The compelling business case for culture integration in M&As

By Jim Hart, Senn Delaney President and CEO

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M&A activity has heated up significantly in this surging economy, especially in health care, technology, life sciences and financial services, industries that rely increasingly on M&A to drive revenue growth and bottom-line performance. It's a good time to remind CEOs and senior executives involved in M&A activity of the best practices in integrating cultures and warn of the pitfalls of failing to address commoncultural challenges.

I was spurred to write this after reading the recently released Deloitte and The Deal survey, Corporate Development 2010 – Refining the M&A Playbook. I was dismayed to read that the survey of 150 companies found that although integration is generally recognized as a major part of a deal's success, executives generally spend quite a bit less of their time focused on this than other aspects..

The survey tells us that corporate development executives are becoming advisors to the CEO and CFO in shaping and executing strategy, which is great. The disappointing part is that they aren't linked closely to post-integration to help realize the expected benefits and synergies. According to the Deloitte study: "Integration responsibility is often assigned to line executives, who may not have been actively engaged with the deal. The responsibility may even be spread across several groups, diluting ownership of the process, and allowing value to slip through the cracks."

It's been well documented over many years that up to one third of mergers fail within five years, and as many as 80 percent never live up to their full potential. A great deal of evidence indicates that the ultimate success of mergers and the amount of time it takes to get them on track is determined by how well the cultural aspects of the transition are managed. This was underscored in 2007 by Steven Davidoff, a law professor at Wayne State University and a former practicing attorney who advised U.S. companies on acquisitions. "I think it has now become increasingly clear that meshing of corporate cultures… is one of the most important, if not the most important, drivers in a successful strategic merger," he stated in an article.

I wish Davidoff's viewpoint was as widely held among executives handling M&As. In reality, there is much more work to be done to convince CEOs involved in these deals to put more time and effort into cultural integration. A Mercer survey two years ago found that many organizations are not well-prepared to effectively manage cultural integration issues. Nearly one quarter of companies were moving towards developing a more formal cultural integration process, but 68 percent still did not regularly use a systematic approach to identify gaps between organizational cultures of the merging companies. Only 37 percent of organizations surveyed had invested in developing leaders with the expertise to understand and lead cultural change.

And now, in 2010, the new Deloitte findings suggest that the importance of culture integration in M&A is still not getting through to senior leaders as clearly as it should. Here are some of the key points that we have learned through our work with CEOs who have had greater success in mergers and acquisitions by quickly addressing common cultural challenges.

Leaders considering or in the process of a major merger or acquisition will find our thought paper Culture Clash in Mergers and Acquisitions a helpful guide.

WellPoint's merger with Anthem is one of the most successful mega-mergers of the decade. Learn why the union of two health benefits giants succeeded where so many have failed. Download WellPoint: Prescription for a Healthy Merger.

The business case for culture integration is compelling

Unaddressed cultural integration issues in M&A transactions have direct negative financial impact on deal value. Nearly half of American respondents in a survey of 100 companies estimated that between $1 million and $5 million was lost or not realized in a significant transaction their organization had undertaken, with nearly one quarter estimating the loss at more than $5 million. Forty-three percent of European respondents reported that between €1 and €5 million was lost or not realized in a significant transaction, and nearly 30 percent estimate losses at more than €5 million. One organization estimated that its failure to quickly manage conflicting cultures early on cost them hundreds of millions of dollars of lost revenue over a three-year period.

Failing to integrate the team at the top can cause a stampede for the door

A study published in the July/August 2008 issue of the *Journal of Business Strategy* suggests that mergers and acquisitions destroy leadership continuity in target companies' top management teams for at least a decade following a deal. The study found that target companies lose

21 percent of their executives each year for at least 10 years following an acquisition – more than double the turnover experienced in non-merged firms.

"These findings are especially important in light of the correlation between the loss of top executives and a company's poor performance," said Jeffrey Krug, associate professor of strategic management in the VCU School of Business and lead author of the study. "Companies involved in these deals need to understand the long-term effect on their executive ranks and they need to find ways to keep key executives on board."

Examples of failure when culture is not addressed

There are many examples of culture's influence in failed mergers. One that immediately comes to mind is the union of Time Warner and AOL. The concept of leveraging the content and distribution advantages that each firm brought to the deal sounded great, but the cultural clash wasn't addressed, and that kept them from making the vision a reality.

The Wall Street Journal called the Sprint-Nextel marriage the deal from Hell. The combined company wrote down nearly $30 billion related to their 2005 merger, which was pretty much the entire stock value of Nextel before the deal was announced. Some have speculated that the problem was that Sprint was so desperate to build scale that leaders overlooked the vast cultural and technological differences between the two companies during the acquisitions process. In the UK, the merger of Lloyds and HBOS is heading in the same direction.

In 1993, in what was then the largest planned corporate merger, Bell Atlantic, a phone company serving northeastern U.S. states, agreed to pay $33 billion for the nation's largest cable-TV company, Tele-Communications. The deal collapsed early the next year as John Malone, then-CEO of TCI, and Raymond W. Smith, head of Bell Atlantic, found their corporate cultures clashed.

