# cultural clash in mergers and acquisitions

Mergers and acquisitions are a fact of life in today's highly competitive global business environment. Unfortunately, statistics indicate that up to one third of mergers fail within five years, and as many as 80 percent never live up to their full expectations.

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 article provides insights on how to systematically and consciously avoid cultural clash to gain the most synergy from any merger or acquisition.

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**Mergers and acquisitions are a key part of many organizations' strategies. Often, billions of dollars are at stake as well as the very future of the organizations and the executives who are coordinating the merger. Unfortunately, more often than not, the benefits of mergers or acquisitions fail to materialize or fall short of expectations.**

Learning to systematically and consciously avoid cultural clash is a necessary skill because mergers are a fact of life in business. One reason is the continuing consolidation of industries. Phone companies, cellular companies, utilities, oil companies, financial services companies, insurance companies, healthcare organizations, retailers, defence and electronic companies, and dozens of others are a part of this consolidation trend.

Historical, industry-shaping mergers are common today. Examples include the telecommunications industry, with SBC's acquisition of AT&T, Sprint and Nextel, Cingular and AT&T Wireless and Verizon's acquisition of MCI.

In retailing, Federated's acquisition of The May Department Stores Company and Kmart's surprise acquisition of Sears are a part of competitive strategies for companies to fill their niche and compete with winning formulas like those of Walmart and Target.

In healthcare, Anthem's acquisition of WellPoint made it the largest healthcare management company in America. The question in each case is, "Can merging companies achieve the necessary synergy, or will the cultures clash?"

An article in the *Los Angeles Times* entitled, "After Back-Slapping Wanes, Mega-Mergers Often Fail" concluded that "Perhaps more than anything else, senior management stumbles over cultural issues". They noted that: "The most important issue is trust. Along with cultivating trust, the keys to success in pulling together companies are crafting a shared vision, developing a precise transition plan, which includes more than structure and processes and avoiding the common pitfall of focusing so much on the merger details that customers (and employees) are neglected".

While it is clear that successful mergers and acquisitions must be based primarily on strategic, financial and other objective criteria, ignoring a potential clash of cultures can lead to financial failure. Far too often, cultural and leadership style differences are not considered seriously enough or systematically addressed. Many acquisitions that looked very promising from a strategic or financial viewpoint ultimately fail, require major surgery and/or extensive subsequent hand-holding because these "soft" issues were neglected.

## Evidence of the magnitude of the challenge

Most articles written about mergers mention cultural compatibility as an obvious challenge. The AOL/Time Warner merger never lived up to expectations. The concept of leveraging the content and distribution advantages that each company brought to the deal sounded great, however, the cultural clash wasn't addressed, and that kept them from making the vision a reality. The traditional publishing world and the Internet were on different wavelengths. The cultural and style differences between deal-oriented investment banking and brokerage divisions plagued Morgan Stanley/Dean Witter for years and unseated a CEO.

Statistics indicate that up to one third of mergers fail within five years and as many as 80 percent never live up to their full expectations. The majority of merger shortfalls are due to human factors, not to quantitative analysis. "You can run all your discounted cash flows and have the numbers come out perfectly, but it's the human resources side of a merger acquisition that spells failure or success" (*Training Magazine*).

It's interesting to note the parallel in the divorce rate in America and the fallout in mergers. The number of divorces each year is approximately 50 percent of the number of marriages. The number of successful mergers is about the same.

## The Importance of addressing the Impact of culture

Since the human factor is so critical, it is important to understand the role of this phenomenon and to address it in each phase of the merger or acquisition process.

Over a period of time, organizations, like people, develop distinctive and unique personalities. This personality of the organization has been referred to most often as corporate culture. An individual's personality is made up of one's habits, beliefs, values and behavioral traits. A company's culture is also made up of its habits, values system, customs and norms that govern behavior within the organization. The culture reflects the unwritten ground rules of behavior, or simply "the way we do things around here".

