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Merging People and Culture: 5 Things You Should Know

M&A Insights: Best Practices to Avoid Culture Clash During M&A Integration

Dec. 8, 2015

Audit | Tax | Advisory | Risk | Performance

Webinar Agenda

During this webinar, we will explore cultural risk identification and mitigation best practices during mergers, emphasizing the following topics:

- The Seven Foundational Pillars Which Drive Deal Value
- The Business Case for Managing Cultural Risks
- The Challenges of Identifying Meaningful Cultural Differences
- Determining Which Cultural Differences Matter
- Five Best Practices for Managing Cultural Risks

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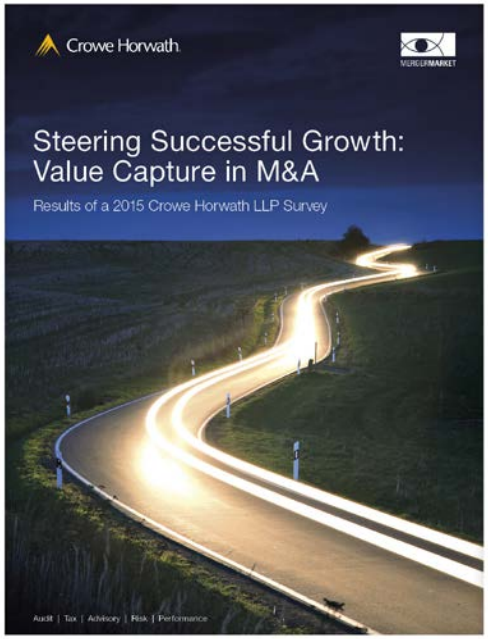
Introduction: The Latest Findings are In

Crowe Horwath LLP and Mergermarket (2015)

Survey Methodology: targeted, confidential interviews with 100 leading strategic (corporate) buyers, asked to self-assess their deal execution performance



"We got decent results but, honestly, I have no doubt the combination had the potential for a lot more."

"In order to reduce our risk in the implementation phase, we dramatically broadened our scope during the diligence phase."

"The integration scorecard was probably the most important element in our deal success."

"Because M&A is a point-in-time opportunity, bringing in quality external help more than paid for itself"

Source: "Steering Successful Growth: Value Capture in M&A" survey, Crowe Horwath LLP and Mergermarket

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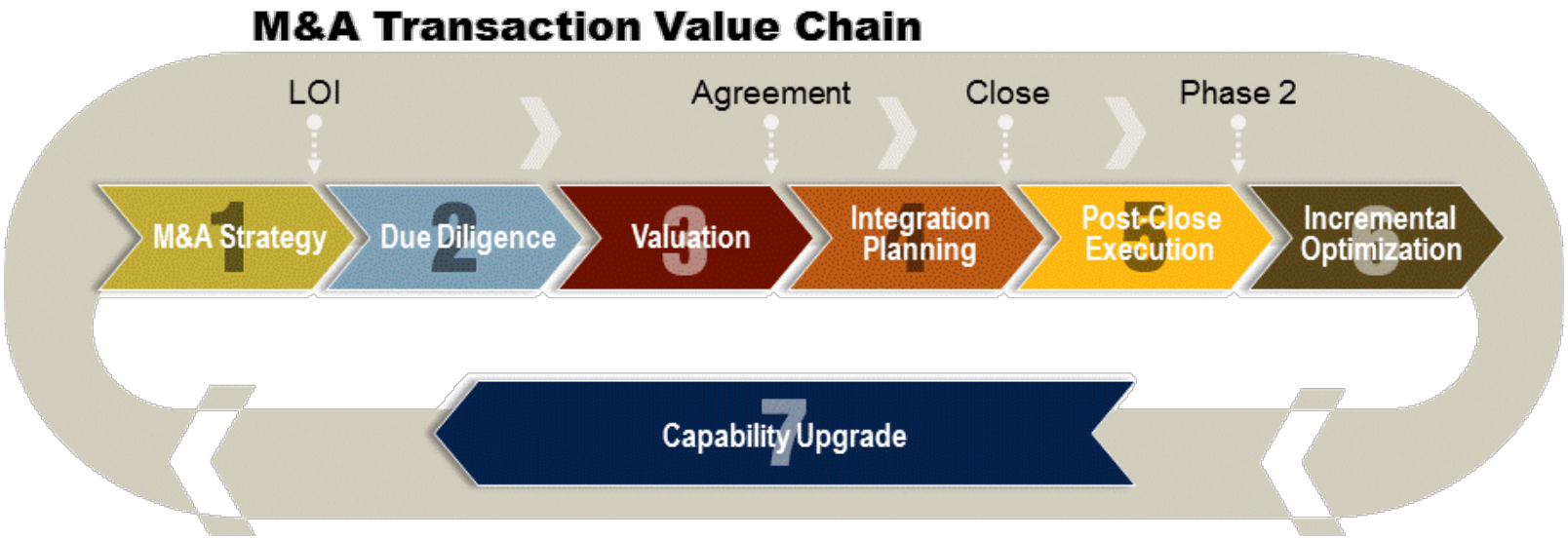
What We Know

