Brief

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Using culture to merge faster and more successfully – and avoid the reasons why most M&A fail

Research shows most mergers do not deliver on promises – and culture is a key factor

M&A booms (and the merchant banking hoo-ha that goes with them) are normally associated with wider economic booms. Certainly, such activity all but dries up through early years of recessions. Towards the end there can be a wave of "defensive", "distress" or "best way out" mergers and acquisitions. Now, given ongoing unpredictability M&A activity has been picking-up although there is little sign of returning to pre-recession levels. The real focus of leadership teams now is quality of outcome above all else

There have been years of studies to show that between 50% and 80% of mergers fail to deliver the intended benefit. The most frequent problems identified are that cultural factors are not being addressed until too late, and when they are addressed, actions taken are not quick enough. This need not be the case.

There are four ways to improve cultural integration and so merge faster and more successfully. These are:

1. Focus on the market, customer and delivery, over cost-cutting
2. Plan the culture side of integration very early and act fast
3. The new culture should enable the business model - so clarity and understanding about how value will be created is an important early step
4. Understand and manage the different change dynamics of the two entities.

This article is a synthesis of a range of material including work by consultancies AT Kearney, Booz, Boston Consulting Group, Hay, McKinsey and Mercer.

Differences in organisation culture drive integration failure – and sacked CEOs

Surveys of leaders who had been through a merger found that differences of organisational culture were the most significant issue they faced. It also seems that 63% believe that notable differences in culture remain even after 'integration' is complete. All of this is dangerous for CEOs. The evidence is that 42% of CEOs leave a company within two years of a merger, when planned benefits are not delivered (compared to only 16% among successful mergers).

Routes to success – act fast, culture is being changed from the moment the merger is announced

The evidence suggests that organisation culture is not successfully addressed in mergers because it is seen as a long-term issue that will take a great deal of effort and not show benefits for years. Traditional teaching on culture has generally emphasised this deep, long-term aspect. This leads to two common failings, with increased risk and opportunities lost:

- ***a.*** Planning for cultural integration is left until after "more urgent" activities
- ***b.*** When plans are made, they are for medium and long-term outcomes, and pressure to implement loses out (in terms of attention) to more immediate, "tangible" areas such as cost.

The very action of a merger or acquisition influences culture. It has a destabilising effect and people expect change. Opportunities for cementing good and bad behaviours come thick and fast in the first few months.

To repeat an old story: when Napoleon was shown the plans for the Champs Elysée in Paris he asked the designer what certain marks meant. When the designer said “They are the plane trees, they are not urgent, they will take 50 years to grow”, Napoleon replied “then you had better start planting them tomorrow”.

Four routes to act fast and effectively on cultural integration

So the answer is: act fast, and urgently, on culture. There are four main routes to do this, and help accelerate overall success. They apply to the whole spectrum of mergers, from complete integration, through to an acquisition that is mainly left as it is.

1. **Focus on the market, customer and delivery, over cost-cutting**

   As recent research by AT Kearney shows, most commercial acquisitions now achieve their cost-saving targets. The failures relate to the top line - to sales, customer relationships and to delivery. There, the average merger showed a sales drop of 6% and EBIT growth of minus 9% over three years. McKinsey discovered that only 11% of merged organisations had not suffered a slowdown within the first three quarters after the merger. And over three years, only 12% outperformed organic growth in their sectors. Around half of this underperformance was due to unsettled customers and distracted staff (including leaders). The maths is stark: a 1% shortfall in planned sales may require a 25% increase in the planned cost savings to compensate. A 2% rise above planned sales may mean you can miss savings targets by 50%.

In one Silicon Valley merger, both parties had IBM as a major customer. Within months of Day 1 of integration, both had lost IBM. They had not told IBM early enough, or in the right way, so IBM concluded that they did not value the relationship.

In contrast, a CEO of a medical supplies company is quoted: "One of the best decisions we made in the merger integration process was to maintain our focus on customer service, even when it meant slowing down the rush to exploit synergies. If we kept our customers satisfied through the integration, we reasoned, it was worth delaying the savings for a couple of months."