The term "cultural clash" has been coined to describe what happens when two companies' philosophies, styles, values and habits are in conflict. That may, in fact, be the most dangerous factor when two companies decide to combine.

One classic example of a cultural clash was the merger of Price Club and Costco Wholesale. While Costco has gone on to be ultimately quite successful, the merger almost derailed the company and took far longer than it should have to come together. According to Michael Shea of Charter Investment Group: "The Price Club guys had much more of a real estate strip mall mentality. The Costco guys were the type who started working at grocery stores bagging groceries when they were 10 years old and worked their way up the ladder." Since no team alignment work was done to bridge the gap, the combination was deadly.

## International acquisitions — cross-cultural challenges

Merging two corporate cultures from the same country with the same language and traditions is challenge enough. That challenge is compounded when differing country cultures and norms are added to the equation. What might be seen as a healthy, assertive "bias for action" in one society may be seen as rude, offensive and inappropriate behavior in another. These issues must be dealt with because more and more multinational acquisitions are taking place. Chrysler and Daimler greatly underestimated the challenge and have still not fully sorted it out.

## Within-company merger issues

The success of a number of critical internal initiatives and strategies are dependent on a form of "within-company mergers" of different teams or divisions. Shared services, cross-selling, reengineering, customer single source and zero inventory manufacturing all require that different parts of the company (and often suppliers) come together and perform as a single enterprise. The same kinds of cultural clashes found between merging companies often happen within companies as they try to work together on broad cross-organizational issues and opportunities.

This can be seen with the new megabanks and one-stop-shop financial services organizations where the big win will come from cross-selling and cost savings from shared services. To date, few, if any, have pulled that off. Unfortunately, all too often, different parts of the companies have their own styles, norms and biases and never really "merge".

The challenges, as well as the techniques and approaches that bring the cultures of two different organizations together, are discussed in the sections below.

## Key human problem areas to avoid

### 1) Loss of key people

Whenever acquiring an organization, remember that "the natives have the maps." Even if you need to downsize, if not handled right, the wrong people will leave and the venture can be jeopardized. A number of studies document the high exit rate from acquired companies. One survey indicated that only 42 percent of the managers remained with the acquired company for as long as five years ("Merging Human Resources", *Merger and Acquisition Magazine).*

SBC's acquisition of Pacific Bell is an example of an exodus of senior talent. It was heralded as a merger of equals when the two chairmen announced the historic coupling. It didn't turn out that way. "Within months all six top officers were gone, having either retired or quit. Of its 35 corporate officers, just six remained," reported the article "Executive Exodus" in the *San Francisco Business Times*. Mmost of this was due to a clash in cultures and no attempt to bring the cultures together.

### 2) Winners versus losers — we versus they

When companies are acquired or combined, people almost immediately start to focus on the differences in the companies. They also quickly begin to "keep score" on who are the winners and losers. It is typical in an acquisition 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 views those in the acquired company as highly resistant to change. On the other hand, the most frequent complaint from employees of companies that are being acquired is that the new owners don't appreciate them. They often feel that they don't get any credit for what they've done well and what is working and that their new leaders only want to point out how the new way is better.

In a newly merged or acquired company, the appointment of people to positions is closely watched. This is a specific area in which people immediately keep score, tallying which side won or lost on each issue or appointment.

### 3) Judgment versus respect for differences

There is a tendency for each group to be judgmental about the way things are handled by the other. Rather than respecting and building on differences, people frequently enter into right and wrong judgments.

### 4) Fear of the unknown — insecurity is the enemy

Uncertainty and insecurity are associated with almost all mergers or acquisitions. As a merger is announced, fears and anxieties are fuelled by uncertainty about what the changes will bring. There is typically a feeling of personal vulnerability and loss of control. People often spend time updating their resumes and exploring their options.

People fear the unknown. It might be more accurately called "fear of the imagined,"since people have a tendency to fill in the blanks of what they don't know by imagining the worst.