- M&A deals typically follow seven basic steps/stages as they move through the pipe.



- While deals start off as “theoretical constructs” (e.g., CIM, thesis, financial model, etc.), they progressively become more tangible and tied to tactical execution.
- As such, the issue of people (buy-in, transition, engagement, etc.) is progressively critical.

Source: Crowe Horwath LLP

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What We Know

- We've identified seven focus areas (foundational "pillars") that drive or destroy a deal's value as it moves through the Value Chain.

Source: Crowe Horwath LLP

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The 6th Pillar: People and Culture Management

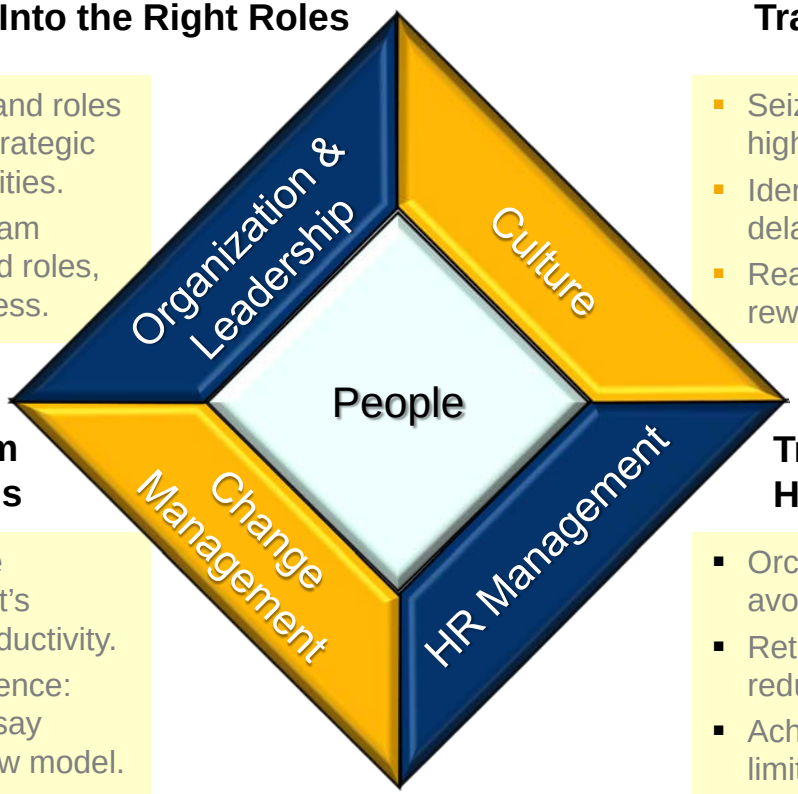
There are four necessary people and culture transitions for a successful merger.

Transition the Right People Into the Right Roles

- Create an operating structure and roles that fit the new organization, strategic objectives, and integration realities.
- Select the senior leadership team based on the new structure and roles, and accelerate their effectiveness.

Transition to Desired Culture

- Seize the opportunity to transition to a high-performance culture.
- Identify and manage culture risks that delay meeting integration objectives.
- Realign people policies, processes, and rewards to drive the desired culture.



Transition Employees From Endings to New Beginnings

- Implement a plan to accelerate employee transitions from what's ending to a new plateau of productivity.
- Focus on the employee experience: what they see, hear, feel, and say during their transition to the new model.

Transition Benefits and Harmonize Policies

- Orchestrate multiple moving parts to avoid "fails" like missed paychecks.
- Retain key employees and delay and/or reduce unwanted turnover.
- Achieve headcount synergies while limiting litigation exposure.

Source: Crowe Horwath LLP, based on the transition methodology of William Bridges

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People/Culture Complexity Reflects the Employee Experience

During a merger, nine employee stimuli impact the scope and complexity of change management and reflect the culture of the acquirer and target company.

