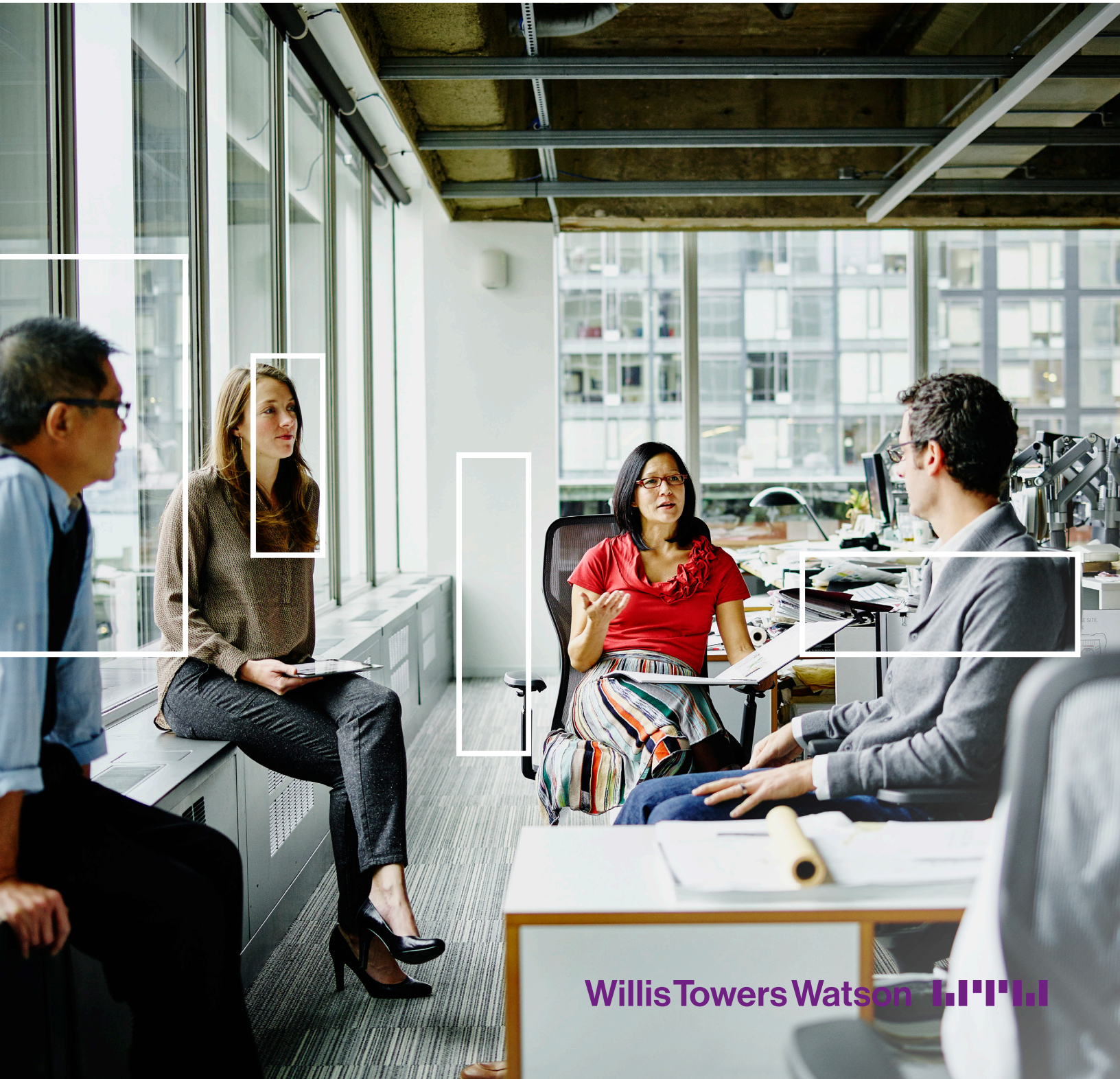
Building the business case for culture in M&A

Findings from the Willis Towers Watson M&A Culture Group



Willis Towers Watson

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Introduction

This paper is the second 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.