Harry Levinson, a management psychologist and Harvard professor emeritus, stresses the psychological consequences of the merger experience. He states that even when a merger offers new opportunities, it still tends to be perceived as a threat to one's equilibrium.

Whether a merger is for the better or worse, it throws relationships, norms, work behavior and support systems out of balance. If these psychological losses are not addressed early on, chronic problems in attitude and behavior can result.

### 5) Loss of organizational effectiveness

The uncertainty surrounding the change often causes the employees to lose enthusiasm about their work and their organization, and a drop in morale and organizational pride follows the merger. Countless hours are spent fuelling the rumor mill, and large numbers of people adopt a wait-and-see attitude. Results usually suffer and customers are lost.

## Guidelines for creating a successful merger

1) **Retain key leaders.** It is essential to identify those people critical to continued success and initiate a plan to ensure that these key people stay and remain engaged and aligned.

2) **Communicate the vision.** The sooner that some semblance of certainty about the future can be communicated, the sooner people will settle down. Once a new vision for the organization is created, new future targets are set and new teams are connected and aligned, people can refocus their energy in a forward direction.

3) **Address the new organizational structure as early as possible.** Failed mergers are characterized by a tendency to have unclear reporting relationships and frequent changes in the reporting structure. In one study of merger successes and failures, it was found that 81percent of the failures were characterized by frequent changes in the reporting relationship after the merger. Successful acquisitions were characterized by clear reporting relationships that were established early on and not changed ("Merging Human Resources", *Merger and Acquisition Magazine*).

4) **As leaders of an acquiring company, go out of your way to acknowledge as many positive aspects of the acquired company as possible.** At the same time, set clear expectations and create an environment in which there is a high level of openness to change.

5) **Avoid throwing out the baby with the bathwater by identifying which cultural factors have historically made an organization great.** For example, if a company had historically been successful based on its culture of service and quality, rapid and insensitive cost-cutting could begin to destroy what made that organization great in the first place.

   One example is the acquisition of a smaller, highly entrepreneurial company by a larger, more formalized one. That combination poses cultural challenges because it is hard to provide direction and additional structure. However, this must be done without killing the entrepreneurial goose that lays the golden eggs.

6) **Be clear about the nature of the union and be willing to talk about it.** Is it a true merger of equals, an acquisition that attempts to use the best of both, a stand-alone holding company or just an assimilation?

7) **Communicate the reasons.** Most people understand that mergers and acquisitions take place for business reasons. It is important at the outset to communicate the 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 and employees are more likely to accept it.

8) **Make sure the acquiring company's leader(s) communicates in person as much as possible.** It is easier to be resentful towards an unknown, invisible ogre, than it is to be resentful about a person you have personally experienced as being real, rational and concerned. Successful mergers only happen when senior managers make themselves visible and accessible to all employees affected by the merger and promote the benefits at all levels. Employees at all levels need to experience the buy-in and support of their leaders for the merger or acquisition.

9) **Create an integration plan.** Do due diligence on the cultures both before and after as systematically as you do on the numbers, and create a specific cultural integration plan led by the CEO and senior team, not just delegated to an HR team.

## A cultural challenge — familiarity blindness

It is hard for people in a culture to see a culture. That is why outside "stranger's eyes" are needed. One of the difficulties of meshing two organizations is that each group tends to see the world through its own biased cultural filters.

This is often referred to as familiarity blindness, or a cultural trance. For example, if everyone around you is risk-averse, then it appears to you as if the world is that way — and should be. That is often the case when two organizations get together. People in each company look at the same events, the same decisions, the same situations, but colored by their culture and past experiences, they legitimately see them from two different points of view.

