How advanced acquirers approach culture in M&A

Findings from the Willis Towers Watson M&A Culture Group

Willis Towers Watson

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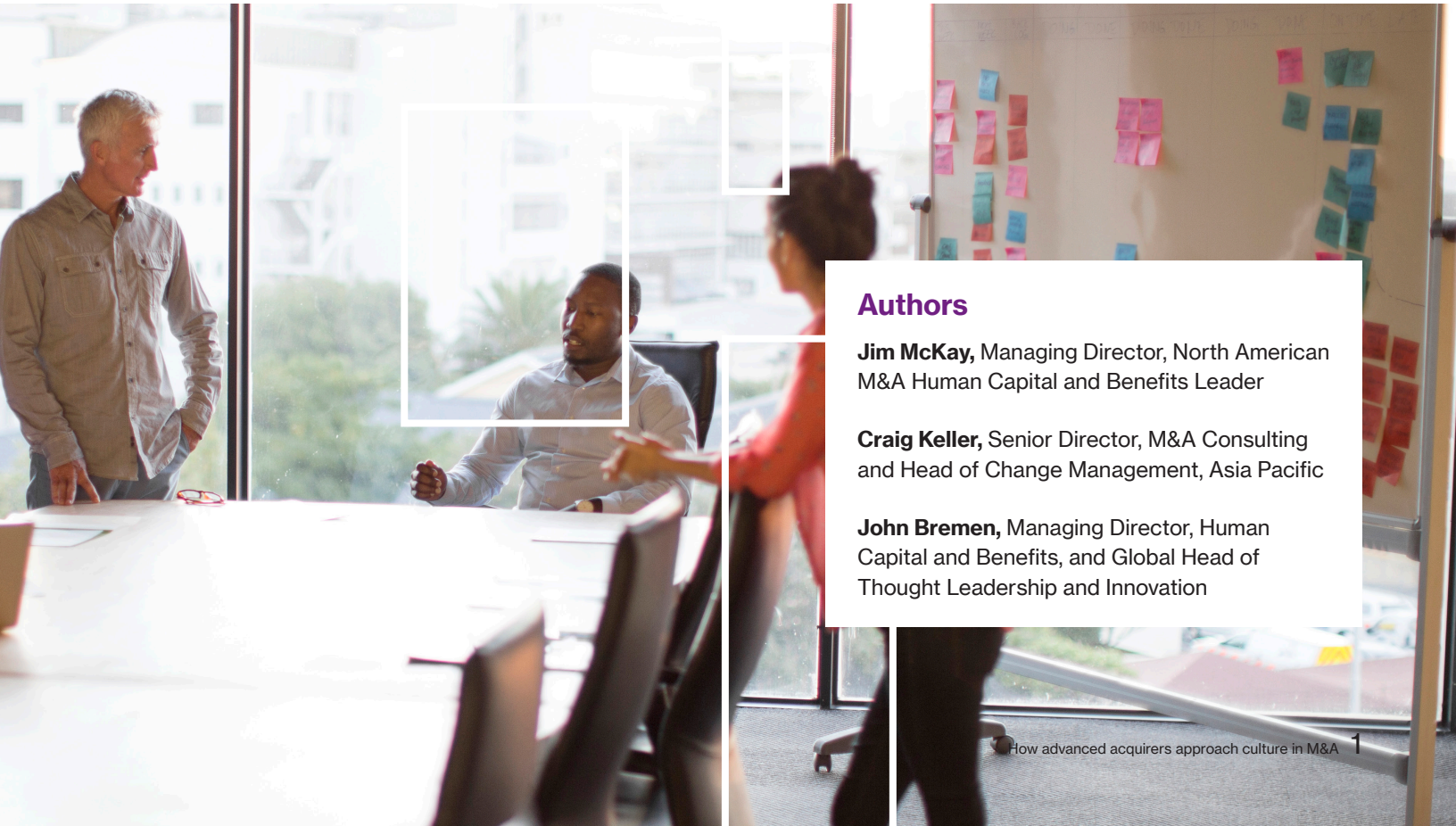
Table of contents



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Introduction

This paper is part of a series about advanced M&A cultural practices. The intent of the series is to share the current state of leading practices in cultural work, specifically and only for the M&A situation.

