

# The Culture of Combination: Changing Behaviors and Deal Success in Mergers and Acquisitions

**A**s difficult as it is to successfully complete a merger or acquisition, it seems that nothing can stop the extraordinary economic momentum generated by the corporate urge to merge. Recent reports show that worldwide M&A activity climbed to a record \$3.8 trillion in 2006, topping the previous high of \$3.4 trillion set in 2000, according to Thomson Financial. In the United States alone, M&A activity in 2006 approached \$1.6 trillion, a 35.7-percent increase over the 2005 volume of \$1.2 trillion.

Investment bankers seem to think that this rampant merger mania will only continue in 2007, further establishing what might be called a global business culture of combination. And culture is at the heart of M&A activity. Just mentioning the word “culture” around people familiar with M&A results in two reactions: (1) everyone will acknowledge how important culture is to the deal’s success, and (2) everyone will provide a harrowing example of the consequences of a cultural misalignment that they witnessed or experienced. Yet, few organizations that have done anything about it. Why? Because “culture” is a problematic concept; it is multifaceted, “soft,” elusive, difficult to define and even more difficult to



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measure. To read the volumes of research devoted to it, it seems that there are as many definitions of culture as there are organizational psychologists who study it. One study found 164 definitions of culture—and that was 54 years ago.

But, just because culture is problematic doesn't mean that the only way to deal with it is to ignore it and pretend it will either go away or simply work itself out. In fact, the problem often lies with leaders—CEOs, business-unit heads or others—who don't see the value of spending time and money on cultural integration/change until they've been burned by it. As former IBM CEO Louis Gerstner wrote in his book *Who Says Elephants Can't Dance?*, "I came to see, in my time at IBM, that culture isn't just one aspect of the game—it is the game."

Note that Gerstner said he "came to see," suggesting that the importance of cultural integration wasn't apparent to him until it bit him—and probably more than once. Often, too many leaders and members of the deal team don't realize that simply getting the deal done is a necessary, but not sufficient, condition for success. Indeed, making the deal work is what matters, requiring the same dosage of attention, time and energy which is devoted to closing the deal. And, cultural integration is often the key to making it work.

## THE NEGATIVE IMPACT OF CULTURE

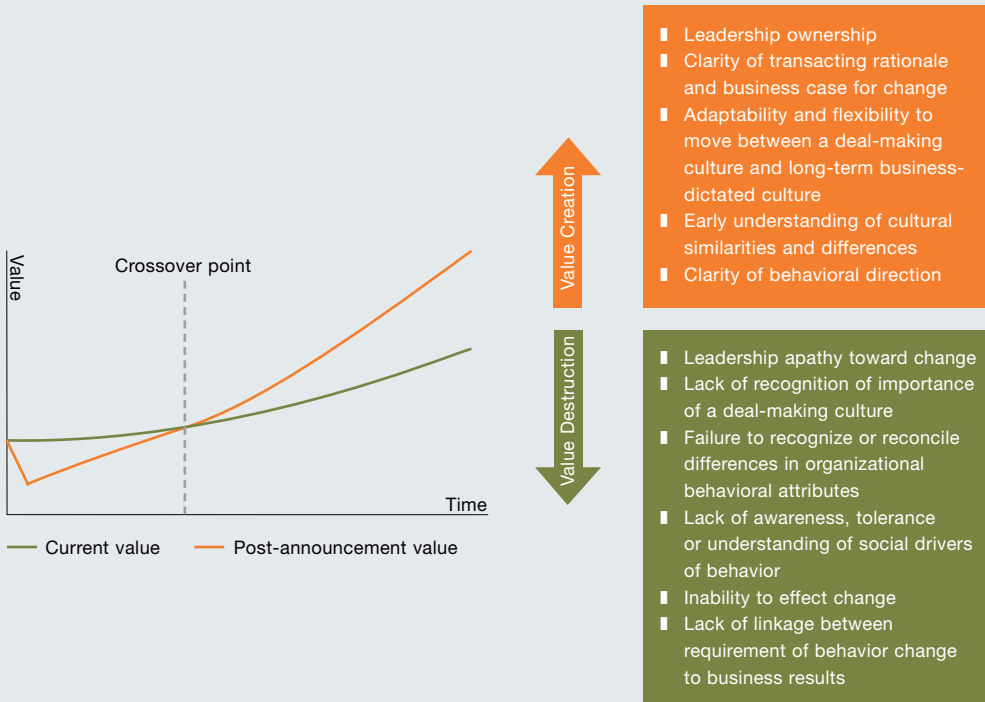
Failed cultural integrations are often at the heart of merger difficulties. Business leaders and those who study business have known that for decades. For example, a 2004 Mercer transatlantic study of executives involved in M&A deals found that 75 percent of the executives cited "harmonizing culture and communicating with employees" as the most important factors for successful post-merger integration. And, a 2006 white paper from The Economist Intelligence Unit revealed that 67 percent of respondents pointed to cultural integration as the most important people issue and the most critical success factor in an M&A deal—even more important than business-process integration.