Roles	Changes in job description/responsibilities and tasks in functional areas
Staffing	Changes in size of workforce (outsourcing, position/redundancy eliminations, centralization)
Relationships	Changes in organizational structure/interactions and nature of customer/supplier relationships
Competencies	Changes in employee skill and knowledge requirements
Authority	Changes in decision-making processes and scope/types of decisions people will make
Information	Changes in type of information and/or tools required to perform work
Training	Changes in available training to reskill and upgrade existing employee capabilities
Culture	Changes in vision/values, teamwork, politics, protocol, goal alignment to drive desired behavior
Facilities	Changes in location and physical work areas

Viewed this way, change management becomes actionable, not nebulous and academic.

Source: Crowe Horwath LLP

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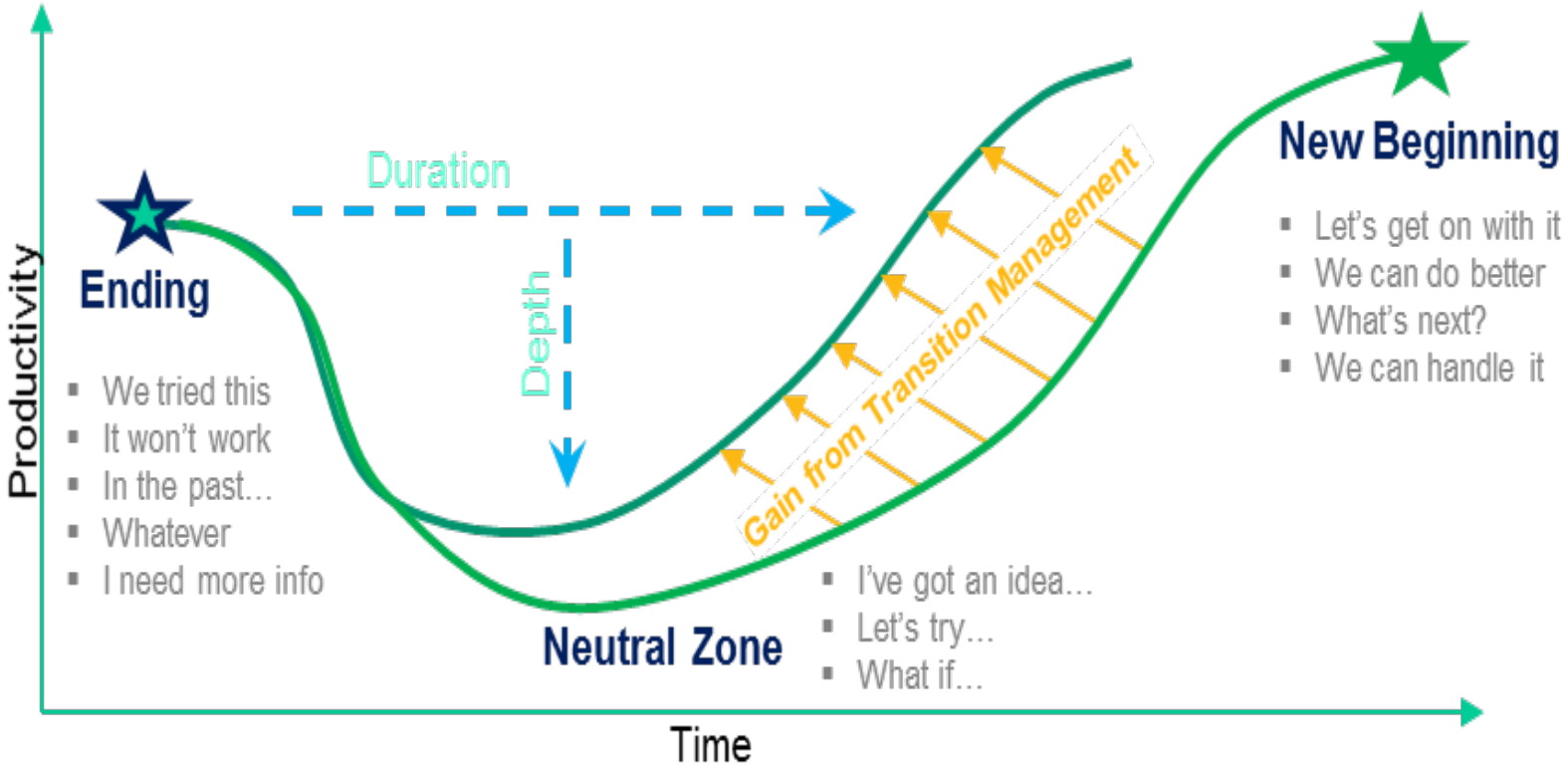
Every Employee Must Move Through Three Transition Stages

Effective change management helps people to more quickly transition from cultural endings (e.g., change of control) to new levels of productivity and engagement.



