ZacharyScott

IN$IGHT
PERSPECTIVES ON THE CAPITAL MARKETS

REPRINT
FALL 2020

Assessing Cultural Fit In Acquisitions

Harmony between two organization cultures is not automatic.

by David Working

We have previously mentioned the importance of assessing cultural fit in the context of a business combination ("Where Private Business Acquisitions Go Wrong – Part II, IN$IGHT, Summer 2018). It is our experience that company culture plays a meaningful role in the newly combined entity achieving performance targets, yet culture is rarely assessed or measured in the due diligence process in the same manner as other critical yet more easily quantifiable characteristics. A company's culture—the set of values, beliefs, and behaviors that guide how things get done—is wide-ranging and touches every part of the business. For the scope of this discussion, rather than trying to define a "good" culture or how to develop one, our goal is to lay out a framework that considers a few key areas that are critical to predicting if two cultures will harmonize when the transaction is complete. In our experience, there are three key areas that stand out as the most common sources of disconnect: decision-making processes, communication style, and support of core values.

The most critical element of cultural alignment in the first twelve months post-acquisition is the collection of norms around how decisions are made in the company. Almost every employee thinks their organization's decision-making process is "normal," but our experience is that there are as many decision-making structures as there are organizations. For instance:

- Who makes final decisions? Does final approval lie with an individual, or with a group? If a group, what's the mechanism for resolution (formal vote, informal discussion and consensus)? Is the group making the decision explicitly defined? Is power formalized behind a role or title, or does an individual wield informal power through personality or interpersonal relationships? Does the organization have "stakeholders," individuals or groups that don't have responsibility over the final decision but are affected by the decision? Do stakeholders have an obligation or expectation to be part of the decision-making process?
- At what level are decisions made? Is the organization autocratic, where direction is decided at the top and disseminated to lower levels? Is the organization grassroots, where initiatives are envisioned or defined at lower levels and brought to leaders for approval? Are all major decisions approved by leaders or managers, or is there significant delegation and associated responsibility for key decisions? How material does a decision have to be before it requires higher-level approval?
- When are decisions made? Do they happen in formal settings (a recorded vote at a board meeting) or informal (a strategy session at a manager's house)? Is it always clear that a decision has been made – is the decision shared with a larger group?
- Is there clarity around the decision-making process? If everyone on a team were asked these questions, would they be able to answer? Would they come up with the same answers?
- Is there consistency around the decision-making process? Does it work the same way at all levels of the organization? Does it work the same way across all segments or business units?

The bottom line is that a single culture will survive in a combination of two businesses and it is important to see how far apart the cultures are and how much work will be required to bring them together.

These elements collectively have an impact on another important source of cultural disconnect – communication style. More than the content being communicated, communication style is the timing and format of how ideas or decisions are communicated within and between teams. Because of the nature of their work, expectations around work style, and personal preference, groups of people vary widely in how and what they communicate to each other. For instance:

- What's the preferred medium of daily communication? In-person meetings? Video chats? Conference calls? Emails? Slack/Teams? Text messages?
- Is there an expectation for response time? Immediate? Same day? Next workday? Same week?
- Are communications scheduled (put a time on the calendar) or not (swing by my office)?
- How often do colleagues communicate? Consistently through a workday with high degrees of collaboration? Check-ins hourly or several times a day? Once a week? Less frequently?
- How often do managers communicate with their direct reports? Is the communication style similar to that among teammates, or is it more formal?

The other major element to be considered in an acquisition is the degree to which a business supports its core values. Almost every business has a stated (and sometimes published) core set of values—a group of guiding goals or principles that align employee behavior at every level of an organization. But, often businesses state a goal without strategically supporting that goal. For example:

- Most service organizations aspire to a "customer-centric" core value. But, is customer satisfaction measured? How often? Are employees rewarded (or reprimanded) based on assessments of service quality? Does the budget provide for the staffing or training necessary to support high-quality service? Are employees allowed to make on-the-spot decisions in the best interest of the customer?
- Many businesses describe themselves as "innovative." How is innovation fostered in the company? How are employees rewarded for developing new ideas? Are employees reprimanded when promising ideas don't work out? Is there time set aside to work on new concepts and is that prioritized? How have previous innovations been integrated into the company's operations or products?
- How do employees at different levels respond to a list of the company's core values? Do they know them? Do they take them seriously? Are they at odds with the employees' day-to-day experience?

In the context of an acquisition, the

(continued p. 2)

intent is not to "grade" culture or to assess the necessary actions needed in order to change a company's culture (although those elements may be part of a merger thesis and could be a focus post-close). The primary end is to assess how easily the two organizations will be able to merge, which will come from commonality in their respective cultures. No matter how well two businesses combine on paper, employees at a company that expects 24/7 availability by email will struggle to be productive with a company that sets firm boundaries around "home" and "work" time. Similarly, project leaders at two organizations can be very experienced and capable—but if one is used to receiving a plan from their manager, and the other is used to generating the plan for review by their manager, those opposing expectations can be a source of frustration and lost productivity.

The primary assessment of culture in an acquisition process will first come from high-level management and can come from a simple interview guide or set of questions such as in this discussion. At some point, likely after an agreement on a letter of intent, a broader assessment of culture at multiple levels of an organization led by a third-party source will bring to light the way things commonly work. This work should be performed as part of a broader due diligence process alongside other workstreams to assess cultural fit before an acquisition is complete.

The bottom line is that a single culture will survive in a combination of two businesses and it is important to see how far apart the cultures are and how much work will be required to bring them together. **ZS**

ZacharyScott

1200 Fifth Avenue, Suite 1500
Seattle, Washington 98101
ZacharyScott.com

ABOUT ZACHARY SCOTT

Since 1991, Zachary Scott has assisted owners of privately-held businesses in the greater Pacific Northwest to plan and execute major business or ownership transitions by offering sell-side M&A and acquisition and investment advice. For more information on Zachary Scott, go to **ZacharyScott.com.**

Ben Adams
206.838.5526
badams@zacharyscott.com

Brian Bergsagel
206.838.5527
bbergsagel@zacharyscott.com

Frank Buhler
206.224.7383
fbuhler@zacharyscott.com

William Hanneman
206.224.7381
bhanneman@zacharyscott.com

Ray Rezab
206.224.7386
rrezab@zacharyscott.com

Jay Schembs
206.838.5524
jschembs@zacharyscott.com

David Working
206.224.7850
dworking@zacharyscott.com

Mark Working
206.224.7382
mworking@zacharyscott.com