Figure 1

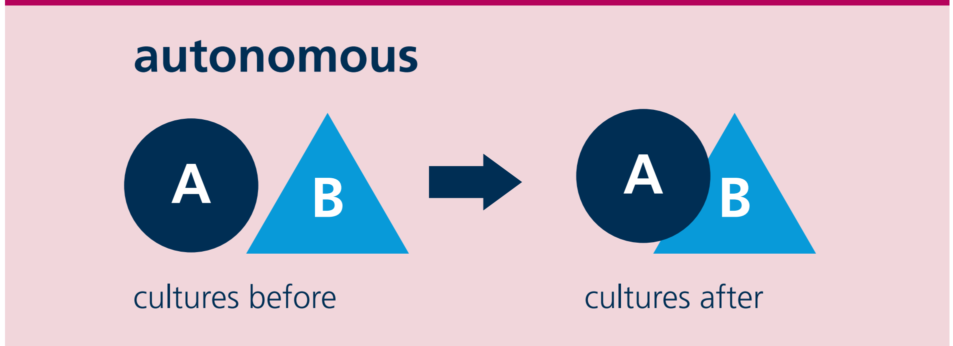
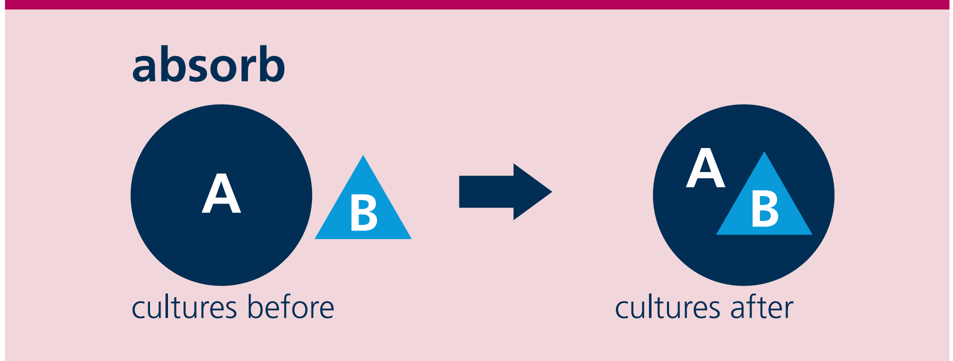



Figure 2




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

*The Wall Street Journal* ran a front-page article entitled "Culture Clashes after Combinations Spur a New Brand of Due Diligence". It stated: "Fights over everything from management style to company picnics can foul up corporate marriages. So, some executives weigh a company's corporate culture as well as its finances before clinching a deal. Cultural audits identify potential conflicts and solutions."

The article cited a new legal question facing mergers: "A Delaware court has recognized culture as a valid criterion for deciding a deal's merit and ignoring it could bring shareholder law suits."

## Avoiding familiarity blindness

The analysis of mergers and acquisitions during the due diligence process understandably focuses heavily on financial information. A lot of money is spent on accountants and lawyers even though it is now better understood that the cultures will make or break the deal.

Equal attention is needed using "stranger's eyes" to understand the cultures and the areas which may clash.  A process should be used to:

- Develop a simple and quick profile of the two companies' cultures through surveys and interviews and note similarities and differences in decision styles and the internal reinforcement systems, including compensation/ benefit systems, performance review systems, performance criteria (written and unwritten) and hiring and firing criteria and practices.

- Compare philosophies of the dominant leaders, especially if they are both to stay on, and have them openly discuss not only financial considerations, but the similarities and differences in the cultures and the proposed nature of the cultural integration, e.g., autonomous organizations, assimilation or creation of a new entity.

## Variations in the nature of mergers and acquisitions

Specific steps needed to deal with the human side of the merger or acquisition are greatly influenced by the basis for the merger as well as the cultures of the organizations. For example, in a merger where the acquiring company is interested only in the physical and financial assets of a target company and expects to lay off most managers and employees, major efforts to manage culture are unnecessary. However, when a true "marriage of two equals" is the end goal, attention to the management of culture becomes critical and detailed planning is most crucial. The varying goals for merger outcomes are shown below in their three most common forms.

### 1) Autonomy or semi-autonomy

In the "hands-off" scenario, the goal is to create mutual support and synergy without necessarily changing the nature of the organizations. It is unrealistic to assume that the acquiring company will not want some modifications. For example, there may be a desire to shift one or more qualities, such as innovation, bias for action and a higher level of expectations.

