Paris Phoenix Group

WHITE PAPER

Why Does Organizational Culture Matter in Mergers and Acquisitions?

Elizabeth Pavese-Kaplan, M.A.
Consultant

Mergers and acquisitions (M&As) are a common way to gain competitive advantage. However, research on the success/failure rates of (M&As) has indicated that approximately 55-77% of all M&As fail (Lajoux, 2005), both in terms of delivering on the anticipated financial guarantees outlined when the M&A is initiated and in disruptions to the people side of business (e.g., loss of talent, significant decreases in motivation and morale, and decreased customer satisfaction). Given this finding and that the rate of M&As is continually increasing, it is unsurprising to find research efforts increase over the last few decades that have aimed toward understanding why so many of these ventures fail to return on the promising benefits. In general, research (Cartwright & Cooper, 1993) indicates that all too often organizations overlook or ignore human capital and organizational culture issues in selection decisions and the due diligence process prior to a merger or acquisition. Executives tend to primarily focus on the more tactical business aspects such as processes, finances, legal, and customer issues. Moreover, there is little attention given to the integration process (Lajoux, 2005), the very tactical issues of joining the two companies. Even when it makes good business sense (e.g., increased market share, diversification, increased profit), integrating people and belief systems (organizational culture) is very difficult to do well.

ORGANIZATIONAL CULTURE IS A PRIMARY CULPRIT

Organizational culture has an important impact on an organization's performance, thus interest in how the combination of two cultures affects M&A performance has become an issue of interest among researchers and practitioners alike. In particular, research has focused on understanding the relationship between cultural fit/differences and M&A performance. One way cultural differences have been studied is by looking at differences in top management teams (TMTs). For example, Chatterjee, Lubatkin, Schweiger, and Weber (1992) examined a variety of cultural dimensions (e.g., risk-taking, performance-orientation, and innovation) in TMTs of 30 M&As and found that TMT cultural differences were inversely related to stock market gains. In a similar study of TMT cultural differences and firm performance (Weber, 1996) post-merger financial performance was unrelated to TMT cultural differences, a finding that contrast those found by Chatterjee et al. (1992). However, Weber (1996) did find that TMT cultural differences were negatively related to integration effectiveness. Meta-analytical findings (Stahl & Voight, 2008) provide further support for both the positive and negative relationships found in previous research. More specifically, organizational culture differences matter in varying ways in relation to M&A performance, in some cases they lead to synergy realization, value creation, and financial performance and in others they lead to decreases in stock-market value and no synergy realization. These contingencies are perhaps best explained by the existence of an effective integration process (Stahl & Voight, 2008; Weber, 1996), which guides the intentional management of cultural differences to maximize the potential benefits of the M&A and minimize the dysfunctional outcomes that so many firms experience.

Organizational Culture is a complex and deeper issue to understand on its own. We recommend reading our related white paper, *What is Organizational Culture and Why Does it Matter?*, for a more comprehensive review.

Collectively, it is clear that culture should not be ignored in the M&A process as research demonstrates how organizational culture can negatively and positively impact important organizational outcomes. Culture may be a tipping point for making or breaking M&A success however, culture in and of itself is not to blame. The ways in which organizational leaders and M&A steering committees deal with the meeting of the two cultures is the culprit. What is more, the integration process and intentional, continuous management of cultural issues are often where M&As break down.

WHAT ABOUT CULTURE MAKES AN M&A MORE CHALLENGING?