Our first paper in the "M&A cultural practices of advanced acquirers" series showed how M&A practitioners brought structure and discipline to cultural discussions through capturing in one place the parts of culture that have the greatest impact on a transaction. This paper focuses on how they created the business rationale for incorporating culture as part of their M&A process in the first instance. Each firm has different ways of describing the work they do in "culture" and so the terms "cultural work," "assessments," "investigations" and "organizational assessments" (the term several use for their cultural work) are used interchangeably. The important point being that each firm has an organized and disciplined approach to the work and a clear rationale for what they do and why they do it.

As in any approach to complex problems, the first step is to understand the specifics of the business situation. For M&A deals this means understanding how a transaction is put together, from beginning to end, and what happens, and what is important, throughout this journey. To achieve this means understanding, the deal life cycle, the phases within this cycle and the goals within each phase before determining where "culture" fits.

Commentary on studies on culture in M&A

The group reviewed the vast amount of external research in this area to consider what could be learned from what others outside the group were doing. The comments below reflect the summary of several of the group's discussions in this area but are not specific to any research paper or article.

Generally, the research confirms that, by any measure, M&A is a complex, high risk venture. Based on the source of the research material, between 50% and 70% of deals fail to meet their intended goals. This statistic does need more explanation. It relates to whether the deals reached or exceeded the goals on which the decision to invest was made. But it does not mean these are necessarily bad or poorly performing deals; they may well be profitable in their own right, but they have not reached the profit and performance measures on which the deal investment was based, or for a deal built upon multiple goals, only some of which have been fully met.

The research shows that cultural issues consistently rate as a key source of deal failure. Generally, though, studies did not have a consistent definition of culture and definitions were either based on author's definition, not defined at all or often applied with the benefit of hindsight to a deal already classified as a "failure." Therefore, there is no certainty in reviewing the studies that respondents were thinking about the same issues and terms when responding to their views on the role of culture in deal failures. But this is not an uncommon finding, in that when respondents are asked about their definition of culture, answers can vary, even for respondents within the same organization.

But no matter what the definition, culture is clearly one of the most complex areas for organizations to address; partly because these organizations find it hard to express the compelling business reasons to conduct cultural work in M&A in the first place and partly because they don't have the knowledge, skills or experience to do anything meaningful about it.

Chapter 1

The deal life cycle and typical goals

The deal life cycle is the essential starting point because, in framing the work in business terms, this is the M&A situation culture work is designed to address. But the deal life cycle is difficult to understand in its entirety, and barely understood by those not deeply ingrained in M&A.

To address this issue the group developed the deal life cycle to help leaders understand the transaction in a comprehensive and visual way. (The deal life cycle table is available as an attachment.) For the purposes of this paper, the deal life cycle is defined as consisting of five phases along with an explanation of what happens at each phase, the typical goals for each phase and the corporate decisions and legal milestones that signify the progression of the transaction and the movement from one phase to the next. However, note that this is an "aggregated" model, and each firm has its own variation suitable for its own company-specific purposes, based on how they describe the deal life cycle and how they position the deal goals.

It is also important to point out that it is not a clean, linear process, as the deal life cycle table may imply. The phases and goals are not separate and distinct and can and do overlap in many areas. The key is that each deal phase is built on the previous one, and deal goals are adapted, refined or added as more information becomes available.

This "build" is critical to understand for transactions and further that the "quality" of the build is based on the decisions made, or not made, or deferred, from the previous phase, which itself depends on the deal situation, the information gathered at any one phase and the time constraints and typical limitations in each deal.

The business case is then developed around the life cycle and goals.

> **"We use the deal life cycle table to orientate our leaders. While in corporate development, it's 'M&A 101 stuff,' for others it's 'rocket science.' We have to manage our own leaders at times and the fact that many outside commentators have their 'ear.' I'm amazed at the 'commentators' who speak about how culture work can impact our deal success, and our deal goals. We know that. What they struggle to define is what success means in the context of any of the phases within the overall transaction. On top of that many just don't seem to understand how a deal unfolds and how decisions must be made within each phase to ensure the deal keeps moving forward. They often miss this fact, and are blind to how these decisions, however imperfect, impact what happens in the next phase. And each phase does not start off with a 'blank sheet of paper' as some seem to think. At times, I'm not even sure these people know what the corporate development function even does."**
>
> Corporate development leader in responding to the prolific amount of outside advice their leaders get about the place of culture in M&A.