Source: Crowe Horwath LLP, based on the transition methodology of William Bridges

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The Business Case for Managing Cultural Transitions

Culture is typically recognized as a major reason for merger success or failure.

"**… organizational culture differences** and human capital integration (are) the two most significant issues."

– "M&A Beyond Borders: Opportunities and Risks," Economist Intelligence Unit and Large Consulting Firm, 2008

"We found that harmonizing the cultures was the single biggest success factor in getting the value from this deal long-term."

– "Steering Successful Growth: Value Capture in M&A" Crowe Horwath Strategic Buyer Survey, 2015

"Culture is the organization's immune system."

– The First 90 Days; Critical Success Strategies for New Leaders at All Levels, Michael Watkins, 2003

"You **can't just pop a culture in a microwave** and out pops a McCulture."

– The Corporate Culture Survival Guide, Edgar Schein, 1999

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What We Know About Organizational Culture

Culture is a strong force behind how people behave at the acquirer and target company, and is influenced by organizational and personal values and attitudes.

- **Inertia:** Culture is expressed through the actions of hundreds or thousands of people.
- **Self-policing:** Culture acts like "social glue," influencing ways of behaving and working together.
- **Unconscious:** Cultural behavior occurs without conscious intent, so it's difficult for insiders to observe and define.
- **Unwritten:** Culture expresses the ways things are done "around here" as opposed to everywhere else, so there may be conflicts if incentives or actions are misaligned.
- **Experiential:** Culture shapes the way that employees think about newcomers and "reality" (e.g., "Do *they* have the expertise to manage the combined company?").
- **Defining:** Culture expresses the identity of a company to customers, potential customers, suppliers, competitors, and potential recruits.

Merger risks include lost productivity and turnover – and even implementation failure.

Source: Crowe Horwath LLP

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Identifying Meaningful Cultural Differences Is Challenging

Culture exists at four levels. Cross-level patterns and complexities are often invisible to insiders and/or their unintended merger implications are unclear.

National Cultures

An example: country-unique cultural norms and practices. Expatriates may identify both with their original culture and new culture and experience conflicting values. Critical for success during cross-border mergers.

Industry and Professional Cultures

For example, manufacturers have different cultural elements than software or healthcare companies. Automotive is different than life sciences. Engineers and salespeople have different personal characteristics.

Organization Culture

Cultures can range from family-oriented (stressing work/life balance) to paternalistic (in which personal life matters are seen as irrelevant). Cultures may be strong or weak.

Subcultures

Intercompany hierarchies or functions may have different cultures: blue collar vs. white collar jobs; degree of functional importance/value; or command-and-control vs. collaborative.

External Culture Indicators
(Easier to Observe)

- Mission statements, website content
- Catchphrases, rituals, ceremonies
- Methods and means of decision-making, control, motivation, objectives, commitment, and accountability
- Behavior and patterns of behavior
- Work environment

Internal Culture Indicators
(Challenging to observe)

- Values
- Attitudes
- Unconscious behaviors
- Views of newcomers and organization "realities" about the ability to change
- Stories people tell others about organization history, its heroes and heroines, its successes and failures