The merger of Compaq and Digital Equipment Corp. was unsuccessful largely due to a culture clash The business challenges created by the culturally troublesome merger are viewed as a reason that Compaq lost its position as the No. 1 computer maker to Dell, its longtime competitor.

Example of success when culture is addressed

Organizations we have worked with on cultural integration have been able to achieve higher levels of value faster from their transactions. The most notable recent example of a successful merger was the WellPoint-Anthem mega-merger. Anthem's acquisition of WellPoint made it the largest health care management company in America.

Larry Glasscock, CEO of the acquiring Anthem, became CEO and president of the combined company. Glasscock knew that leaders must quickly and thoroughly address the cultural issues involved in mergers, especially in mergers of equals such as this one. He acted early to minimize uncertainty, align leadership and maximize synergies to ensure that the goals for the merger were realized. He engaged Senn Delaney to help define and support the leadership in building a new, high-performance culture for the new company.

Senn Delaney began its culture-shaping work with Glasscock and his Executive Leadership Team by diagnosing the cultures of the merging companies. The ELT was brought together in a culture-shaping process. They spent time connecting, understanding each other's behavioral styles and working together to define the customer-focused culture and the new strategy. As a result, the company quickly achieved the synergy savings it envisioned from the merger. This process needed to be led by Glasscock as the CEO, rather than delegated to Human Resources or other leaders.

Here are some key best practices that will ensure greater success in a merger or major acquisition.

■ Create a merger integration team

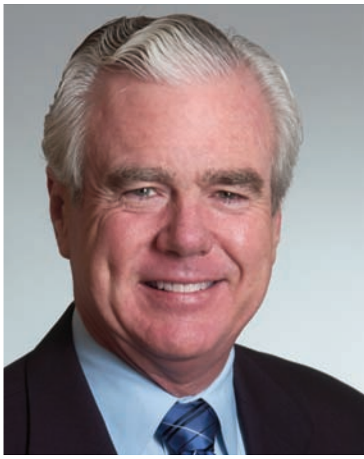
Transition merger teams play a critical role in the success or failure of the newly merged organization. They help establish the new structure and processes, while being a key vehicle in building a new culture. In addition, they give each side their first experience of the "other" company. A fulltime merger integration executive should be appointed immediately whose responsibility is solely the successful operational and cultural integration of the merged organizations.

■ Build a high-performance team at the top

There is always an acquirer and acquiree in a merger and it is typical for the acquiring company to see themselves as the winners and the acquired company as the losers. Typically, the controlling company wants to impose changes, and people view those in the acquired company as highly resistant to change. It becomes critical for the new senior team to quickly come together as a new high-performing team, modeling the new organizational culture. These senior executives need to establish the cultural rules of engagement in the new entity as quickly and effectively as possible. They should spend time in a well-designed, facilitated process to consolidate and align the team on the shared values and guiding behaviors for the merged entity. The transition merger integration team should also participate in this process.

■ Establish a new set of shared values

In a true merger designed to create a new combined entity, the senior teams of



about the author

Jim Hart is president and CEO of Senn Delaney. He has 25 years of experience working with top leaders of Global 1000 and Fortune 500 companies around the world to create Thriving leaders and organizational cultures that consistently deliver better results.

each organization need to work together to clarify the new organizational mission, and the shared values or behavioral ground rules by which they are all going to play. In an assimilation acquisition, the acquiring firm needs to have a clear vision, values, and guiding behaviors and a process to orient the newly acquired employees.

The senior team needs to define the new vision and values quickly, and share them with the merger integration teams. The transition merger integration teams will use the vision and values as their guide in deciding and implementing changes and serving as role models for the new values.

■ Perform a culture audit

Understanding how things are seen in the other cultures, learning mutual respect, and being open to exploring different points of view are the keys to the human factor in any merger or acquisition.

If a cultural audit was not done during the due diligence phase of the merger process, then a Corporate Culture Profile™ (CCP) should be conducted immediately within both organizations to identify the areas of similarity and disparity. The data provides empirical data to assist the merger integration team to utilize the best of both organizations and identify areas where behaviors need to shift.

■ Communicate benefits to reduce resistance to change

It is important to communicate the reasons and benefits of the merger. People may not like it, but if they see that it has a legitimate purpose, and the benefits are obvious, there is less resentment, fewer rumors and employees are more likely to embrace change. Successful mergers only happen when upper managers are visible and accessible to all employees affected by the merger and promote the benefits at all levels.

■ Provide a culture integration process for new teams

As new teams are created through restructuring and assimilation, they must also be given the opportunity to partake in a customized culture-shaping process. This allows them to let go of the past, focus on the new vision, strategies and values, and learn to know each other as people rather than from the legacy or acquiring company.

Contact us to learn more about how overcome the cultural challenges in any M&A for greater success. ■

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