Chapter 2

How these acquirers built their business case and the ROI question

As noted, cultural investigations are now an accepted part of the M&A process, but it was not always so. These serial acquirers had to build a business case to incorporate cultural work into their process, given the comprehensiveness of the proposed undertaking and the impact the work would have across the entire organization. It was not introducing a superficial cultural conversation, supplementary to what other work was going on, but planting the culture as a central part of the process, and a priority discussion topic on any deal agenda meetings.

And they did this by:

- Doing the research to understand root problems and opportunities.
- Being clear on the goals and risks that the work would support and the costs and benefits of any analysis.
- Presenting the case in terms their business leaders could relate to by using the company's internal style and terminology.

> **"It's not working on culture, for culture's sake. Some of our first attempts at this business case took this rather naïve approach. We knew culture was important, but we did not have much substance behind the statement. We 'crashed and burned' in front of some our leaders, when it was not explicitly clear to them what this work would lead to, what it would impact."**
>
> Corporate development leader

But first, let's get to the "elephant in the room" – and the first question that finance professionals raise in reviewing any business case: "What is the direct return on investment (ROI) from cultural work?" However none of these leading companies could show a return in terms of pure numbers. They could not find a direct mathematical line of sight between culture work and financial returns, either within the group's review of their vast database of deals, or from external research. Absent any ROI, the focus of the business case must be grounded on the benefits of this work, over and above the cost of doing it, by showing how the output of the work supports specific transaction goals or mitigates risks.

> **"Yes, this ROI question comes up, more than we'd like it to, and we'd like to have a good clean answer. But we don't. Invariably it's asked by leaders new to M&A and continuously by our finance function. It's not a measure that can be meaningfully attributed to culture in deals. It's the wrong question, the wrong road to go down. It's a bit like asking what the ROI is on one component that goes into our airplanes. We have to stay true to the business case we have developed, but the ROI question will never go away."**
>
> Corporate development leader

Chapter 3

Eight key steps in building the business case

Successfully navigating the challenges that come up in a corporate environment

1. **Start with the root causes and opportunities and use facts to support the case.** The most powerful fact is that managing culture leads to more successful outcomes, and not managing culture poses a higher risk of deal failure. The facts that support this statement are drawn from both publicly available research on how cultural problems lead to deal failure (refer to the commentary on studies on culture in M&A) coupled with each firm's own specific experiences and reviews of the success or otherwise of their own deals.
2. **Have a cultural framework built for M&A purposes.** This shows the components of culture that are relevant to the M&A situation and is the subject of our first paper. The framework presents one of the first challenges.

> **"Make sure that leaders understand that the framework is for M&A purposes only; otherwise you will lose the argument. If you don't link this directly with M&A, many will think you are trying to change the entire culture of your company, which others view as their remit. We had several battles internally in this respect, until we understood what the M&A team were trying to accomplish in incorporating culture in their M&A process, and equally what they were not trying to do, they were not trying to change how we defined culture as a firm."**
>
> Chief Human Resource Officer, responding to the cultural framework not being the same as their existing definition of culture and the related components

3. **Prepare a deal life cycle framework showing typical goals.** The starting point being the deal life cycle table to ground leaders on the complete transaction process, beginning to end, "what happens, when and why it's important and the specific goals culture can support within each phase of the process. Also, the deal limitations commentary reinforces the fact that decisions are often made with incomplete information.
4. **Describe the output of cultural work in terms of potential deal impact, by stakeholder group.** The business case needs to go further than the "reasoning" and into showing how the results of the work can be used. There are many users of this work but structure any presentation on the value of culture work based on the parts of most interest to each group. The key here is that the information gathered on culture, needs to be broken up and prioritized based on the needs and interests of the different stakeholders at each phase of the deal, with each cultural component mapping or supporting a very specific transaction goal or risk (the next section shows how the output is used).
5. **Identify the role of the key people that are responsible for driving changes.** In parallel and equally important is the process to identify the people or groups of people, charged with driving the changes throughout the organization to achieve these goals. Changes depends on these specific people and the role they will play in the integration and the changes they will need to make to their own business priorities and actions.