Source: Crowe Horwath LLP

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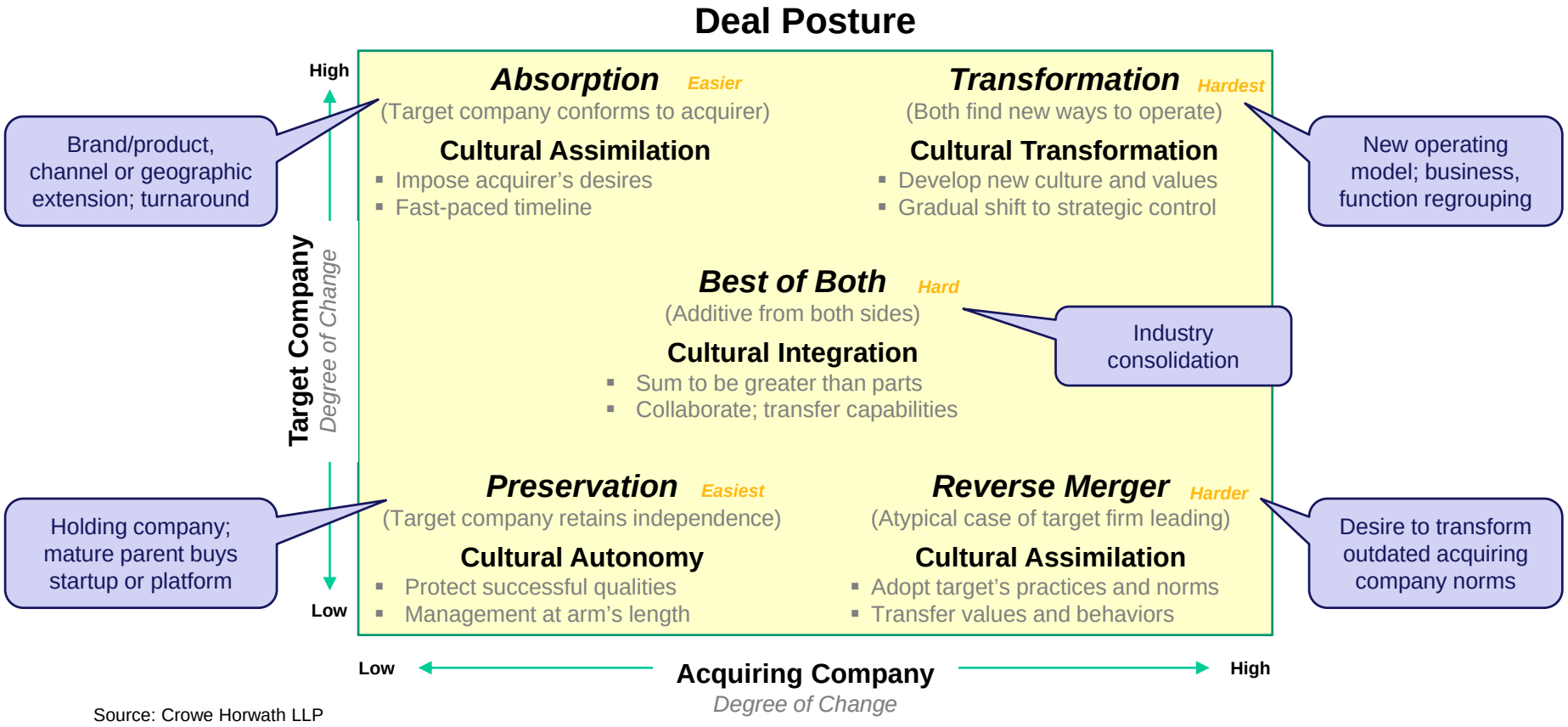
1st Practice: Assess Cultural Risks Based on Deal and Goals

Sometimes culture is not a major factor; when it is, there are several basic strategies to minimize potential delays and even accelerate success.



Source: Crowe Horwath LLP

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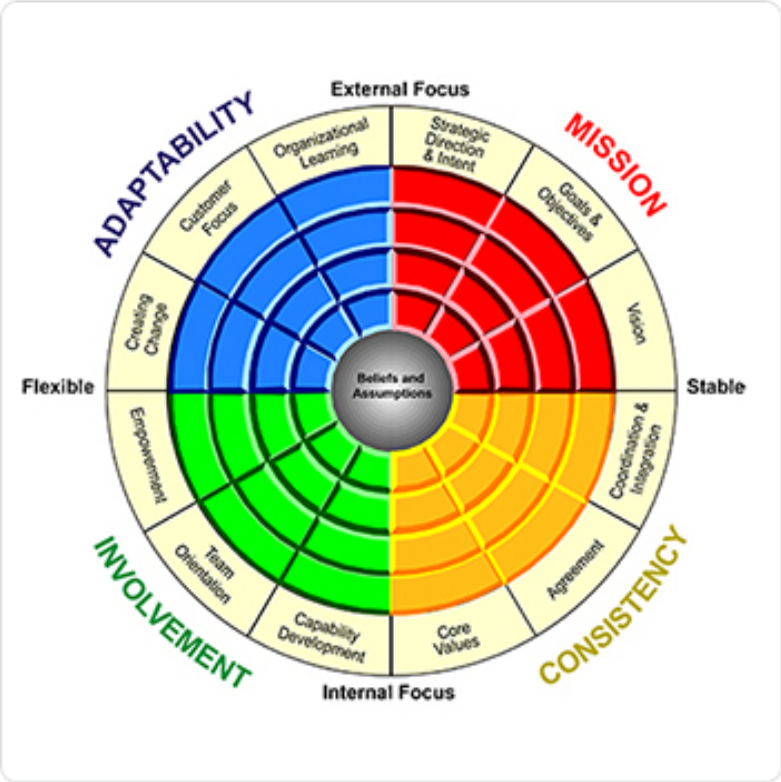
2nd Practice: Determine Cultural Differences With Surveys