However, when the basis for the acquisition is autonomy or semi-autonomy, it is important to respect the reasons for the differences in culture and to proceed slowly with integration activities.

**The result of such a shift is shown in the Figure 1, above.**

### 2) Absorb and assimilate

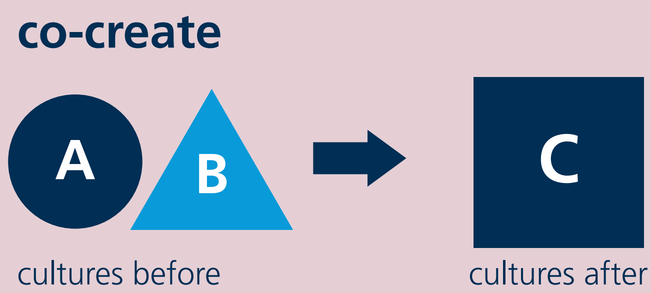
If the goal is to completely absorb and assimilate the acquired company (Figure 2), then the primary need is to educate the acquired employees in the rules of the new game.

It should be remembered that they have been playing a different game under a different set of unwritten as well as written ground rules. Orientation to the new organization should include letting them know about the vision and values of their new organization. It is also important to focus on how the new game is going to be different and not on judging the past or telling them why what they were doing was wrong.

### 3) Co-create a new entity

While avoiding cultural clash is always important, the greatest attention should be paid to successful cultural integration when a true marriage of equals is intended (see Figure 3).

**Figure 3**




**Here are several key steps to successfully integrate cultures:**

### Integrate teams and shape culture

Whenever new leaders or new teams at any level are put in place, processes to align those teams around the greater vision and direction are vital. Companies can no longer afford to take months to get acquainted and work out differences.

Off-site sessions with the top leaders are vital as part of a process to begin reshaping the culture to a desired new state. This brings new teams together in a relaxed and collaborative environment to focus their energy in the same direction.

Use of a more formal, customized culture-shaping process is often skipped due to the demand of business. This leads to unintended loss of people, slow starts for teams, and wastes time and energy. Cultural clash is not hypothetical. It is real and it happens among people who haven't taken the time to develop openness and trust. Think of a team of newly-drafted ball players trying to play in the major leagues with no practice, no commonly understood signals and no time to learn to play well together. It wouldn't matter how good the individual players were; they probably wouldn't succeed. A customized process can be used to embed the new values and shape the culture through values and guiding behaviors.

### Inspire and align people around vision, mission, and shared values

During a merger or acquisition, people need to be inspired to move towards new goals and visions. In the absence of a compelling purpose for a new organization, people tend to stay locked in the past and to unhealthy speculation.

In a true merger designed to create a new combined entity, the senior teams of each organization need to work together to clarify the new mission and the shared values, or behavioral ground rules by which they are all going to play.

In acquisitions that are assimilations, the acquiring company needs to have a clear vision and set of values and guiding behaviors and a process to orient employees of the acquired company. If the company is not clear about these things themselves, it is very confusing and disruptive.

### Role of the senior team

Studies on culture point to a powerful phenomenon we call the "Shadow of the Leaders." As leaders go, so goes the company and the merger. If leaders show up unaligned, the two merging companies will be unaligned. If they fight over turf, so will all those who look to them. That is why the leaders need to spend time coming together as "one team" and aligning vision and strategy.

The shadow leaders cast across the organization is a powerful form of communication. For that reason, it is critical that the new senior team be the first team to come together (beyond the transition planning team). Members should spend time in a series of well-designed off-site sessions. The alignment process described earlier can be used by the senior team not only to build the team, but to come together around the shared values and guiding behaviors for the merged entity. Because of its importance, this process is best handled with assistance from skilled and experienced outside facilitators.

