Corporate Matrimony: The Make or Break Role of Culture Integration in Mergers and Acquisitions

Building new and lasting relationships is hard. They're exciting, but they're hard. They require effort, intention, and persistence. Relationships are easier when the parties share common values, backgrounds, or future expectations. In a healthy new relationship, both parties can win, but when that is not the case, new relationships can feel forced, uncomfortable, and perhaps doomed to fail.

The same is true in Mergers & Acquisitions. Amidst the strategic maneuvering that dominates the M&A landscape, cultural integration and human capital management often go underappreciated. While operational synergies, market share, and financial projections will grab headlines, the long-term success of any merger hinges on integrating the hearts and minds of two distinct workforces. This is not a one-time event but an ongoing process that demands an intentional focus throughout the M&A lifecycle.

According to McKinsey, almost 70% of M&A transactions fail to meet their expected synergies or valuations: "Organizations too often overlook or ignore organizational culture and human capital issues and pay scant attention to integrating these softer issues into the hard process of post-close integration."[1] Human capital and the culture it generates represent the lifeblood of any organization. M&A deals often bring together talented individuals with diverse skills and experiences. Recognizing and leveraging this combined potential is paramount to post-close deal value.

The primary driver behind M&A's 70% failure rate is a lack of intentional focus on cultural integration.

When we consider the human element in M&A, critical success factors become evident. By prioritizing these elements, you can ensure your new organization doesn't just acquire bodies but unlocks the collective potential of its human capital.

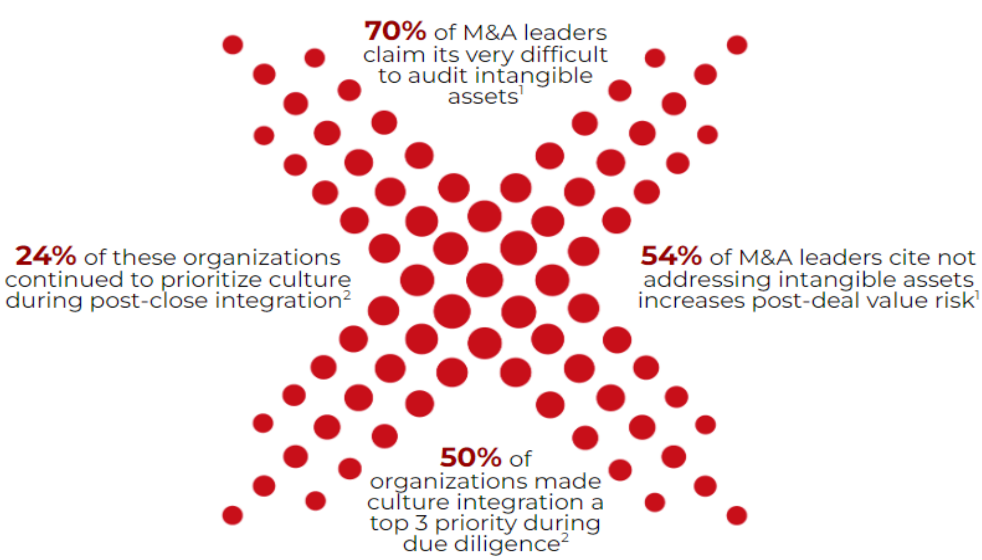
Culture is the key that unlocks the potential of human capital.

[1] *McKinsey & Company, 2017 - "Why Do M&As Fail?"*

Culture has many definitions, but essentially, it's the shared expectations, observable behaviors, motivators, and core values of people. It's how people dress, the way they treat each other, and the way they collaborate. It is the invisible glue that binds disparate entities and their teams. Do we value in-person or remote engagement? Do we have an engineering-minded culture or a sales-driven culture? Do managers respond to public or private rewards? Should new employees ask permission or beg forgiveness?