A focus on sales, customer relationships and delivery requires much more attention to culture than cost-cutting does. As long as it is handled properly, a cost-cutting plan can be implemented without a cultural integration plan.

There are important actions that can help speed up cultural integration and ensure a successful focus on the market from the start:

- ***Separate the running of the business from the management of the integration.*** Clearly the integration team need to be regularly taking advice and leadership from those running the business. The key process is to ensure that those leading the business are visibly focused on (and communicating to) the market and customers.
- ***Identify the differences in cultural approaches to customers as quickly as possible.*** Find out right from the start if one sales team has a 'solution-focused' approach and one is product-focused. Is one transaction-based and one relationship-based? This knowledge can overcome problems faster, maximise success and reduce the risk of leaders making false assumptions about how everyone will approach the market after the merger. Agree the culture you need for the business and ensure that implementation is a priority.

2. Plan the culture side of integration very early and act fast

As one study shows, despite the well known challenges of culture, only 27% of acquirers do anything on culture during due diligence (compared to 41% on leadership capabilities).

Organisations with a track record of successful acquisitions tend to ensure very early culture change planning - well before the deal closes. This ensures positive "management of the soft issues" and will improve the chance of success.

Culture is often neglected until it is almost too late. In a recent takeover of a US company by a European one, the senior executives met for the first time, prior to the close of the deal. A European executive explained that they would use a detailed system for tracking the merger's progress. His US counterpart snapped back "Cowboys don't fill out forms" -

signalling the start of a long and rocky journey. One company was very sales and market focused and believed in empowering teams to be entrepreneurial, the other was technology-driven and had much more of a command and control approach. This could have been a signal to stop and take stock of the cultural issues. Instead, they did not do so until months of problems forced the issue.

Culture can be assessed and the early planning started in at least three stages, beginning very early on - well before the integration.

- ***Arms-length assessment of targets.*** A few far-sighted acquirers make their first assessment of potential cultural differences very early on - even before there has been an offer, or any contact with the target. Thanks to the internet, this is easier than it used to be. An objective analysis of a range of items, including websites, CEO speeches, analyst commentary, media interviews, customer blogs, leaked internal memos, and so on, can provide a wealth of potential information on similarities and differences. Does one web front-page feature customers and the other feature latest products? Does the graduate recruitment material of one emphasise the quality of career development and the other the amount of money that can be earned?

  The outcome can be a set of questions, risks and opportunities to provide a guide for initial conversations with the leaders of the target, and for planning due diligence.

- ***Full use of due diligence (including the "clean team").*** The main reason given in studies for why culture and other 'soft' issues are not addressed during due diligence is that it is too difficult to find data within the bounds of what the regulations allow. This need not be the case. Some acquirers use their clean team approach to undertake surveys of culture among senior leaders on both sides, and then analyse for similarities and differences. This can highlight important differences in the approach to customers, decision-making, empowerment and accountability, risk, and so on. This allows two sets of actions:

  - This data can influence the integration planning, so that, for example, the team looking at organisation structure pay extra attention to particular aspects of decision-making processes, job role descriptions and accountabilities.

  - When the new top team meet for the first time, the results can form the basis of important discussions about the desired culture and, more importantly what the urgent actions are (for example focusing on the sales forces first).

- ***Put culture-related actions into the first 100-day plan.*** By the time the integration process starts it is possible to identify some priority actions that will help cultural integration. During these early days, the actions and decisions of leaders will be scrutinised and they can have stronger-than-normal impact. If the new top team visibly spend a lot of time among customers, for example, or if an early announcement is a change to future performance management processes to reward a new and altered set of behaviours and actions, it sends a clear signal of the desired culture.

3. **The new culture should enable the business model - so clarity and understanding about how value will be created is an important early step.**

   The evidence is that most CEOs and integration teams now understand the importance of communication during acquisitions and integrations. Most major ones have well-planned Day 1 communication programmes that reach everyone across the two organisations. Thanks to intranets and websites, there are now usually widely available updates on integration progress and announcements of key steps.