It is based on the findings from a unique and highly experienced group of M&A practitioners that meet on a regular basis with Willis Towers Watson to share and discuss their views on this area. Each firm's participants are drawn from its in-house M&A functions, representing corporate development, business development or corporate strategy (the term varies based on each firm's internal definition of the role) and its Human Resources M&A group. Throughout the series, the content reflects the discussions within the group and not the sole practices of any one firm.

The distinguishing feature about the group that will also help readers understand the content better is that cultural investigations are an accepted part of their M&A process. This means that the focus of the paper is on:

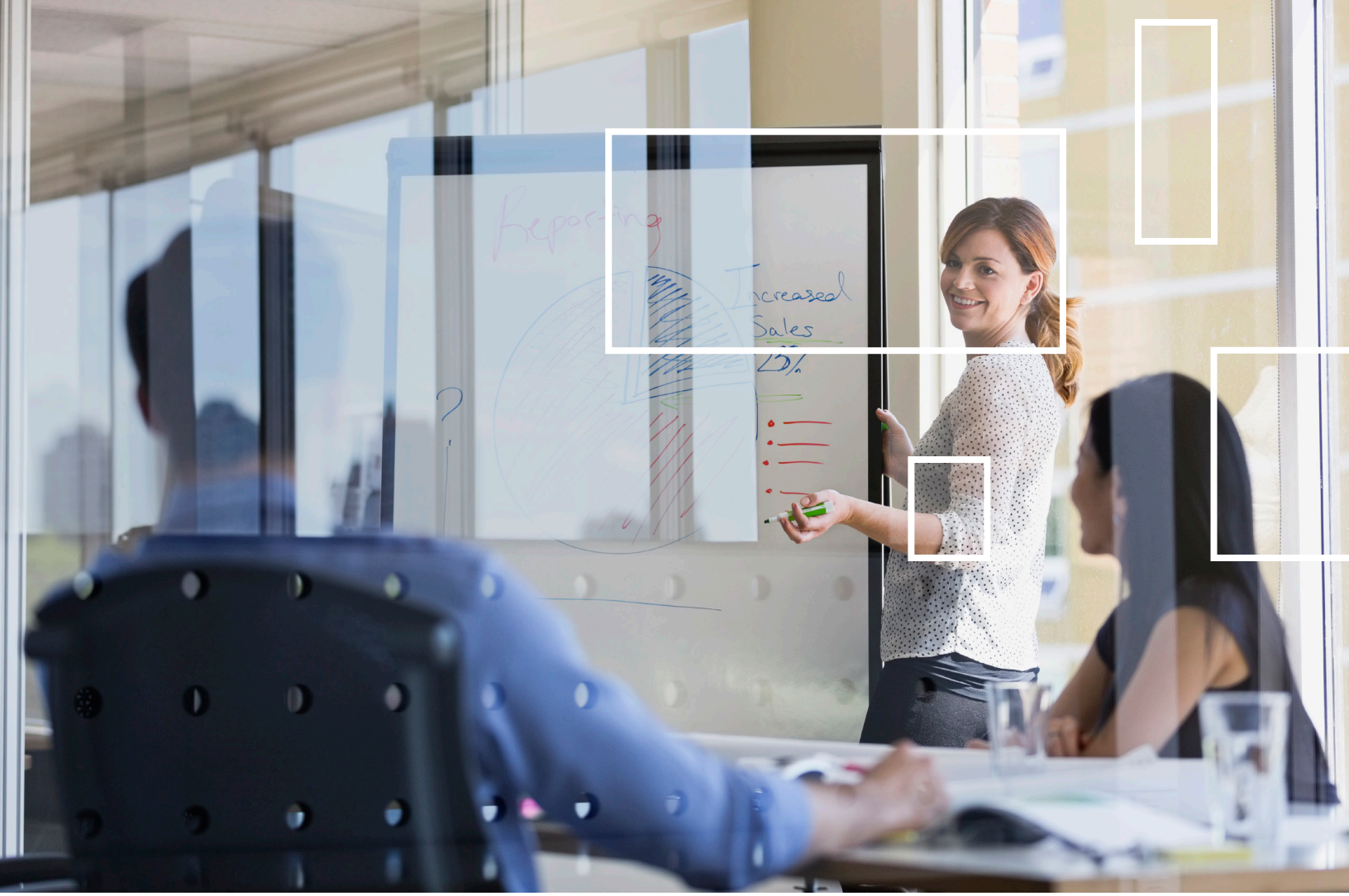
- What they do in culture work
- When and how they do it

This paper does not address why they should do the work in the first place, which is the subject of a separate article in the series.