These values are in a constant state of evolution, either through deliberate interventions, organic evolution, or inorganic impacts (i.e., M&A events). In other words, culture change is inevitable in M&A, whether leaders decide to manage it or not.

Despite this, a study by Aon Hewitt determined that only 50% of organizations place cultural fit and integration among their top three priorities during their due diligence process (with 30% ranking it in their top two). Worse, in the post-close integration phase (PCI), only 24% of these organizations continued to prioritize cultural integration as one of their top two concerns.[2]



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[2] *Aon Hewitt - M&A Deal Value Study*

The correlation between de-prioritizing culture during post-close integration (only 24% of organizations prioritize it) and the reality that 70% of M&A transactions fail to meet expected synergies is not a coincidence. People and culture serve at the heart of realizing post-deal value. The collective skills and institutional knowledge of teams are the lifeblood that drives a merged entity forward. This makes integrating people and cultures not just a consideration but a fundamental cornerstone for a happy corporate marriage that achieves the envisioned synergies and long-term success.

People are the amplifier; it's either 2+2=3 or 2+2=5. Always.

M&A cycles that neglect culture early create unrecoverable risk.

Accounting for people and cultural fit is vital not only during courtship but also during and beyond the post-merger process. Efforts should start before the merger announcement, accelerate during the first 100 days of post-deal integration, and continue after the integration is well underway.

Early in the M&A cycle, culture will start to change. Without intention, planning, and intervention, the result will be unintentional. An undesirable result will likely be far harder to unwind and reset than doing it right the first time.

Merging companies with clashing values, communication styles, and work norms sets the stage for future conflict, confusion, and underperformance. Conversely, fostering a culture that embraces the best of both cultures can foster collaboration, innovation, and employee engagement. This requires time and genuine effort beyond lip service, ranging from leadership buy-in to transparent communication and inclusive decision-making.

In 2017, Amazon bought Whole Foods for US$13.7 billion, which allowed Amazon to enter into the brick-and-mortar grocery retail space. The merger aimed to blend Amazon's technological and e-commerce capabilities with Whole Foods' retail expertise and to enhance the customer experience. Initially, Wall Street reacted positively to the acquisition, believing that Amazon's data-driven approach could be the key to helping Whole Foods expand its footprint without compromising its employee-powered culture. Instead, the mismatched cultures of Amazon and Whole Foods led to a tanking of employee morale and higher-than-normal turnover at Whole Foods.[3] These cultural clashes eventually escalated to near revolt and the impacts are palpable.[4] If you've been in Whole Foods lately, you've likely felt the difference; the vibe has changed. Employees have lost the edge that their culture enabled. The once vibrant grocery store, known for enthusiastic employees and expert knowledge of healthy foods, has now transformed into just another grocery store.

Five years later, very little of the original deal value has come to fruition. The Whole Foods market share remains at around 1%, and Amazon shareholders have seen little to no ROI on their $13.7B investment.

> *"Amazon is all about the cloud, e-commerce, and entertainment," said Jake Dollarhide, CEO of Longbow Asset Management to CNBC, which has counted Amazon as a "core holding" since 2011. "It's almost like the grocery business is an expensive hobby."*

Ouch. Amazon clearly missed the mark on cultural fit, resulting in muted deal value from post-integration team synergies and financial uplift. Did Amazon and Whole Foods fail to account for people's and culture's impact during due diligence? Did these two worthy M&A participants simply neglect to account for the critical role of people and culture and attempt to operationalize post-close integration through a traditional approach to implementation? Yes, they failed on both counts. Clear, early indicators that should have triggered an intentional focus on cultural integration during due diligence were ignored.[5]

During an M&A event, culture and the behaviors it incentivizes are in flux.