Briefly stated, organizational culture is widely accepted as the collective values, norms, and beliefs of the organization (Schein, 2004) or "how and why things are accomplished here." It is highly unlikely that two cultures are exactly alike, thus any differences will present some amount of tension and difficulty during an M&A. Additionally, because cultures are not inherently "good" or "bad" (that is, they are not 'right' or 'wrong', but rather a culture reinforces and rewards desired behaviors and support the strategy, or they are not aligned to the strategy and desired behaviors), it can be difficult for two cultures to come together. Furthermore, when cultural attributes are not shared or are not complimentary, culture clash occurs (Carleton & Lineberry, 2004; Schein, 2004), creating conflict and stress within the organizational system. With marked differences in "why" work is accomplished, and different attitudes toward the value of certain work attributes over others, it is obvious that integration would be potentially challenging. It is very difficult to undo and change patterns of behavior and a belief system that has persisted and been reinforced through organizational processes over time, even if the two organizations are now supposed to be working towards the same goal.

Conflict between cultures is not the only challenging point. The integration process is often further compounded by the fact that many organizations do not have an understanding or measurement of their current culture, and therefore cannot understand how that will or will not match to the organization they are joining or acquiring. The more knowledge of how and in what ways the two cultures compliment and are incompatible, sets the stage for better management of the M&A integration process. Even better than understanding the similarities and differences is a purposeful effort of leaders to explore and articulate what a new post-merger culture should be, including new or changed behaviors desired to move forward.

It's important to note, however, that similarity between cultures is not a necessary precondition for successful integration (Cartwright & Cooper, 1993), nor does it mean that congruence or agreement between the cultures cannot be met. For example, as highlighted by the findings on culture research in M&As (e.g., Stahl & Voight, 2008), differences in culture can yield positive outcomes because they complement one another or fill a necessary void to achieve particular strategies. Yet, when mismatch creates conflict and incompatibility in how work is done and why, more change efforts will need to be accommodated and taken action on in the change process. How the two organizations manage the stress and conflict produced by significant cultural differences will contribute to a more successful integration process.

To start, leaders need to recognize and anticipate which cultural differences are likely to be most challenging to overcome. Deep-level cultural learning (Schweiger & Goulet, 2005) about each other's culture is the first step from a leadership and management perspective as it aids in developing a more shared understanding between firms, where subsequent planning and management of differences can be built off of similarities between the organizations. Additionally, extending cultural learning interventions to the employee level aids in motivating employees to work together for a common purpose, because they receive more interaction with the other culture prior to formal work engagements. Limited interaction prior to the formation of new teams often contributes to more stress and conflict because employees from either side are unaware of the differences that exist and are thus less prepared to work through them. More formal learning or interventions are not the only solution for preparing and actually managing through conflict and stress. Leaders and managers also need to acknowledge employee stresses as a result of cultural differences and demonstrate empathic attunement – the capacity to recognize, understand, and share feelings experienced by others – (Schweiger, Ivancevich, & Power, 1987), while modeling the new behaviors that will help employees bridge the cultural gaps. In many mergers and acquisitions, employees feel that leaders and managers are far removed from the employee experience and do little to help them through the integration process (Buono, Bowditch, & Lewis, 1991). Therefore, purposeful connection with employees is an important step for organizational leaders on both sides to take as M&A success is contingent more on the integration of people than the 'hard' business facets. Overall, the most successful and meaningful integrations are collaborative (Cartwright & Cooper, 1993), with leadership from both sides and a change team that is intentional about creating a more unified organizational culture.

As previously noted, culture can be a deal-breaker or deal-maker in M&As. As such, it is vital for thorough cultural assessment during due diligence to take place – measuring how both cultures are compatible and incompatible – and actively manage culture (e.g., cultural learning, addressing employee concerns and issues, modeling new culture behaviors) throughout the integration process. Once the tactical aspects of an M&A are addressed, what organizations are left with are people from two different backgrounds who need to work together seamlessly. Approaching M&As from an organizational culture perspective provides a systems view on the interdependent components that need to work together to ensure success.