Prior organizational culture and employee surveys are a useful starting point to identify cultural differences and predict employee turnover and productivity risks.

Denison Organizational Culture Survey Model



Used to assess strengths and weaknesses in the 12 areas that most directly impact organizational performance

Highlights four key traits an organization should master:

- Adaptability: ***"Are we listening to the marketplace?"***
- Involvement: ***"Are our people aligned and engaged?"***
- Mission: ***"Do we know where we are going?"***
- Consistency: ***"Does our system create leverage?"***

Results facilitate translating the demands of the business environment into action and delivering communication messages that are meaningful to employees, during a time when:

- **Behavioral norms and decision-making processes are combining**
- **Roles and reporting relationships are shifting**
- **Gaining support is crucial to achieving the goals**

Source: www.denisonconsulting.com; the Denison Organizational Culture Survey (DOCS) has been used by more than 5,000 companies worldwide over 20 years.

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3rd Practice: Determine Cultural Differences Interactively

In the absence of large-scale surveys, leadership conversations and focus groups help assess divergent perspectives and identify potential barriers to change.

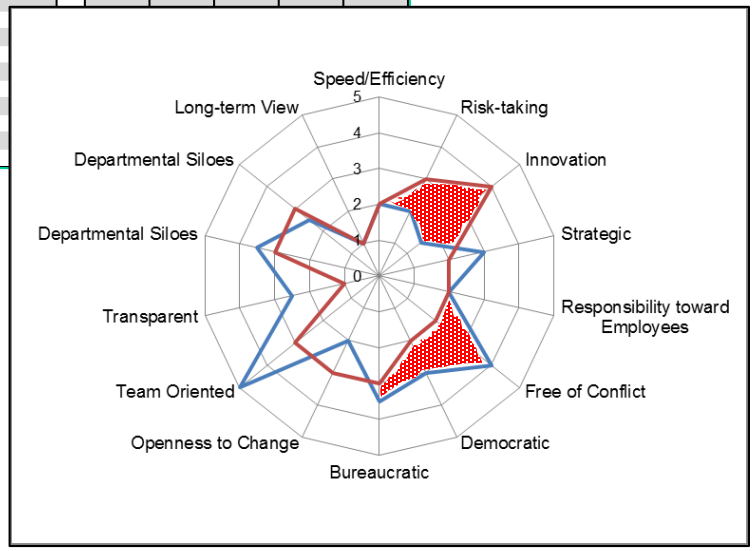
Crowe Culture Characteristics Survey

Cultural Characteristics Survey — Crowe Horwath

To what degree do you find the following statements to be accurate? First, please indicate the type of culture you feel exists within the organization in which you currently operate on a day-to-day basis. Then, separately, indicate the type of culture you believe exists inside XYZ, even if your opinion may be based on little direct experence.

			Our Company					Their Company				
			Not True	Partially Untrue	Equal	Partially True	True	Not True	Partially Untrue	Equal	Partially True	True
Culture	1.	The current culture stresses speed and efficiency.										
	2.	The current culture values entrepreneurialism and risk-taking.										
	3.	The current culture values innovation.										
	4.	The current culture is well aligned with the company's strategic objectives.										
	5.	The current culture is more people-oriented than task-oriented.										
	6.	The current culture favors avoidance of conflict.										
	7.	The current culture facilitates participative decision-making.										
	8.	The current culture is bureaucratic in nature.										
	9.	The current culture promotes an openness to change.										
	10.	The current culture is team-oriented.										
	11.	The current culture stresses transparency in decision-making.										
	12.	The current culture is siloed along departmental lines.										
	13.	The current culture emphasizes long-term value over short-term gains.										