M&A events introduce non-discretionary, top-down change. Some cultures respond well to directives from the C-Suite or Board of Directors. Others thrive on grass-roots change. M&A projects are executed in environments fraught with ambiguity and subject to severe time constraints. These factors change the way people behave. Some people make decisions based on a hunch, habit, or bias instead of data or

[3] *Business Insider, 2018 - Seeing Someone Cry at Work is Becoming Normal*
[4] *CNBC, 2018 - Whole Foods Employees Step Up Efforts to Unionize*
[5] *Harvard Business Review - One Reason Mergers Fail - The Two Cultures Aren't Compatible*

logic. Some grow fearful or become bold, others may want to be left alone or be involved in every detail, and this preference can change daily.

Not accounting for these unique attributes will result in misaligned individuals, teams, or leaders. These misalignments manifest as incorrect priorities, disincentives to desired behavior or negative changes to morale, all of which lead to unintended behaviors. Unintended behaviors put deal value at risk through extended timelines, blown budgets, or unrealized synergies. Because the M&A cycle is long, early failures can have a cascading impact, increasing the effort required to course correct later on. Unwinding an undesired behavior and shifting to the desired behavior can take far more effort than getting it right the first time.

The key is understanding that the fundamental nature of an M&A event is different. In the case of the Amazon and Whole Foods merger, the culture clash was obvious and possibly even forewarned. However, even when differences are not as stark, any initiative that happens during an M&A event can face similar failures.

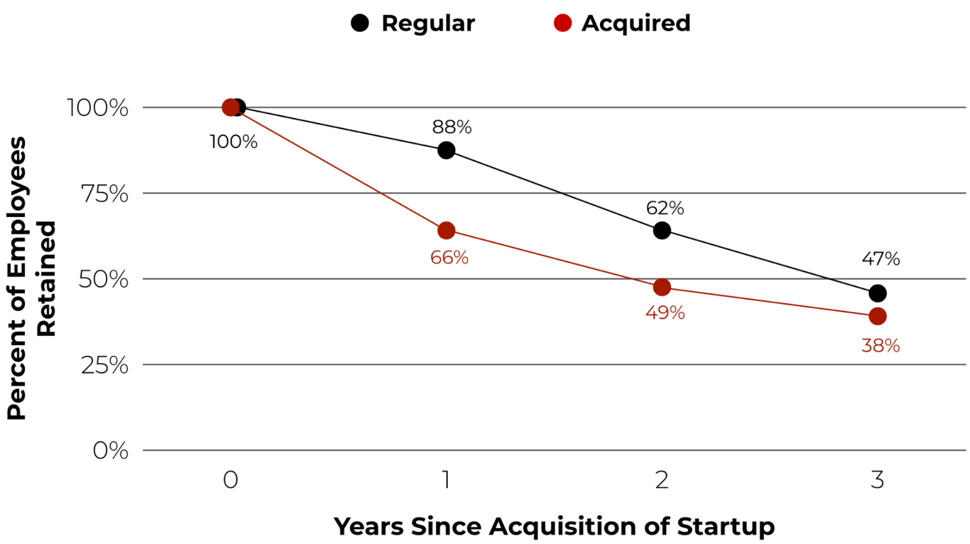
Unintended impacts on culture can trigger costly turnover.

From a financial perspective, the implications of having a poorly managed cultural integration are substantial. Perhaps the most glaring financial implication is attrition and regrettable losses. These losses do not just happen during the transaction but continue for years post-acquisition.

In fact, in merger scenarios, workers from the acquired company are more likely to leave their jobs than workers from the acquiring company, introducing risk to customer relations, “tribal knowledge” of products or processes, and overall business continuity.

Employees of acquired companies can experience a sense of alienation when confronted with the perceived dominant culture of the buyer, which can lead to turnover. The adoption of new cultural norms and expectations can require more effort and compromise than some employees are willing to give. The departure of key talent with unique, high-value skills can erode profit margins as hiring managers scramble to fill gaps. According to a study conducted by SHRM, companies should expect to incur $7,500-$28,000 in hard costs to find, onboard, and train a new employee.