CULTURE ASSESSMENT AND COMPARISON

We believe it's important to measure cultures of both the acquiring company and company being acquired, as most M&As fail (i.e., not returning on financial prospects and experiencing significant dysfunction in their employee system) due to issues resulting from culture clash and the non-management of those issues. In fact, Carleton and Lineberry (2004) indicated that most M&As fail for two key reasons: (a) failure to assess the impact of merging and integrating corporate cultures and (b) failure to plan systemic, systematic, and efficient integration of cultures. These are perhaps some of the most difficult and challenging issues to management effectively during any change process. However, organizations that understand the implications of potential acquired organization's cultures will be better positioned to achieve profitable integrations.

Understanding the "why" behind people's behavior is important to know early on in the process as it forms the underlying reasons why employees act in the ways that they do. Assessment of cultures will help organizations better manage the integration process because they will know where the cultures complement each other and where they diverge. A culture assessment process we have used with organizations includes a broad culture assessment administered to all employees of the acquisition with the results compiled and compared to the acquiring company's current culture results. This phase enables the identification of gaps and similarities between the cultures and recommendations for where culture integration will be more and less difficult and guide the integration and other change management processes. Next, it is important to discuss how the new cultures will come together to create the new culture and way of being that best supports the business strategy. The conversation needs to focus on what each organization can keep, give up, and embrace from the other to reach an aligned culture supportive of the newly merged company. A third and highly recommended step in the assessment process is to administer a second survey after the acquisition has 'closed'. This survey is directed toward the acquired employees inquiring about their experience during the integration process. The primary focus is on integration and planning activities but also include elements of workplace climate and administrative elements of the acquisition.

> **It's important to measure cultures of both the acquiring company and company being acquired.**

Although culture is recognized as a critical issue to the success (or failure) of M&As (Schein, 2004), it is rarely assessed during the due diligence phase of the M&A. While there are off-the-shelf culture assessments available commercially, we have found that they make the assumption that there are 'good' or 'right' cultures for an organization, rather than our perspective that there is a culture appropriate for each organization to reach its business strategy. Therefore, we have found the aforementioned process using our customized culture assessments, unique to the companies and situation, to be particularly effective in helping organizations to think more strategically about the integration process, and to be more useful and applicable.

Starting with an assessment of organizational cultures allows for more effective and strategic alignment of the entire integration process. It informs the overall plan for how integration will occur and where the most effort is needed. However, culture assessment as part of the due diligence process is only one piece toward ensuring M&A success.

REDESIGN PROCESSES

Organizational culture is also created and continually reinforced by processes (both daily, tactical processes and large scale practices) that take place within the system (Carleton & Lindeberry, 2004; Galpin & Herndon, 2007). Thus, to ensure M&A success the desired culture needs to be supported by systems and daily practices that reinforce the new values and behaviors. To begin the revamp of organizational processes, it is prudent to assess organizational compatibility between the two cultures related to tactical, day-to-day routines which invariably underlie larger systems (e.g., performance management). Conducting a "compatibility audit" is important to identify and understand how basic processes play out on a daily basis in the two organizations versus what needs to happen in the new culture. For example, just because two cultures are highly collaborative, that does not mean that they approach collaboration in the same way. Specifically, one organization's approach to collaborating may be having large, face-to-face meetings with open dialogue, and many people participating at once. Another organization's approach could also be large, face-to-face meetings; however one person speaks at a time rather than the more free-for-all dialogue. And yet a third organization's collaboration might solely exist in email, with no meetings ever taking place. It's not that either approach is less or more collaborative, each company just approaches it differently based on the various norms and values they hold. Integration of the cultures can occur more smoothly when organizations are prepared to deal with these tactical differences in how work is approached.