Comparison



- Used to provide insights, build trust, and avoid friction and culture clash during the integration process
- Focus groups facilitate a productive dialogue about:
  - Strengths and challenges at each company
  - Important aspects necessary to retain employees
  - Perceptions of each other's leadership style and culture
  - Potential integration challenges and solutions

Source: Crowe Horwath LLP

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3rd Practice Example: Global Information Services Firm

Background

- Initiated by the $350M global business unit of a $10B+ parent company, which acted as a strategic buyer.
- Purchased two divisions of an educational testing company to add paper and pencil testing capability to an online testing business and acquire industry-leading specialists.

Value Add

- Identified cultural similarities and differences using multiple formal and information methods.
- Created formal and informal influencer networks to communicate and provide feedback.
- Applied Kotter's model of organizational change and William Bridges' "Managing Transitions" model to achieve early wins and accelerate the pace of change.

Results

- Reduced controllable turnover to <4% within the first 180 days.
- Identified and mitigated short-term culture, change, and communication integration risks.
- Managed through sensitive employee transition issues (e.g., roles, structure, accountability).
- Integrated acquired leaders into the existing leadership development process, which increased their commitment and contributed to meeting revenue synergies within 18 months.

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3rd Practice Example: Consider Acquirer & Target Perceptions

Each company in a merger has a view of itself – and possibly diverging perceptions of the other – which may lead to clashes during integration.

	Acquirer Perceptions	Target Perceptions
Internal	*How the Acquirer Viewed Its Culture*	*How the Target Viewed Its Culture*
	▪ Empowered ▪ Push-back required ▪ Setting the bar high ▪ Few layers and small staff ▪ Broad career paths ▪ Change-orientation ▪ Minimal oversight ▪ Preferring speed and simplicity	▪ Collegial decision-making ▪ Respectful of people ▪ Civil ▪ Participative ▪ Responsive to the customer ▪ Emphasizes ethics, integrity ▪ Balances business and technical approaches
External	*How the Target Viewed the Acquirer*	*How the Acquirer Viewed the Target*
	▪ In your face ▪ Processes not documented ▪ Business vs. project orientation ▪ Decisions don't hold – need to argue and revisit ▪ Darwinian system ▪ Financially driven	▪ Bureaucratic ▪ Too much consensus ▪ Too polite ▪ Unwilling to change ▪ 1950s organization ▪ Decisions made at top ▪ Project orientation ▪ Too serious about themselves

In this example, immediate and significant clash is likely if not properly mitigated.

Source of images: Google Images

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4th Practice: Include Cultural Transition in Change Management

We use a simple framework to integrate culture into the change management plan.

Objectives

- Move quickly but systematically to provide focus, direction, and reduce uncertainty.
- Define "success" internally and as viewed externally by customers.
- Support long-term strategy while achieving near-term integration objectives.
- Select the right leaders to fit the desired structure and culture, not the other way around.
- Drive effectiveness and reinforce desired cultural behaviors throughout the change.

Key Culture/Change Plan Considerations(1)

What are our strategies and integration goals? What culture would support reaching our new objectives?
- How will we win in the market?
- How will we accomplish our deal drivers?

What roles and role relationships will drive integration and cultural transformation?
- What is the accountability of each role?
- Where is authority across the organization?
- What relationships are important?

What effect do structures and culture have on internal and external processes?
- What processes cross organization boundaries?
- What processes are key to control? To allocating resources? To creating cultural leverage?

What will be our formal and informal reward strategies?
- How do rewards and practices align with goals?
- Is attainment congruent to the desired culture?
- How do we measure and link culture to the performance management system?

What gaps exists between the current structure and the future culture?
- Transition plan alternatives and trade-offs?
- Change management plan?
- Training or recruiting to close skill gaps?
- Implications for recruiting, selection, development, and retention processes to build capabilities?

Source: (1) Adapted from Jay Galbraith's Star Model™ of Organization Design

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4th Practice Example: Mid-Market Technology Firm

Background

- $350M public company managed by the founder; headquartered in Parsippany, New Jersey.
- The company grew to 3,000 employees by providing supplemental staffing services at hourly rates. Due to pricing pressures that reduced margins, the company added project management services to its offering at a fixed fee or gain-sharing pricing model.
- The new division was staffed through acquisition and a new staffing model aligned with a project management consulting business model, rather than the prior staffing model.

Value Add

- Separated the staffing process by creating hiring profiles based on different cultural models.
- Realigned compensation, development, and retention processes to reflect two hiring tracks.
- Designed a separate operating structure (except for IT and financial shared services) staffed by a separate executive team, reporting to the company CEO.