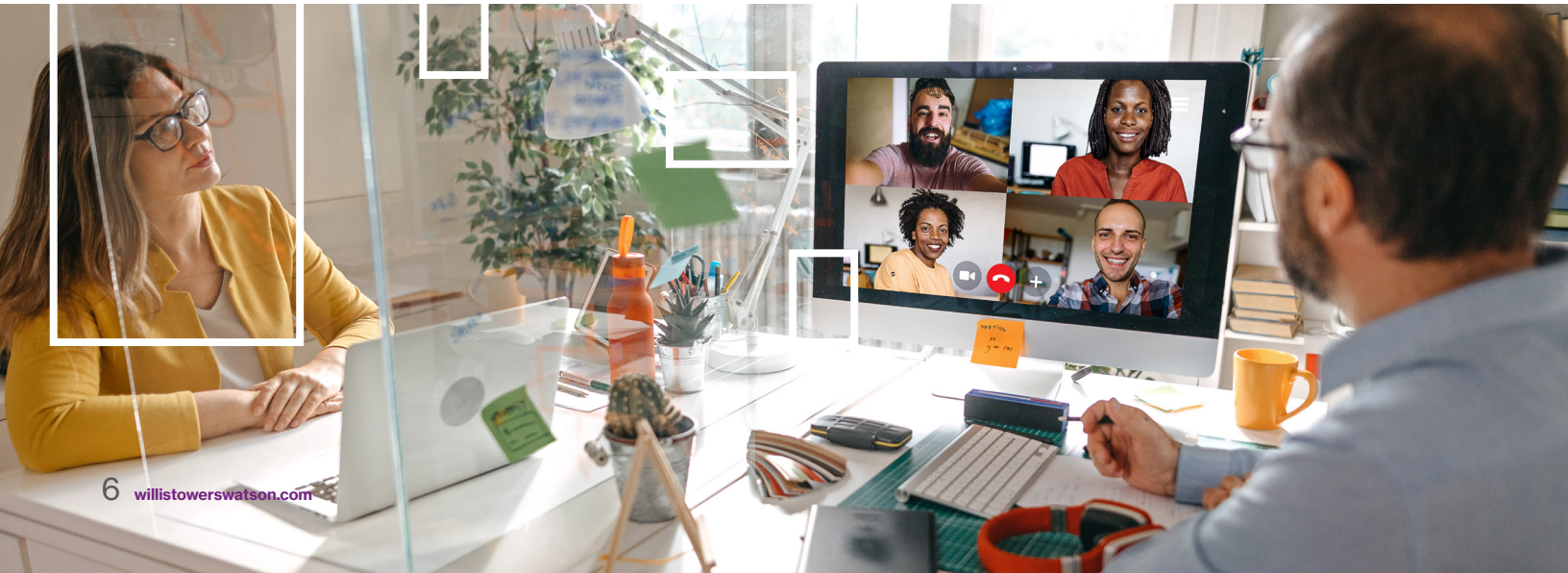
> **We have slipped up in the past by not putting enough attention on the people part, particularly what priorities and actions we wanted them to change. We used to speak about changing behaviors in the past, but that was too vague and not time dependent or urgent enough for many to make changes a priority. We had to be explicit. We found that without the people changing, our brilliant strategies, tactics, plans and checklists were not nearly enough."**
>
> Integration leader, Human Resources

6. **Present the business case to the top stakeholders first.** Typically the top stakeholders are the leadership requesting the funds to pursue the deal and any deal committee overseeing the deal (those approving the funds). With their approval, culture becomes part of the process, and not an "initiative" to be debated separately within each deal.

7. **Be aware of the need to assist leaders answering questions from other stakeholders.** There are numerous potential stakeholders, dependent on the size of the deal. More stakeholders get involved the larger the deal, and this is especially true in talent-based deals with a high price tag, a relatively low employee headcount and with the high risk of the key employees walking out the door.