Challenging current organizational systems and identifying how they align to the needed culture must also occur so that pitfalls can be avoided and success can be enabled. For example, consider training and development. Several questions an organization may ask to determine whether or not the current training and development systems are supportive of the needed culture include: What training and development activities are needed to support the creation and maintenance of the desired culture? What do we currently do that supports and doesn't support the desired culture? Are we teaching and expecting a theory of behavior (or competency model) that undermines our desired outcomes? Do we need to provide training in any areas related to supporting the new culture? Another example is in performance management systems. An organization needs to determine if they are expecting, reinforcing, and rewarding the types of behaviors desired in the new merged culture, or if they are still tied to an outdated system that reinforces undesired behaviors. Without changing the systems, the desired culture does not have the support it needs to become the enacted culture. Overall, organizational alignment is a primary part of the integration process not only to reconcile the differences in organizational infrastructure but to build systems that help create and reinforce "the new way". If the right mechanisms aren't in place to help support the new cultural state and how people will work together day to day, the M&A is likely to fail. Continuous management is necessary and dealing with cultural issues does not stop with assessment.

LEADERSHIP PLAYS AN IMPORTANT ROLE

As culture is the ideology (i.e., norms, values, and beliefs) of an organization, leaders play a critical role in molding and reinforcing organizational culture. Founders especially play a central role in creating and reinforcing organizational culture as the culture stems from their own core ideologies and assumptions. In the context of M&As, leaders from both organizations will inevitably have different ways of operating, distinct ideas about how work should be completed, different expectations regarding communication in the organization, and divergent leadership styles. When the founder is still involved in the organization during an M&A the integration process becomes even more difficult because overtime he/she has had ample opportunity to embed and reinforce his/her ideology into every practice, process, and routine of the organization. Thus, culture change when the founder is involved may require significantly more change management efforts than in cases when the founder in no longer in the picture. As such, given the difficulties that can arise between leaders it is important that leaders co-manage and co-architect the culture changes and reinforce and model the desired culture on an ongoing basis.

Leaders need to be cognizant and call-out potential cultural issues from the start of the M&A process (i.e., in the initial decision-making stages). As previously noted, culture incompatibilities are often what leaders and managers pinpoint as the reason for M&A failure, yet they consistently fall short of approaching these issues from the start (Schein, 2004). Leaders need to plan the integration and align the organization for effective integration from the beginning by mapping and ensuring the organization's mission, values, strategy, processes, and culture all support achievement of the desired results of the M&A integration process. However, leaders need to be flexible in that process as well by adjusting the integration plan, as necessary, based on the results from the due diligence assessment (Carleton & Lindeberry, 2004). Understanding the unique aspects of the culture coming together and how they may clash is essential to leading and supporting the rest of the organization through the changes that need to occur to ensure success. To ultimately drive the M&A to success, leaders must demonstrate the new ways of working and other behaviors that are essential to truly combining the two cultures together.

FOCUS ON COMMUNICATION

Like other major organizational changes, an important factor in M&A success is communication. It is not only imperative from the standpoint of leaders modeling, transmitting, and reinforcing the new culture and ways of behaving. Information sharing is necessary to keep employees informed of upcoming changes which helps put employees at ease. Any failure to communicate leaves employees uncertain and stressed (Buono et al., 1991) about their future employment as well as organizational direction. As such, when there is limited information sharing, employees will seek other means for decreasing their uncertainty and stress typically relying on rumors and other informal communications. However, the reliance on rumor mill information often creates more anxiety and negativity among employees as rumors tend to be embellished, inaccurate, and focus more on negative information. These anxieties and stress levels can lead to more detrimental effects in the employee base including decreases in job satisfaction, organizational commitment, intentions to stay with the organization, perceptions of organizational trustworthiness, honesty, and caring (Schweiger & Denisi, 1991) . One way to combat these negative outcomes and ease employee concerns is by providing a realistic preview of what to expect prior to, during, and after the merger. In fact, Schweiger and DeNisi's (1991) research indicates that employees who received a realistic merger preview experienced more positive outcomes (e.g., less uncertainty and greater perceptions of the organization being trustworthy and honest) compared to employees who did not have that preview. Overall, it is of utmost importance for leaders and steering committees to communicate clear, honest, and factual information in a consistent and timely manner prior to and throughout the entire M&A process.