The reason for this approach is that these firms concluded many years ago that cultural problems are a major factor contributing to deal failures. While they had seen all the publicly available research on how cultural problems led to deal failure, it was their own specific reviews of the success or otherwise of their own deals, led by their corporate development function, that gave them the reason to improve their overall approach to culture, both in the acquisition phase – when they are spending capital – and in the integration phases and beyond – when the return on the capital invested is expected to materialize.

As a result, the group of M&A practitioners developed their approach to address culture in a structured way, similar to how their firms approached any business problem (i.e., being clear on the root causes and problems, and the goals and risks or costs and benefits of any analysis, explained in terms a business leader could understand).

This paper shows how they first brought that structure and discipline to cultural discussions through capturing in one place the parts of culture that have the greatest impact on a transaction. This was accomplished by creating a cultural framework built for M&A purposes, to facilitate the structured and organized discussions in this area taking place. This framework formed the platform for ongoing cultural investigations because it more precisely maps culture's impact on deal outcomes, goals and risks. As one participant commented, "Culture is a business imperative for us; it is not investigating culture for culture's sake."



About the types of transactions in the group's discussion

The discussion is centered on bigger firms buying smaller firms with an emphasis on "talent-based deals," meaning deals where the people at a target are deemed the most important asset among all the other assets at a target. For most buyers, the deal strategy centers on acquiring to expand their capabilities (also known as "scope deals" in M&A circles).

We did not consider any transaction that transformed a company to such an extent that creating a "new" culture, or third culture, was required. While these transactions do happen, they are a very small percentage of actual deals. Likewise, large industrial deals, and mega-mergers, while discussed within the group, are not the focus of this paper. The consensus was that the size, scale and global scope of these deals made it difficult to incorporate the approaches discussed here early, and also that there were many other "assets" in the combining firms, well beyond just talent and employees.

Finally, the issue of growth or erosion of shareholder value as a specific goal, as seen through buyer stock price changes, is not typically a goal of talent-based deals and was not a factor in our analysis. In contrast, larger deals lend themselves better to share price comparisons with peer companies, as this data is publicly available and can then be analyzed by consulting firms and academics alike.

However, the general principles reviewed here can be adjusted and applied in varying "doses" to most deals.

Chapter 1

Key imperatives of addressing culture in M&A transactions

> **“Successful transactions require people to change, and to do that we need to be specific on the changes, not just the what, but the why and how. We need to tell them what the priorities are, and what actions they need to take, that they had not done before. And you can’t throw too many changes at one time and expect anyone to work through them effectively. That’s just not how humans are wired to work. Nor can you talk about the importance of changes if those changes have a weak line of sight to specific goals and risks.”**
>
> Integration Leader, Corporate Development

The group highlighted nine imperatives to addressing culture in M&A, in three broad categories:

