Avoid M&A assimilation heartburn: an actionable model for cultural due diligence and integration

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Abstract:
Offers an approach to deal with the value destruction caused when culturally incompatible organizations merge. A field-tested Cultural Comparison and Integration Model is demonstrated. The model illustrates how managers can compare and integrate cultures of combining firms using "cultural levers." A case example of the model in practice is included. The model has been tested in large and medium size organizations in a variety of industries and nationalities.

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Introduction

The maxim "Culture eats strategy for breakfast" has been attributed to the late management guru Peter Drucker [1], and it's especially germane now that M&A -- including mergers, acquisitions, and joint ventures -- has become the go to strategy to drive growth for many firms across the globe. [2] Many observers have warned that mismanagement of cultural aspects during M&A significantly contributes to value destruction.[3] For example, 92 percent of respondents to a McKinsey survey on M&A performance said their transactions would "have substantially benefitted from a greater cultural understanding prior to the merger" and 70 percent acknowledged "too little effort focuses on culture during integration." [4] So, it appears culture mismanagement often causes M&A heartburn.

An actionable culture comparison and integration model

Even if firms intend to pay more attention to culture during their pre- and post-deal M&A activities, little information exists concerning how to go about it. As a guide for practitioners the field-tested "Culture Comparison and Integration Model" offers firms a methodology for comparing and integrating the organizational cultures of combing firms using twelve "cultural levers" (see Exhibit 1).

Exhibit 1: Culture Comparison and Integration Model

Cultural Levers	Company A (design, delivery, content)	Company B (design, delivery, content)	Key Similarities	Key Differences	Integration Actions (short, medium, long-term)
1. Organizational Values					
2. Staffing and Selection					
3. Communications					
4. Training					
5. Rules and Policies					
6. Goals and Measures					
7. Rewards and Recognition					
8. Decision-making					
9. Organization Structure					
10. Physical Environment					
11. Customs and Norms					
12. Ceremonies and Events					

Origins of the Culture Comparison and Integration Model
An early version of the Culture Comparison and Integration Model in Exhibit 1 originated over 20 years ago as a framework to improve strategy implementation at several UK firms. [5] In the ensuing decades, following the principles of action-based research [6], the model has been applied and refined while conducting cultural due diligence and integration during numerous mergers, acquisitions, and joint ventures, across various industries and geographies.

A mobilizing jolt of energy

A typical reaction from various executives who have not approached cultural integration using the twelve levers identified in Exhibit 1 is that the approach appears to be overly bureaucratic. It is a natural tendency of executives to want simple answers to complex issues such as cultural due diligence and integration, frequently asking "Can't we just replace a few people who don't match the culture we want?" Or, "Can we just put everyone through a culture training program?" What has been proven through multiple iterations of applying the model during numerous transactions is applying only one, or even a few, of the twelve levers is ineffective.

A cultural training program, for example, may provide some awareness of the desired culture of the combined company, along with a brief “boost” toward instilling the desired culture of the combined firms. But, when everyone returns back from the culture training to their daily jobs, the rest of the organizational environment hasn’t changed at all, reinforcing the disparities in the cultures which existed in the separate companies. Thus, cultural training as the sole source of cultural integration is ineffective. In contrast, implementing most, or all, of the twelve levers is effective at comparing and integrating cultures. To make the application of the model manageable, a phased approach should be taken, including short (“Day One” to 30 days post transaction close), medium (during the first six months post close), and longer-term implementation actions (six to twelve months plus post close).

Applying all twelve levers simultaneously to compare and integrate combining firms’ cultures can seem like an intimidating task to most managers. But changing everything at once would send “a mobilizing jolt of energy through the company…We imagine it would also send a chill through the spine of most CEOs.” [7] Consequently, addressing all twelve levers over the short, medium, and long-term during M&A will effectively stimulate cultural change, but it requires determined and persistent leadership.