   Examples of other stakeholders are the board, but also investment firms or fund managers covering the company and potentially activist investors. These stakeholders are asking deeper questions about leadership, talent, culture and cultural integration once news of a deal is announced. Answers such as: "We met with them and they are a great cultural fit" or "Our cultures are very similar" may be truisms but are not good enough answers for these stakeholders. The work will prepare leaders better to address the cultural questions and stating that there is a team working on the cultural integration challenges is a very powerful answer by itself and often enough to avoid further external questions in this area.

8. **Prepare a checklist of common challenge questions.** The best of business case explanations can be derailed if the difficult cultural questions are not anticipated ahead of time. The two most common are the ROI question, and the question about how the M&A approach aligns with existing internal cultural initiatives. Added to this there is also the need to keep up to speed on the latest research and developments in the broader area of "culture" in a business context. Culture is one of the most written about topics and many outside commentators constantly feed ideas to leadership so there is a need to understand current thinking and then explain what's relevant in this thinking and what's not for M&A work. None of these issues should be a threat, given the explicit and therefore narrow M&A focus of the business case but it does continue to show the need to keep abreast of developments.



Chapter 4

Who uses the output of this work?

Some examples of how the results of the culture work can be used by the typical stakeholder groups in M&A are:

Corporate development and the business unit leading the acquisition: The stakeholder group that initiates culture work. The work provides the needed information for three purposes:

1. To present to the board or deal committee for ongoing review.
2. To gain a better understanding of the deal as a whole and the complexities of the acquisition integration.
3. To ensure the focus on business stabilization is a priority.

The focus on business stabilization warrants some further explanation. This goal is particular to M&A situations where productivity drops are a real feature of transactions, and typically surface once a deal is announced. This can impact buyer and seller pre-close and then the combined business post-close.

The first impact is typically on the target as their workforce becomes aware that their future is about to change. But there can also be an impact on the buyer's workforce if significant changes are expected to their business as part of the integration strategy too. It's difficult to achieve any other goal if the base business starts to decline. Some examples where this shows through is in revenue declining, more clients or customers than normal leaving, new clients not coming in or key people leaving, or all the above.

"This was a problem in one of our bigger deals. We had so many key people involved in the integration process, from both sides. We collaborated exceptionally well, and the integration management and process itself was flawless from that perspective. But our business performance was not, and it took us some time to figure out why.

Our business began slowly to show a downward trend as we realized that our pipeline was not as strong as before, the number of proposals showed a decline and our success rate in sales pitches dropped, all adding up to less business. We could not understand why, until we started looking at how some of our key consultant talent was spending their time. Too much of the key talent that we should have had focused on the market, on selling and delivering, were instead involved in integration planning and other meetings. We lost focus, but our competitors did not. In fact, I believe they ramped up their attention on our clients and prospects."

Chief Executive Officer of a consulting firm

Board or deal committee team: The top decision-making group that approves the progress of the transaction or makes the decision to pull out of the deal (in the earlier phases), this group will focus on top priority goals and the people who will be responsible for these goals. Examples are:

- Leadership goals: The process of determining and selecting the right leaders and talent not just to run and grow the business, but also to lead the formal integration team and efforts.
- Synergy goals: Validating the synergies and identifying the group of talent responsible for achieving these targets.
- Value goals: Understanding the value of the business as a standalone entity and in the combination. And once recognized, identifying the group of talent responsible for achieving these goals in the combination.

> **"We have to focus on the business impact and address culture using the terminology that we use across the business in deals for this group. This means showing how results from any analysis directly supports a deal goal, issue or risk. It's that simple. Our deal committee (group that oversees all transactions) won't entertain any work that does not meet these standards. 'Nice to do's' can come later."**
>
> Corporate development leader, explaining how they work with their deal committee

Negotiation team: These companies use negotiations as an opportunity to go beyond "getting the deal done" and delve deeper into the integration issues with the target's leadership. Information here will help both the buyer and seller teams prepare better for integration.