Results

- The new division earned $50M in project revenue in the first two years, with controllable turnover of <10%.
- Managed through sensitive cultural change issues (e.g., roles, structure, and accountability).
- Acquisition integration strategies were aligned to the staffing or project management culture.

This $350M, 3,000-employee global technology services firm grew through organic growth and acquisition. It provided information technology services to telecommunications, insurance, finance, and manufacturing firms, offering customer relationship management, e-business, network services, enterprise resource planning, strategic outsourcing, and managed resourcing.

Source: Crowe Horwath LLP

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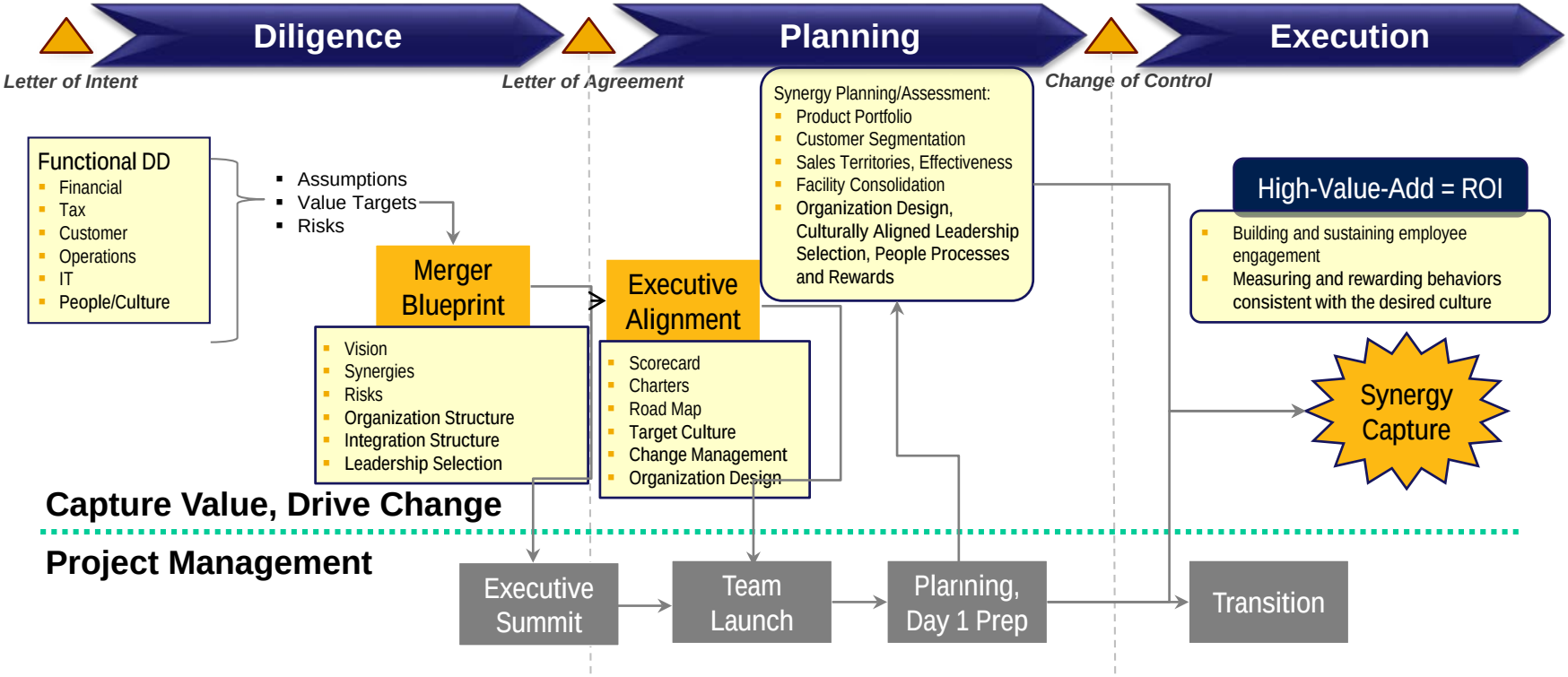
5th Practice: Focus on Cultural Elements Across the Deal Cycle

We embed people and culture strategies within the two key elements of integration:

- **Value Capture**: to meet and exceed the expected benefits while building employee engagement
- **Project Management**: rigorous activity and task management to maintain focus, discipline, effective execution, and timely decision-making to mitigate risks, maintain operating continuity, manage people and culture, etc.



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