- Culture
- Leadership
- Developing people

About culture

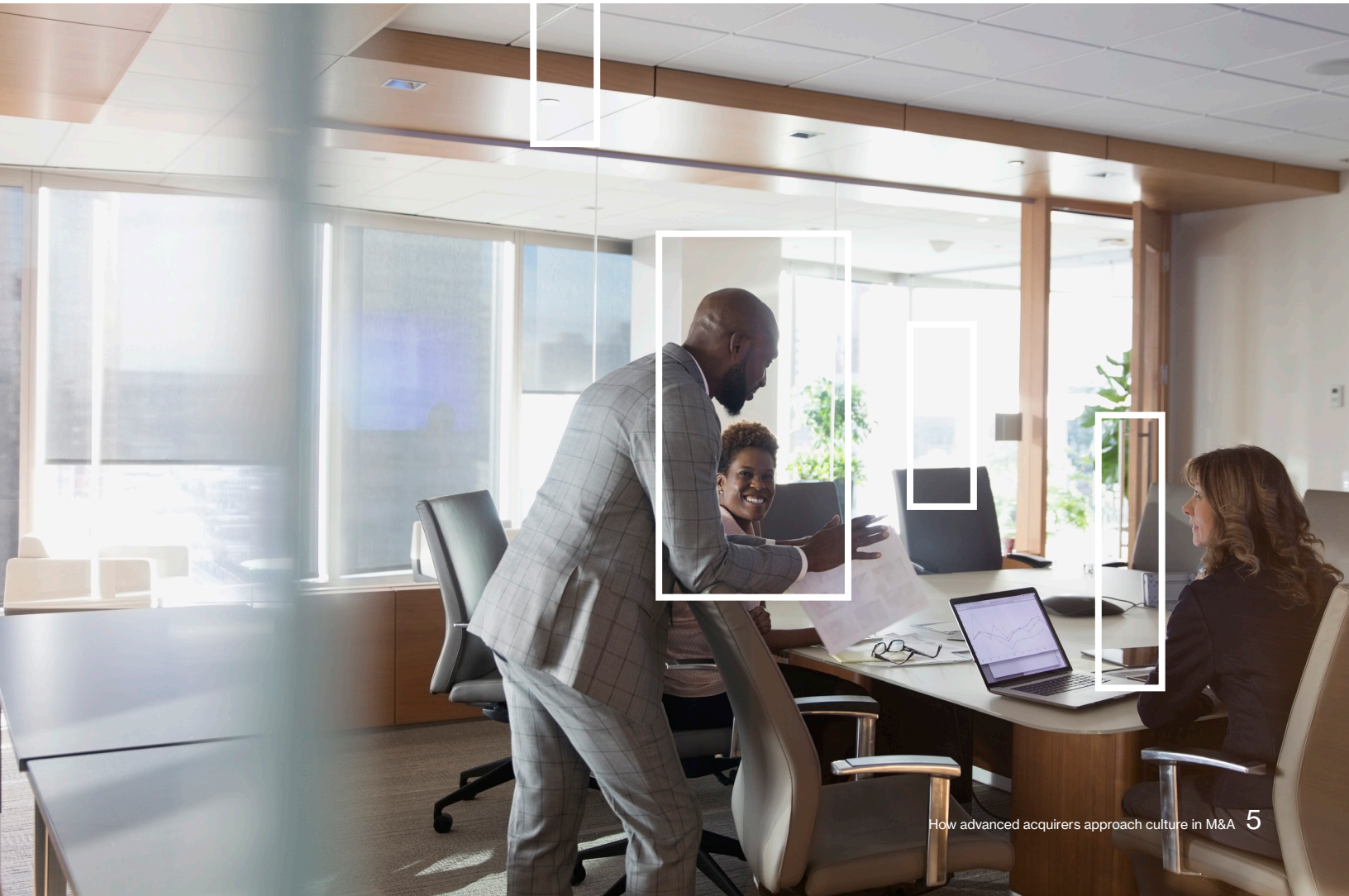
1. **Culture and cultural integration are important** in all transactions where people are involved, but even more so in talent-based deals, where people are the most significant asset of the target.
2. **Don’t leave culture to be an integration activity.** Start early. Most cultural problems are entirely predictable and can be traced back to decisions made – or not made – early in the deal life cycle. The consequence of leaving culture work to the post-close phase is that, by then, it’s too late to effectively resolve many of these predictable problems or issues, and the opportunity to prevent them happening in the first place will have been lost.
3. **Prepare the approach before any deal surfaces.** Develop the cultural approach and framework so the organization is ready to apply it in the transaction. It’s far more difficult to create a new approach during the heat of any deal.
4. **While a framework is vital, the components are what matter.** Be clear what the term “culture” means in this context to better facilitate conversations about the significant components within that term and how these components directly impact deal success.
5. **It is not just about behaviors.** Do not get caught up thinking that culture is just about behaviors. To impact the deal, it boils down to people – specifically, what they should do differently than what they have done before. They must know what the priorities are and the actions to take more so than “behavioral changes.” Priorities and actions get to urgency and importance, while “behaviors” can fall into the category of “generalizations,” often to be addressed much later in the post-close phase.