There is often an added twist here that relates to transactions and that is that concessions are often made just to get the deal done. Deal negotiations here take a feel more akin to political give and take. Some of the seller's leadership and talent may be selected for future roles even if the initial thinking was that they were not the best people for those roles.

> **"This is a real issue that we've had to deal with on more than one occasion. But in these cases, we have a strategy in place, in conjunction with our corporate HR colleagues. We have a heightened focus on the post-close working relationship issues and on coaching those leaders that are deemed a concern."**
>
> Integration leader, Human Resources

Integration management and functional integration teams: These stakeholder teams manage the formal integration process, building on the preliminary and business wide integration strategy. They typically use culture work to help develop an accurate understanding of the complexity of the integration and therefore better estimate the costs of the integration, resources needed, changes needed and how to best time or phase the changes. However, integration strategies are complex and can vary enormously.

Human resource function: This function is at the heart of the people part, which impacts not just their function, but any other area where people are a factor – which is nearly everything. For their own role, assessments create the input for people decisions and change plans, not just for their function, but how they can help other functions and workstreams in their people and change work (HR's role will be the subject of a future article).

> **"The magnitude of change expected on the leaders, talent and employees is directly related to the integration strategy. Our integration strategies have evolved over the years. It used to be that we fully integrated them into us. But we realized that was more of a 'convenience' for our organization, and less about growing and developing what we bought. Now our strategies are deal specific, and can vary enormously, from one extreme where the seller is assimilated into the acquired business unit to the other end of the spectrum where we keep it stand-alone as a new business unit with most of its existing identity and way of doing business kept intact. In these cases, integration is limited to our 'non-negotiables,' such as areas of financial reporting, back office infrastructure, legal requirements and executive incentive plans."**
>
> Corporate development

> **"Just a review of the goals in one deal surfaced the tension that may occur in allocating and prioritizing resources and the talent needed to achieve these goals. For example, the talent needed to stabilize the business was much the same pool as we identified to achieve the value goals, and achieve the synergy goals, and be heavily involved in the formal integration process. We had many of the same people on multiple parallel initiatives, sometimes requiring them to be in different time zones at the same time. This was just not feasible. We just did not have those planning the separate goal initiatives, talk this through with each other. The same 'stars' were being picked for multiple teams."**
>
> Corporate development leader and HR Integration leader during a review of "who does what"

Summary

While we know that experienced acquirers evaluate culture. We also know that there is no "silver bullet," no one way or the best way. Each firm in the group does it differently, but they all share one common principle: they all have an organized and disciplined approach and built their business cases to embed culture in their M&A processes.

They know the high-risk nature of transactions and know that success means that they must work through all parts of the deal cycle successfully: buy well, integrate flawlessly and ensure the business operations run successfully all the way through to the "business as usual" phase, and beyond. Culture work is necessary part to improve the odds that their deals meet or exceed the performance expected.

> **"Meeting any goals in our firm is expected and that gets an 'average' rating, no matter what the project or initiative. But we strive to go above expectations, and this means blowing through the deal goals and that means using every strategy and tactic at our disposal – and culture work has, without doubt, helped us do better."**
>
> Corporate development leader

These leading firms have strategies in place and leaders do not have to be convinced of the need for this work but are focused on the extent and timing of the initiatives, depending on the deal. However, less experienced acquirers find that they need to build a solid business case for this work.

The principles to follow are to develop strong business reasons for working on culture, grounded in the phases within the deal life cycle and supported by the facts and data that can stand up to any challenges or questions. Develop a framework that captures the essential features of culture that can be understood by leaders, and mapped to a specific goal or risk, and focus on the benefits of the work but avoid the pitfall of hunting for a specific financial ROI.

> **“We needed an ‘end-to-end’ cultural approach. An approach which connects all the phases and where the decisions and output from one phase forms the input for the next phase. Truly anchoring the work around the practical realities and constraints of putting a deal together, using the total deal life cycle and the specific phases, and the issues and risks appropriate to each phase of this cycle. And starting this at the beginning, deal origination.”**
>
> Corporate development leader

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 is that the size, scale, and global scope of these deals made it difficult to incorporate the approaches discussed here early, and 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, since 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.

About Willis Towers Watson

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