Applying the model

Exhibit 2 identifies seven key steps for applying the Culture Comparison and Integration Model to conduct pre-close “cultural due diligence” and post-close “cultural integration,” while Exhibit 3 provides a case illustration of how the model was applied during an acquisition in the chemical industry.

Exhibit 2: Seven steps for M&A cultural due diligence and integration

Component	Key activities
Pre-transaction close	
1. Form a ‘Culture Comparison and Integration Team’	• Identify line and HR management representatives from both firms to serve as a ‘Culture Comparison and Integration Team’ (1-4 representatives per firm, depending on the size and scope of the transaction). • Schedule at least one full day for the team to meet and begin the cultural comparison and integration planning process.
2. Compare the firms’ cultures	• Using the Culture Comparison and Integration Model as a template, identify the key design, delivery, and content elements across the twelve cultural levers for each firm.
3. Highlight key similarities	• Identify and record key overlaps between the firms in design, delivery, and content across the twelve cultural levers.

4. Highlight key differences	• Identify and record key divergence between the firms in design, delivery, and content across the twelve cultural levers.
5. Develop a 'Cultural Integration Plan', based upon the level of cultural integration desired/ required (i.e. stand-alone/no integration, partial integration, or full/integration via absorption or a "best of both" approach)	• Identify and record short, medium, and long-term integration actions for combining the firms' cultures, across all twelve cultural levers. • Develop a project implementation plan, including timelines, budgets, milestones, and accountabilities for implementation across each of the twelve cultural levers. • Gain senior leadership approval for the 'Cultural Integration Plan'.
Post-transaction close	
6. Implement and build momentum	• Begin by implementing the short-team integration actions for various 'cultural levers' (i.e. "Quick Wins" that can be implemented between "Day One" and 30 days after transaction close to demonstrate progress and build momentum for cultural integration). • Then, progress to implementing the medium (during the first six months post close), and long-term integration actions (six to twelve months plus post close). • Involve senior leaders in the implementation across the twelve levers.
7. Track progress, collect evidence, and adjust	• Conduct regular reviews (monthly to begin, then quarterly) regarding progress of the cultural integration actions (i.e. what is working well, what needs to be adjusted). • Gather data (combined workforce feedback via surveys and focus groups) about the cultural integration (visibility of actions, views of success, suggestions for improvement). • Adjust as required, based on the data gathered.

Exhibit 3: Combining cultures during an acquisition

Applying the Cultural Comparison and Integration Model during an acquisition
The transaction: • "ChemOperate, Inc." (acquirer/buyer): headquarters in the southeastern US, revenues $4bn US, 5,000 employees, operations in North America, South America, Europe, and Asia.

- "ChemInnovate, Inc." (target/seller): headquarters in the northeastern US, revenues $2bn US, 3,500 employees, operations in North America, South America, Europe, and Asia.
- Identified $300mm US recurring synergy cost savings, achieved within 36 months through site consolidation, headquarters consolidation, purchasing efficiencies, and operating efficiencies.

The need:

- Management of both firms were aware that the organizational culture of ChemOperate was more "operationally efficient," and that the culture of ChemInnovate was more "innovative." But, they did not know how the cultures of both firms were shaped and perpetuated over time.
- The senior team of ChemOperate wanted to visibly compare, and subsequently combine the cultures of the two companies; using a "best of both" approach post-acquisition.
- Due to their prior acquisition experience involving several "poorly managed and ineffective cultural integration processes," the senior team of ChemOperate wanted to apply a defined cultural due diligence and integration approach, that was tangible and measurable.