About business leadership

6. **The business leaders must take ownership of culture.** The key here is that the business takes ownership of "culture as a business challenge" rather than leaving it in the hands of any function or delegating it to the integration management team. There is nothing special or unique about culture challenges, and this means culture needs to take its place alongside many other competing priorities and challenges. But it cannot be a stand-alone item, blind to what other challenges exist in a deal.

Developing people who can lead the cultural assessments

7. **Educate them to ensure they understand M&A deeply.** The lack of understanding of the M&A process and its phases; all the dynamics relating to speed, confidentiality, ambiguity, lack of access to people broadly; and the challenges of working with leaders who often hold conflicting views or no views at all need to be understood and processed before understanding where "culture" fits.
8. **Train them to prepare and educate other leaders.** Help them understand the reasoning, process, issues and benefits of the work. Do this before any transaction surfaces because it is not easy to get consensus during the actual transaction, especially with leaders relatively inexperienced in either M&A or "culture."
9. **Give those running the investigation the authority to act and intervene.** They are the leaders responsible for defining and controlling the culture discussion at the start. But it is nearly impossible to make an impact in this area if they do not have the authority and support to do so.



Chapter 2

Cultural realities in M&A transactions

> **“It is hard to solve a problem you can’t define. The problem with the term ‘culture’ itself is that there are so many definitions out there. We concluded that definitions fit for the ‘steady state,’ which we already have in our organization, were not fit for the practical realities of a M&A and all the dynamics and constraints that come with trying to do a deal. Culture change at the best of times is a slow process, whereas in contrast M&A is fast and chaotic.”**
>
> Vice President, Human Resources

Definition. Just defining culture is one of the most difficult parts of the M&A process to address because there are so many definitions out there (just try an internet search of the term). Furthermore, as commented previously, definitions fit for the steady state are not fit for the M&A environment. So, to ground the reader, we will explain what we mean by culture in an M&A context, but we will also explain why the constituent parts are more important than the definition.

Components of culture (shown in the culture framework). The fact is that not all components of organizational culture are equally important or will have a major impact on the performance of the organization during the critical acquisition and integration phases that form part of the total deal life cycle. The challenge is to distinguish the truly important from the elements of lesser importance based on the type of deal and the phase within the deal life cycle. While, this challenge should not be underestimated, in practice no firm tries to tackle all the parts of culture shown in the framework at the same time, or places equal weight on the components. And while it is true to say that each deal is different, requiring a different emphasis, the overall process and starting point are relatively consistent from deal to deal.

People and culture are interrelated. Understand the connection between people and culture. They are inseparable, interrelated and interdependent. The two must be tackled together, since, simply stated, if there are no people in a transaction, then there are no cultural problems to worry about.

As one CEO said,

> **“I don’t buy the cultural excuses. The fact is, we did not have the right leaders who could lead through a transaction, or the right managers who could manage through it.”**
>
> CEO, Fortune 500 firm

This quote places the responsibility for solving cultural problems firmly on the shoulders of leaders first; the group universally agreed that leaders are the people that most influence deal success and together with managers are most likely to keep the key talent and the rest of the employee population motivated and productive.

Everyone takes time to learn culture. This is true for the CEO down to the rank and file. The fact is that people learn culture over time, as they join and work in any organization. People cannot learn culture overnight, but in a transaction, the acquired company’s employees need to learn a lot about the acquirer, very quickly. In the overwhelming number of transactions, the target’s people need to adapt to the acquirer’s way of doing things and not vice versa.

The need for speed in transactions prevails. If the first stages of the deal do not go well, the rest of the deal will likely follow the same path. The general rule in M&A to ensure that deals do start off well is to focus on decisions and actions that impact the short-term goals first and longer-term goals second. Any other activities that don’t support these goals explicitly get deferred. The rule results in the principle of ruthless prioritization of initiatives and supporting actions.