BOTTOM LINE

Intentionality is key. To ensure that organizations realize the business results leaders anticipate from an M&A, the entire process should be approached from a cultural perspective – one that focuses on both the 'hard' and 'soft' elements of the organizational system. As outlined here, there are many different ways in which Industrial/Organizational Psychology professionals provide added-value to and influence in the M&A process as well as larger organizational systems surrounding those ventures.

Consultant's Corner

Being strategic and thoughtful about the M&A process from a cultural perspective is just as, if not more, important as focusing on 'hard' business metrics. Not only do we learn these lessons from empirical research, legal systems have also highlighted the importance of considering culture issues in M&As – a key lesson from the potential merger of Time Inc. and Paramount Communications in 1989 and the ultimate merger of Time Inc. and Warner Communications. The Delaware Supreme Court ruled that is was more appropriate for Time Inc. to safeguard its culture by merging with Warner Communications despite the more profitable offer from Paramount. This ruling established that organizational culture is a practical and important consideration in merger decisions above and beyond short term financial gains. In addition, large business M&As, for example the HP-Compaq merger in 2002, provide detailed case study on the approaches industry leaders take during these business ventures. In-depth cultural due diligence and a comprehensive integration plan were cornerstone to creating a successful merger. HP took a rigorous qualitative approach toward analyzing and comparing the company cultures, which included over 100 interviews with executives, more than 100 focus groups with employees across the globe, site observations, and detailed reviews of internal documentation from both companies. Following the analysis, a cultural steering committee planned and oversaw all integration initiatives.

References:

Buono, A.F., Bodwitch, J.L., & Lewis, J.W. (1991). When cultures collide: The anatomy of a merger. Human Relations, 38, 477-500.

Carleton, J.R. & Lineberry, C.S. (2004). Achieving post-merger success: A stakeholder's guide to cultural due diligence, assessment, and integration. San Francisco, CA: Jossey-Bass.

Cartwright, S. & Cooper, C.L. (1993). The role of culture compatibility in successful organizational marriage. Academy of Management Review, 2, 57-70.

Chatterjee, S., Lubatkin, M.H., Schweiger, D.M., & Weber, Y. (1992). Cultural differences and shareholder value in related mergers: Linking equity and human capital. Strategic Management Journal, 13, 319-334.

Galpin, T.J. & Herndon, M. (2007). The complete guide to mergers & acquisitions: Process tools to support M&A integration at every level. San Francisco, CA: Jossey-Bass.

Lajoux, A.R. (2005). The art of M&A integration: A guide to merging resources, process, and responsibilities. New York: McGraw-Hill.

Schein, E.H. (2004). Organizational culture and leadership (3rd edition). San Francisco, CA: Jossey-Bass.

Schweiger, D.M. & DeNisi, A.S. (1991). Communication with employees following a merger: A longitudinal field experiment. Academy of Management Journal, 34, 110-135.

Schweiger, D.M., Invancevich, J.M., & Power, F.R. (1987). Executive actions for managing human resources before and after acquisition. Academy of Management Executive, 1, 127-138.

Schweiger, D.M. & Goulet, P.K. (2005). Facilitating acquisition integration through deep-level cultural learning interventions: A longitudinal field experiment. Organization Studies, 26, 1477-1499.

Stahl, G.K. & Voight, A. (2008). Do cultural differences matter in mergers and acquisitions: A tentative model and examination. Organization Science, 19, 160-176.

Weber, Y. (1996). Corporate cultural fit and performance in mergers and acquisitions. Human Relations, 49, 1181-1202.

Through customized business solutions, Paris Phoenix Group helps answer complex organizational questions around employee issues. Our consultants focus on understanding how the employee perspective fits into the organizational people system. Each of our customized solutions is founded on a rigorous research approach. This allows us to provide our clients with well-founded and effective solutions to meet their business needs.