The solution:

- As part of the overall due diligence process and subsequent integration planning effort, a six-person "Culture Integration Team" was formed, comprised of three people from each firm (two line representatives and one HR representative).
- The Culture Integration Team A applied the *Culture Comparison and Integration Model* to assess the culture fit between ChemOperate and ChemInnovate across all twelve "cultural levers."
- During the cultural due diligence process, several similarities and a number of differences between the firms', across the twelve levers were identified.
- Using the desired "best of both approach," the team designed and implemented cultural integration actions for each of the twelve "cultural levers," over three timeframes:
  - Short-term "Quick Wins" -- between "Day One" and 30 days post transaction close -- including: combined company values (best of both), new uniforms for former ChemInnovate employees, new signage on all former ChemInnovate facilities, cultural awareness communications to all employees of the combined firm, announcement of a new organizational structure and reporting relationships.
  - Medium-term -- during the first six months post close -- including: cultural training for all employees of the combined firm, reduction of decision-making approvals required across the combined firm, new goals and measures for all management and employees of the combined firm.
  - Longer-term implementation actions --six to twelve months plus post close -- including: new rewards and recognition for all management and employees of the combined firm, the creation of an annual ceremony for the combined firm rewarding operating improvements and innovative process and product design.

The results:

- A majority of the planned cultural integration actions were in place within the first six months post transaction close.
- Survey and focus group feedback from the combined management and employees was collected monthly for the first six-months, and then quarterly thereafter.
- For all rating periods during the first year after transaction close, over three quarters of the combined workforce rated the cultural integration across all twelve levers as “highly effective” or “extremely effective.”
- Based on the feedback collected, regular adjustments were made throughout the cultural integration effort.
- Employee engagement was also measured annually, across the combined firm, demonstrating increased engagement at both one year and two years post transaction close.

A spectrum of cultural integration

As identified in both Exhibits 3 and 4, a key step in the process of applying the Cultural Comparison and Integration Model is to determine the degree of cultural integration desired. Similar to operational integration, cultural integration exists on a continuum from: stand-alone/no integration, to partial integration, to full integration. Moreover, full cultural integration can be either: a) absorption of one organization’s culture into the other organization’s culture, or b) a “best of both” approach, combining what are determined to be the “best aspects” of each company’s culture.

Why the model works in practice

The Culture Comparison and Integration Model works in practice because it addresses how individual behavior is driven by a person’s environment. [8] Behavior theory offers a practical assessment and combination approach when applied to cultural due diligence and integration. Appropriately altering the firm’s internal environment incentivizes desired workforce behaviors, which collectively form an organization’s culture.

Although existing since the 1950s, behavioral theory has seen a recent resurgence of popularity in shaping culture. Described in the book *Nudge*, compelling research demonstrates that individual and collective behavior can be influenced through what is termed “choice architecture.” The research found that people’s behavior can be "nudged" by arranging “environmental architecture” in different ways. [9]

Moreover, a behavioral approach to managing organizational culture enables clear measurement of progress. Desired workforce behaviors can be readily observed, evaluated, recorded and reported. [10] It offers a practical alternative to cultural assessment of attitudes, beliefs and values that are the basis of a personality theory approach (see Exhibit 4).

Exhibit 4: Managing organizational culture based on personality theory versus behavioral theory

Personality Theory	**Behavioral Theory**
Managing the combined employees' attitudes and beliefs, shapes the combined workforces' behaviors, which comprise the combined organization's culture.	Managing the combined firms' internal environment, shapes the combined workforces' behaviors, which comprise the combined organization's culture.
• Attitudes	• Environment
• Beliefs	• Processes
• Values	• Systems
• Shared meanings	• Actions
• Invisible	• Visible
• Difficult to manage	• Easier to manage
• Difficult to measure	• Easier to measure

Underpinned by behavioral theory, the key premise of the Culture Comparison and Integration Model is: an integrated set of environmental levers that shape collective workforce behavior provides management a pragmatic approach to conduct pre-deal due diligence and post-deal integration of organizational cultures.

Takeaway

Too often, when conducting transactions, M&A professionals focus only on the financial and operational aspects of the combining firms, ignoring organizational culture because it appears so difficult to assess and manage. However, applying an integrated set of "cultural levers" that can be used to shape collective workforce behavior offers managers a pragmatic approach to conduct pre-deal comparison and post-deal integration of organizational cultures, so that culture does not eat their M&A for breakfast.

Notes

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