The dominance (inflexibility) of the big firm’s existing culture. The essential starting point in transactions involves two existing cultures: the buyer’s and the target’s. Big firms have multiple business units, often hundreds of thousands of employees and well-established cultures. Even then, in today’s environment, many of these firms are in the process of changing or adapting their companywide cultures as they try to grow, innovate, transform or just survive.

For acquisitions, the reality is that larger firms cannot change their structure to accommodate any one deal (and these firms may do multiple deals each year). In the vast majority of deals, the buyer must integrate the target into its culture, even if the buyer sees elements of the target’s culture that it likes, which often happens.

HQ’s need for consistency versus preserving and growing the business. From the headquarters level, the buyer wants to implement many of its required policies and procedures (often referred to as “’non-negotiables”). But from the deal strategy perspective, the business doing the deal wants to not just preserve what made the target successful but also grow the integrated business. There is always continued tension between this need to “integrate” and the need to preserve and grow value.

> **We don't try to push 'cultural' ideas up to HQ but keep them at the acquiring business unit level. For example, if the seller has better ways of selling to customers, or keeping them, or expanding them, or charging them a premium, then that's the sort of stuff we want to learn and adopt. But we also need to clearly identify the key employees who truly drive most of these customer relationships, and often that is not as easy as it seems on paper, and even then, we run into another problem. Often the way they are paid is not the way we pay our similarly situated employees."**
>
> Business Unit Leader

The people part and the learning part are culture's essential features, and these often run at odds with the realities of M&A, where the general principle for decisions emphasize "speed over precision." Both these principles, the need for speed and prioritization, must be applied to any culture work in the M&A context. As one participant stated, "*The whole M&A transaction is a compromise — between rules and realities, perfection and time.*"

So, to illustrate some of the misperceptions and challenges with this topic, let's review what one CEO said about culture in a huge merger.

Chapter 3

‘The culture will take care of itself’ and other M&A myths

In 1998 Citicorp and Travelers announced plans to merge to create Citigroup, a huge financial conglomerate that combined banking and insurance. While the merger was a megadeal and highly transformative, it is still notable to our analysis because it ran into many cultural problems right from the start.

While this deal has been the subject of many articles, which another internet search will unearth, the issues around culture and cultural integration are what we are interested in examining. In today’s deals, many of the issues repeat, and the comments below still ring true today even 20 years later.

John Reed, then CEO of Citicorp, was quoted as saying the following:

Shortly after announcement during an Investor Q&A session:

> **“The culture will take care of itself. People will ultimately learn how to work together. They may not like it. They may complain a lot. But you know what? Five years from now, they will be quite surprised at how they have learned to get along.”**
>
> Business Week, June 7, 1999
> *“Is this marriage working?”*

And one year later, a different story:

> **“We are talking about putting two cultures together that are quite different, quite distinct. I am trying hard to understand how to make this work. I will tell you that it is not simple, and it is not easy, and it is not clear to me that it will necessarily be successful. As you put two cultures together, you get all sorts of aberrant behavior. I will tell you that the literature of putting two families together speaks volumes to me. The problem of stepparents, the description of some children rejecting one parent and other children rejecting other parents is all meaningful to me.**
>
> **And what you really have to do in a merger is change. But the willingness of people to change is limited, and what you pay them seems inversely correlated to their willingness to change.”**
>
> Fortune, March 20, 2000
> “*Behind the Shootout at Citigroup*”

His words turned out to be prophetic, Reed left the firm in 2000 and Citi and Traveler’s “separated” in 2002.

In this brief description, he has covered a broad range of issues: from the initial and all-too-common refrain of “culture is not that important” to the pain points that occur if it is left to chance – with leadership, pay and change challenges all wrapped up in a few sentences.

Chapter 4

Defining culture for the specific purpose of the M&A transaction

As noted earlier, there is not one agreed-upon definition of culture, but we will show how these serial acquirers overcame that initial obstacle.