### The emotional cycle of change

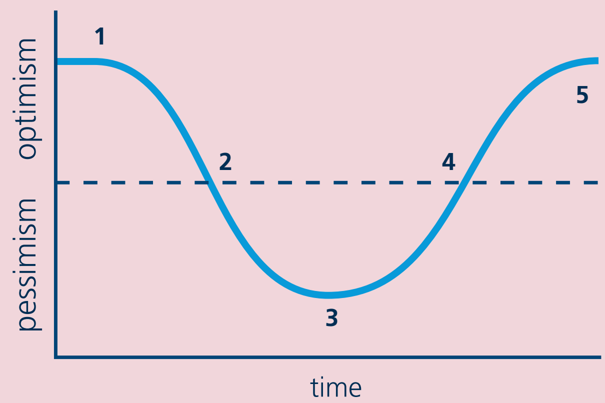
The integration process should be entered into realistically with full knowledge of the obstacles that may be encountered. Most acquisitions considered to be successful follow a pattern that has been described as the "Emotional Cycle of Change" (see chart above).

Phase one is uninformed optimism, when people are excited about the new venture and have not as yet faced the challenges and complications.

Most acquisitions considered to be successful follow a pattern that has been described as the "Emotional Cycle of Change."

**Phase 1: uninformed optimism**
**Phase 2: informed pessimism**
**Phase 3: realism**
**Phase 4: informed optimism**
**Phase 5: Rewarding completion**

## emotional cycle of change




Phase two is informed pessimism when all of the issues, rumors and disruptions are being faced. It can take one of two courses. Without a systematic plan, pessimism can become a long-lasting reality.

In phase three realism sets in. The issues and challenges are understood and success requires determination. However, with a plan in place and continued commitment, the tide will begin to turn to **phase four**, or informed optimism. In **phase five**, planned benefits begin to become a rewarding reality.

### Benefits of a systematic integration process

Among the benefits that can come from systematically dealing with cultural aspects of mergers are:

- Team members operate more quickly and effectively in their new or newly-revised organization without loss of momentum.
- There are fewer defections. People don't move on because of uncertainty or imagined concerns and issues.
- Impact on morale is lessened. People don't waste countless hours on speculation or on feeling victimized.
- Focus on the customer is not lost and customer disruptions are minimized. The planned synergies, such as cross-selling, are captured.
- Consolidation of functions is done faster and more smoothly and the cost benefits of consolidation are better captured. This leads to improved productivity and profitability in a shorter period of time.
- The process of creating a vision, mission, and shared values creates excitement, inspiration and commitment with all people working for a new future goal as opposed to living in the past.
- A sense of community is created sooner since shared vision and values link individuals to the organization and bind people together. ■

Dr. Larry Senn is chairman and founder of international culture-shaping firm Senn Delaney, a Heidrick & Struggles company. Larry's vision and leadership for more than 35 years has helped Senn Delaney become an international firm that is widely recognized as the leading authority and practitioner in the field of culture shaping. Larry has led culture-shaping engagements for the leaders of numerous organizations, including dozens of CEOs of Fortune 500 companies, state governors, members of two U.S. president's cabinets, deans of business schools and the presidents of major universities. Larry is an accomplished consultant, business advisor, group facilitator, author, CEO coach and public speaker. He has co-authored several books, including Winning Teams, Winning Cultures and 21st Century Leadership. In 2013, he published his latest book, Up the Mood Elevator: Living Life at Your Best.

## about Senn Delaney

Senn Delaney, a Heidrick & Struggles company, is widely recognized as the leading international authority and successful practitioner of culture shaping that enhances the spirit and performance of organizations. Founded in 1978, Senn Delaney was the first firm in the world to focus exclusively on transforming cultures. More Fortune 500 and Global 1000 CEOs have chosen Senn Delaney as their trusted partner to guide their cultural transformation. Senn Delaney's passion and singular focus on culture has resulted in a comprehensive and proven culture-shaping methodology that engages people and measurably impacts the spirit and performance of organizations.

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