Employee Retention Rates: Acquired Workers vs. Regular Hires



MIT Sloan School of Management

Success is possible; there is strong correlation between culturally-managed mergers and acquisitions and enduring financial deal value.

In 2014, Norway's retail grocery chain Coop Norge aimed to grow its presence in the market. Coop Norge held a 23% market share yet faced strategic challenges as two larger competitors could use their scale to negotiate favorable prices from suppliers. Coop decided to acquire ICA, which had an operating loss of more than $57M at the time. Strategically, it made sense - ICA had many stores operating in Norway, and both had similar company cultures. Both companies' cultures prioritized and rewarded innovation and collaboration. Structurally, they were both relatively flat. The merger resulted in Coop becoming the 2nd largest retailer in the market and reached 96% of expected results just two years after post-close. The merger's success has enabled Coop to become a serial acquirer in the market as they're still persistent on growing presence in the market.[6]

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[6] *BCG - Lessons from Eight Successful M&A Turnarounds*

It can be done well.

Many of these impacts and human behaviors are predictable and manageable with proper planning and techniques. Here are four discrete steps you can take to ensure your new organization reinforces cultural strengths, identifies and addresses gaps and differences, and ensures that the PCI phase sets the course for a long and successful corporate marriage.

- **Take time to analyze and predict responses to culture change.** Plan to address the impacts at scale. Your predictions and plans won't be perfect, but the act of planning is invaluable and it can uncover opportunities that would otherwise go unnoticed. Game-changing insights can occur if you create opportunities for them to arise. In 1998, Chrysler and Daimler-Benz merged initially as equal partners, but soon after the deal, both companies realized there was a clash in culture. *"Chrysler had a reputation for having a more freewheeling, open culture, in contrast to the more traditional, top-down management style practiced at Daimler-Benz,"* ultimately leading to deal failure.[7] If there had been time and consideration of culture upfront, it might have been possible to mitigate these risks.

- **Gather as much quantifiable culture data as possible.** Gathering data around culture and people is possible by partnering with HR to review Employee Engagement, conducting site visits, building culture profiles for each organization, interviewing key employees, researching public information (have a look at reviews from both customers and employees), and conducting a good old-fashioned employee survey. A data-driven approach supports decision-making, mitigates risks, and ensures the strategic objectives of the M&A are achieved.

- **Tailor the approach to culture change to your unique situation.** Assign a person or team who will be responsible for culture change. This cannot be a checklist exercise, it should be a discrete function of the Integration Program Office. Why does this matter? The "wicked" nature of M&A environments requires specialized skills. Specialized practitioners can bring experience and expertise to cultural and people aspects where most professionals cannot.

[7] *Anatomy of Crisis Management: A Case Focusing on a Major Cross Cultural Clash within DaimlerChrysler*

- **Priority, priority, priority.** There are examples throughout where organizations failed to prioritize culture and subsequently failed to achieve the value of their M&A hypothesis. Address people and culture early, and do it across the full spectrum of due diligence, deal valuation, deal close, and post-close operational integration. Senior leaders generally appreciate the need for culture assessment, but it is deprioritized and eventually forgotten under the stress, time pressure, and heavy workloads associated with M&A transactions. Dedicate experts with leadership access to this work.

The degree to which those responsible for post-merger strategy prioritize getting the cultural variables right can make the difference between an engaged, productive workforce and acrimonious opposition, between a brave new world of value and one of all-out warfare. Persisting in an unhealthy relationship is not pleasant, and divorce can be costly. A harmonious marriage of business cultures is the determining factor between lucrative returns and expensive failures. By prioritizing the people behind the numbers, companies can ensure a smooth transition, unleash the collective potential of their workforce, and ultimately create value that goes beyond the balance sheet.

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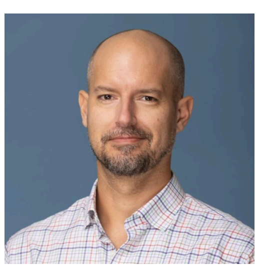

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