> **"First, you have to get the culture elephant out of the room before you can move forward. In M&A circles, culture may be the most widely used business term without an agreed definition. It means different things to different people, even in the same organization. That's not good; it is confusing and wastes leaders' time. We can't expect leaders to spend their time on theoretical debates or trying to provide solutions to broad generalizations. Our leaders can act on specifics; they can't act on generalizations."**
>
> Corporate Development

> **"But, even if leaders recognize the importance of these issues, and believe me, that's not always the case, they still struggle with the relevance of this work early in the deal life cycle while other initiatives are going on at the same time requiring their time, effort and attention. They need to know how important, urgent and impactful any recommendations are. We still have the John Reeds of this world to convince."**
>
> Corporate Development, Participant responding to the quote above

Develop a framework to control the conversation (refer the culture framework PDF)

The first step is to define the scope of the M&A cultural investigations using a framework to initiate the conversation. The framework helps leaders understand the cultural concepts and elements and their importance to the transaction's success in a simple yet comprehensive and visual way, but it needs to be balanced with a heavy M&A educational element to help remove the risk of generalizations or academic debates infiltrating the discussions. This keeps the conversation focused on solving problems and issues in the business situation at hand: the deal itself.

The group developed this framework to house these concepts and illustrate visually the issues and questions leaders need to think about, but also so the group itself could dig into deeper conversations without getting stuck on each firm's way of describing culture.

However, it is important to understand that this is an "aggregated" model, and each firm has its own variation suitable for its own company-specific purposes, which is adapted from how each firm currently describes its culture.

The seven components and the questions or issues they are designed to address are:

1. **Business drivers and basic facts:** This answers the fundamental questions of what you are buying, why you are buying it and where the value is.
2. **Leadership and talent:** This answers the question of who the key people are in the target.
3. **Leadership compensation and performance:** This shows what is truly valued in the target and who is valued when compensation totals are compared.
4. **Organizational design and operating model:** This shows what needs to change, mostly in how the target needs to be organized and operate to be part of the larger firm. This component comes up as the most common and most predictable one that requires change at the target. Also, these predictable changes often cost a lot of time and effort and cause frustration for target employees as they try to adapt to the bigger firm's way of operating.
5. **Non-negotiables:** This term is unique to M&A and answers what areas must change to become part of the buyer. It is closely tied with the organizational design and operating model, but other examples are financial reporting, business budgeting, budgeting approvals, health and safety standards, compliance standards and training, and travel and expense rules.
6. **Inclusion and diversity (sometimes also referred to as diversity and inclusion):** This answers what the current status is and what potential changes may be needed in integration. This is an issue of growing importance especially to large Western firms, but it is not often a priority for smaller firms and not an issue at all in some non-Western countries.
7. **Post-close working relationship:** This answers how employees at all levels from the two organizations work together after close. This is what is learned, over time and is the most intangible of all the components. It is generally thought of as the "softest" element of culture compared with those elements above. Leaders are not excluded from these issues; they face them first.

In reviewing just a few of these components, you can see why M&A professionals are horrified when they hear the statement “Nothing much will change” during deal discussions.

But connecting and coordinating all the above pieces and keeping them connected throughout the whole deal life cycle is a big challenge. The specific M&A challenge, as the saying goes, is that *“Knowing what to do, is not the same as deciding what to do, and that’s also far different from actually doing it.”*

> **“When we first started, we’d get pushback from leaders who reckoned that most of these things can only delay getting the deal consummated, seeing them as problems without immediate solutions, and problems for the integration team to solve. We quickly fell back into our old ways. Issues were worked in siloes and all the interdependencies got lost. What started off as strategic became very tactical. Everyone was responsible but nobody was accountable.”**
>
> Corporate Development

Chapter 5

The practical application of the M&A cultural framework: Input

The cultural analysis begins for these firms as early as possible, with the framework being used to capture the relevant information in one place. The process starts by collecting and organizing the basic facts and data for both organizations, where the core elements shown reflect the building blocks of the organizations.

> **"At first, and like many other firms, we worked on parts of the components in the model. But it was not very strategic. We needed a better starting point and for that starting point to lead to a more, comprehensive, integrated, coordinated and connected approach within our organization."**
>
> Corporate Development

The practical application: Output

Once the basic information is gathered, however incomplete – and it will be incomplete – the first pass in discussing the results forces leaders to be specific about the parts they deem important. The preliminary answers give a faster and better understanding of both organizations and the likely integration challenges, including the complexity of the integration. These reviews serve as a catalyst to help map any one of the components to a specific goal or risk. They bring out the degree of change needed to successfully execute any plans based on the integration strategy.