In the top 10 critical success factors for M&A deals, the cultural attributes of an organization or highly differentiated cultures can undermine each one. For example, an organization that typically doesn't communicate frequently or effectively will likely be less inclined to articulate and share the deal's real context beyond what goes to the market or the press. And a sales-driven organization—i.e., one that's revenue-focused—will have a difficult time concentrating on capturing synergies.

This is not to say that one cultural attribute is better or worse than another; rather, that without change, some behavioral characteristics of organizations may be incompatible with those actions necessary for deal success.

Most organizations will gravitate immediately to addressing the "programmatic" aspects of integration—compensation, benefits, policies, the physical plant, staffing, systems, organization, communications, etc. Employees need to get paid, health coverage needs to be in place and systems need to be operational. However, simultaneously, the organization needs to be engaging the workforce and under-

FIGURE 1 The Value Curve



standing the short- and long-term impact on workforce behavior patterns of decisions being made regarding the programmatic aspects.

## CULTURE AND VALUE

One way to see how culture impacts the value of a deal is by examining the “value curve” (See Figure 1).

What happens to the productive value of the organizations when the deal is announced? In almost every case, it goes down. At best, it decreases while everyone stops to talk about the deal, then rises when everyone goes back to work. But more often, the productive value of an organization will significantly lag, potentially for a long time, as employees try to figure out what the deal means to them. The lag will happen across the board: corporate functions, IT functions, salesforces, customers, executive leadership, etc.

*The Journal of Corporate Accounting and Finance* acknowledged this in its January/February 2006 issue: “The primary reason that cultural differences, if not uncovered and addressed, can affect the value of the deal is that cultural differences often spell decreased productivity, which leads to lower revenues and income, and hence the combined entity may be worth less than expected” (Sherman 2006). Even the professionals responsible for managing the financial side of the deals are beginning to recognize the influence that culture has on the deal’s bottom line.

That growing recognition is important, of course, since business strategists (focused on the deal) and transactional specialists (focused on the integration mechanics) attend so much M&A activity; rarely are people strategists involved in the evaluation, the due diligence or the decision-making process. Nonetheless, HR often is expected to follow through on, and the make the most of, the strategic imperatives of the transaction. Therefore, an M&A process recognizing how culture is at the heart of M&A success will more smoothly support the HR elements at the heart of the deal.

And if the deal is a successful one, value generation should start to rise and, at some point in the future, deliver greater value than the two organizations would have done separately (which is the reason for doing the deal). Three ways exist in which characteristics of organizational behavior can be either value creators or value destroyers: (1) compatibility with a deal-making culture, (2) compatibility among joining organizations and (3) compatibility with the “new” culture required to make the new organization successful.

### DEFINING “CULTURE”

While the definitions of culture are many, in the M&A world, it helps to view it practically rather than academically. The issue is less about culture and more about three intertwined elements: (1) those factors influencing individual behaviors, (2) individual and organizational behaviors and (3) the produced business outcomes.

In describing an organization’s culture, phrases such as “paternalistic,” “collaborative,” “hierarchical,” “consensus” or “entrepreneurial” often are used. And they may accurately describe a resulting group characteristic. The real questions though are: What do people *do* in a “consensus” culture or a “hierarchical” culture? What behaviors would be observed in a “consensus” culture, and how would they differ from the behaviors observed in a “hierarchical” culture?

Again, these behaviors—neutral on their face without the business context—are what people do at work. On this basis, an organization’s culture is defined as the aggregation of those individual behaviors making up how work gets done. Therefore, if a different culture is required as a result of a need for different business results, the behaviors that form the current culture must change.

Of course, when viewed in a vacuum, culture—or the way people behave—is irrelevant. Only when culture is put in context does it become relevant. The environment within which a culture exists, and the *outcomes* resulting from those behaviors, determines whether a culture is good or bad. Logically, a culture is considered “good” if it produces the desired outcomes, and a culture is considered “bad” if the desired outcomes are not produced.

The third element in understanding culture is comprised of those factors influencing behavior, i.e., the *drivers* of individual behavior. Within an organization, each individual behavior and the aggregation of individual behaviors are a result of specific drivers of behavior, both internal and external to the organization.

