 48% would walk away from a target that is culturally misaligned.[1]

Realization of M&A synergies can be complicated by some basic cultural differences between companies:

1. Attitudes Towards Hierarchy Effective integration requires rapid decision-making. However, differing decision-making styles can reduce decisiveness and slow implementation. This was one of the main reasons for the failure of the Daimler-Chrysler merger. Daimler was a hierarchical German company with a clear chain of command and respect for authority. Chrysler had an incompatible, team-oriented and egalitarian approach to decision-making.

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2. Beliefs Around Incentives Employees trained to achieve goals as a team cannot easily coexist with those who are used to being rewarded for personal successes. Interactions between competitive and collaborative employees can lead to friction and reduce overall productivity.

There is not necessarily a "good" or "bad" culture. However, the company's culture must be compatible with its business strategy.

3. Resistance To Change Employees in an acquired company might have a strong bias towards the pre-merger state and goals. However, M&A brings about the inevitable necessity of change and new strategies. The failed AOL-Time Warner merger has often been blamed on staid Time Warner employees who had no appetite for change.

4. Shared Values About Systems and Processes In some organizations, people work together based on formal role definitions and adherence to established processes. In others, it is all about informal relationships.We saw this stark contrast in a recent transaction involving two large beverage distributors. Employees who were used to following established processes became frustrated by their colleagues' "unstructured and cowboy-like" approach.

WHEN CULTURE IS INCOMPATIBLE WITH STRATEGY

There is not necessarily a "good" or "bad" culture. However, the company's culture must be compatible with its business strategy. The following examples show how certain cultures fit with different strategies.

- A business that earns its customers as a result of product innovation thrives when its employees have freedom to investigate new ideas and approaches and where teamwork is supported to bring forth the best ideas to their final form.
- A "hustle" business, which depends on many unique sales of a product, benefits from a compensation culture that rewards individual performers.
- A business that requires consistency and minimal quality deviation usually benefits from a bureaucratic culture of rules, processes, and quality assurance safeguards.

DON'T UNDERESTIMATE HUMAN PSYCHOLOGY

People have different psychological profiles that might make them more or less of a "fit" for different organizational cultures. For example, a manager who craves personal achievement, recognition, and rewards is perhaps not suited to lead a team of technical equals, all of whom must contribute to obtain an optimal result.

Many companies think ascertaining cultural fit is so important that they require employees, typically above certain levels, to take "personality tests" to get them into the right roles.

MANAGING CULTURAL MISMATCH

If not handled properly, cultural mismatch can get in the way of realizing M&A synergies. The following three tried-and-tested suggestions effectively manage this potential

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problem.

1. Conduct Rigorous Analysis Culture should be examined with the same rigor as financial and operational issues during due diligence. The acquirer can have a checklist describing key elements of its own culture and compare it against observations from management meetings with the target. Furthermore, off-the-record conversations with the target's customers, suppliers, and distributors can reveal important differences between internal and external perceptions of behavior and attitude. Finally, websites such as glassdoor.com allow current and former employees to anonymously review their companies and management; these contain a treasure trove of data for assessing cultural fit.

When incompatibilities get exposed, calling off the transaction is not necessarily the only option. Some cultural issues can be tackled during PMI and these interventions can actually be transformative for the combined entity.

2. Clearly Define Expectations Leaders should be very clear about the culture they want to see emerge from the combination of companies. An acquirer has two fundamental choices. It can impose a single culture, either the buyer's or the target's, which usually implies a degree of fall out. Alternatively, it can create a blend of cultures, which is difficult because it means the greatest amount of change. No matter what the choice, to make it stick, cultural expectations need to be made specific and actionable for employees at all levels.

3. Start Change at the Top Culture is immediately reflected in the behaviors and attitudes exhibited by the organization's leaders. Leaders need to realize that managing culture cannot be a one-time effort; this needs their ongoing reinforcement, sponsorship and attention. Like any major change initiative, they will need to constantly "walk the talk."

In summary, to achieve success with M&A, culture cannot be an afterthought. Instead, organizational culture should be an integral part of any M&A strategy. The late management guru Peter Drucker was spot-on when he reportedly said, "Culture eats strategy for breakfast." **zs**

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ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, go to **ZacharyScott.com.**

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