The output helps determine exactly how the integration will be approached as well as the funding and resources needed to raise the probability of success: Any analysis can only increase the probability of success but cannot guarantee it. So begins the "ruthless prioritization" process, based on having better information at hand early enough to make better decisions.

> **"Time is not your friend here, and as the intensity of the deal heats up, financial and legal issues dominate the due diligence stage, and then maintaining operational performance dominates the period from announce to close. And in talent deals, both periods, due diligence and announce-close can be very short. We needed an established starting point; we just don't have time to develop new models or approaches during the heat of a deal."**
>
> Corporate Development

The hard data summarized by the framework responses inform leaders and direct thinking in these situations and move off the common problem of decisions in the cultural space being made by anecdotes, opinion and "stories" from their own beliefs or buildup in the course of target interactions. It is not that these stories and opinions are not important – they are – but now they can be tested against the facts gathered.

However, this is not a "one and done" process. Early decisions need to be revised on a regular basis as new facts and data emerge or circumstances change, which is typical in transactions. In fact, it would be atypical if circumstances did not change over the course of a transaction.

As a related by-product, this approach ensures that areas that leaders have no control or influence over in the early stages do not distract from the conversation. These are mostly addressed in the post-close component and cover such aspects as:

- How will we work together?
- What do we do about employee engagement?
- How do we ensure that we have the right leadership behaviors?

It is important to highlight that these areas are not ignored, because information will be collected to understand how each firm operates. But they are not the focus of the early investigations and no decisions in these areas are made at this stage. These are typically areas that are taught, experienced and observed, which takes time to do, and they unfold mostly after the deal closes – the learning time-based part of culture, mapped to the deal phase where it rises in priority.

The practical benefits: The framework turns cultural generalizations into deeper business discussions because it:

- Helps leaders come to a common understanding of the relevance and meaning of culture within the M&A context for each specific deal
- Breaks culture into terms and components that leaders can easily understand and focuses their attention on the impact of the key components on a specific goal or risk
- Establishes the direct dependency of the people part to the broader cultural part and the people who will be responsible for executing the integration
- Forces early discussions about the value of the target – as a stand-alone firm and then in the potential combination
- Necessitates further discussions about the people who drive that value now and in the future combination, and where these people are currently in the organization – usually even more difficult to get to than the "value" part
- Provides better information to create or refine and resource the integration strategy, plan and tactics

Summary

While we know that experienced acquirers evaluate culture already, we also know that there is no "silver bullet," no "one way" or the "best way." Each firm does it differently, but they all share one principle in common: They all have a very organized and disciplined approach.

The framework is the starting point – but there is nothing unique about the framework, and each firm has variations of this model for its own purposes. The important point is to have a framework in the first place, prepared and ready for use, and for it to contain the elements that support and most impact deal goals and risks.

Most of the planning for integration and the related changes first takes place at the buyer, but then in collaboration with the target as the deal moves through the phases. However, most of the actual changes happen at the acquired business and are actioned by the people who work there. These are the people who must change their daily activities to make the changes "stick."

Done well, this work can have a massive impact on the success of the deal.

> **"We've never looked back once we were able to demonstrate the value of this work. Now business leaders reach out to make sure we're going to do these assessments for them, especially since we can have multiple deals going on at the same time, which frankly stretches our ability to give each deal equal attention."**
>
> Corporate Development, Cultural Assessment Team

About Willis Towers Watson

Willis Towers Watson (NASDAQ: WLTW) is a leading global advisory, broking and solutions company that helps clients around the world turn risk into a path for growth. With roots dating to 1828, Willis Towers Watson has 45,000 employees serving more than 140 countries and markets. We design and deliver solutions that manage risk, optimize benefits, cultivate talent, and expand the power of capital to protect and strengthen institutions and individuals. Our unique perspective allows us to see the critical intersections between talent, assets and ideas – the dynamic formula that drives business performance. Together, we unlock potential. Learn more at willistowerswatson.com.

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