   However, much of the communication, even on a well-planned Day 1, is either focused on the wrong issues (for example highlighting the terms of the deal, or the combined capital value), or has some major aspects missing (for example with plenty of focus on the first 100 days and no clear picture of the end vision).

   To accelerate cultural integration, communication needs to be focused on what will help people across the organisation make the right decisions day-to-day, in ways that are more rather than less aligned. So what is required?

   - ***Communicate the vision and business logic of the deal.*** What is the strategic rationale and how will value be created? Is it to acquire new capabilities? Is it to establish a new business model? Is it to lower costs? Is it to improve market position?
     - Identify and share widely these agreed sources of value creation
     - Set clear and aspirational targets for creating this value, whether growth and customer targets, cost-synergies, changes in customer relationships
     - Ensure this is explicitly and deeply shared by the senior leaders (eg top 30 or top 100) by undertaking workshops and meetings to align and mobilise them
     - Repeat, reinforce and report progress against the value creation targets on a consistent and regular basis. These should be the integration headlines instead of the process management ones that so often come out of project management offices.

     (For more, see our three *Briefs* on engaging employees at times of difficult change: *The hard truth behind the 'soft' side of leadership: why people resist new plans and what we can do about it*; and *The second mouse gets the cheese: why CEOs use stories to spark change*; also *Why won't they just get it? How to use emotion and meaning to unlock the brain and engage people*.)

- ***Place extra emphasis on the middle manager and face to face.*** One European study suggests that typical integrations are opposed within the organisations by over 50% of middle managers. In some cases, this can rise to 70%. Online communication channels are excellent for getting to everyone at the same time, in a timely way - for major news or announcements. However, when looking at successful mergers and acquisitions, leaders tend to spend significant time on the road, talking to middle managers. Leaders often do this in groups or pairs, so that people can see leaders from both 'sides' behaving as a single team, with the same attitude and messages - especially about the focus of value creation and what everyone can do to ensure success.

4. **Understand and manage the different change dynamics of the two entities**

   A key aspect of the investigation into culture is to understand how similar or different the ability to adapt is. Is one organisation used to continual adaptive change and the other to occasional big changes? One M&A team expert at GE (who have a long history of successful integrations), said "One of the first things to find out is - How quickly will they adapt? Companies that seem quite similar on the surface can be vastly different in terms of change orientation." Take two actions early:

- ***Develop mutual understanding of the approach to change across the business.*** There will be different assumptions about this from the two organisations. What is the history of managing change? How short or long were other changes? What are the famous, or infamous, stories of success or failure? What works best? What can be learnt? Above all, what is the right approach to generate the changes required to create value?

- ***Use the expectation of change to improve speed and flexibility, and act fast on this.*** In the early few months of integration people will be expecting change (good news and bad). They will never be more open and potentially flexible. If nothing happens for months that directly affects them, resistance will start to set in, driven by habit, cynicism, self-protection and so on. Raise expectations of change (even painful and turbulent), based on confidence in longer-term outcomes. This is of course even more important (and credible) during a recession, or other period of external uncertainty and change.

And six months in is not too late to start …..

All this is focused on what to do from the start. Tackling organisational culture is best done early. However, the evidence is that even six months into a merger, these actions on market focus, business-model communication and change dynamics will accelerate merger success.

Sources

Sources used for this article include: Rothenbuecher, Schrottke: *To Get Value from a Merger, Grow Sales* (AT Kearney); *Merger Integration: Delivering on the Promise* (Booz); *Powering up for PMI* (Boston Consulting Group); *Successful M&A: The Method in the Madness* (Boston Consulting Group); *Winning Through Mergers in Lean Times* (Boston Consulting Group); *Dangerous Liaisons* (Hay); *Why Mergers Fail* (McKinsey); *M&A Beyond Borders: Opportunities and Risks* (Mercer, with the Economist Intelligence Unit); *Why Do So Many Mergers Fail?* (Wharton business school @Knowledge blog)