There are four basic categories of drivers of behavior:

- personal
- social
- organizational
- models.

Two of these—organizational and models—can change the underlying behaviors of a given culture, and two—personal and social—generally result in a better understanding of behavior but will not likely result in behavioral change. Recognizing this fundamental difference of how and where an organization influences behavioral change is the first step in developing and executing a practical approach to cultural integration.

It is difficult, and perhaps inappropriate, for corporations to attempt to change personal (e.g., personality, genetics, gender and ethnicity) and social (e.g., national origin, religion and local customs) drivers of behavior.

However, organizations can and should aggressively manage the other two drivers: organizational and models. Organizational drivers include vision, values, programs, policies, workforce strategies and the work environment. Model drivers represent the behavior of others—whether peers, leaders, coaches or role models. In fact, the most powerful models reflect the behavior of both organizational leadership and peer groups.

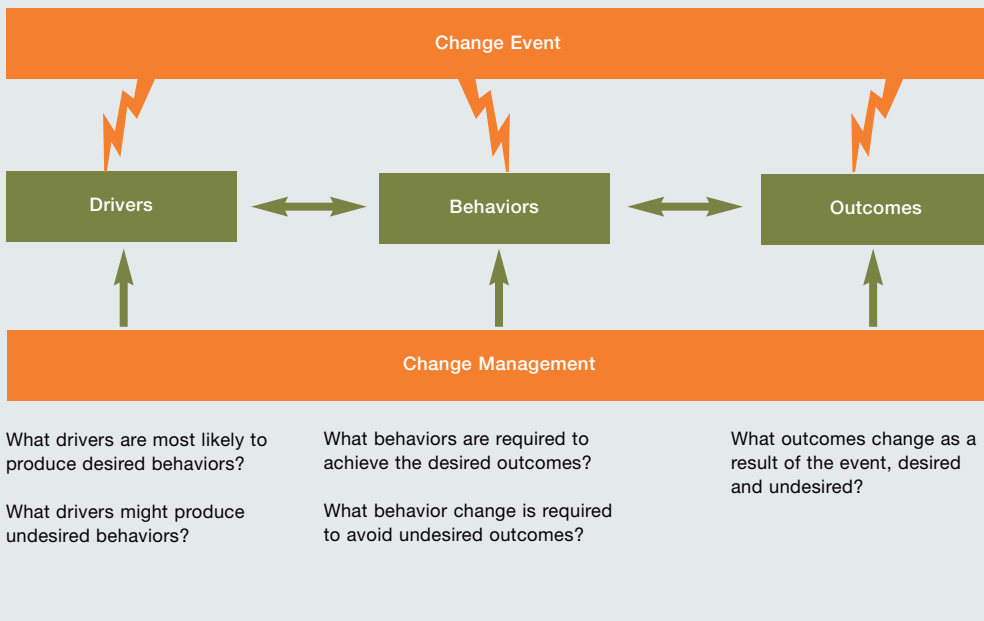
To express this in a form of systems thinking: *drivers influence individual behavior, and the aggregation of individual behaviors produces outcomes.* Considered another way, if an organization desires a different set of outcomes, individual and collective behaviors must change. And if individual behaviors need to change, then different drivers must be in place to cause different behavior.

## THE M&A CHANGE EVENT

What happens when a change event such as an acquisition, joint venture or divestiture occurs? Almost by definition, the parties to the deal expect a different set of outcomes (such as more revenue, less expense, greater market share, etc.). Achieving these new outcomes requires some level of behavior change and therefore some change of the behavioral drivers. However, even without regard to outcomes, most change events cause changes to behavior, much like what was illustrated in the earlier discussion of the value curve. And, even without considering outcomes or behaviors, in almost every transaction, drivers will change.

The three elements—drivers, behaviors and outcomes—are inextricably intertwined. No element can be changed without impacting the other two. Successfully dealing with a change event such as an M&A transaction requires not only consideration of the behaviors, it also requires equal consideration given to the outcomes and drivers of behavior as well as to change management, which is the process by which drivers to change behaviors are implemented and new behaviors created. In the change-management process, all aspects of integration decisions are drivers of organizational behavior, including business design and work processes, leadership and organiza-

**FIGURE 2** The Merger and Acquisition Change Event



tional design, people practices and the way the organization is engaged. Each will influence behavior which, in turn, will influence deal outcomes (See Figure 2).

### THE CULTURAL INTEGRATION PROCESS

To be successful, both in the short and long term, cultural integration must necessarily follow a process accounting for all four of these elements. Specifically:

- *outcomes* are well defined and understood in the context of the deal
- *behaviors* are clear in terms of the culture of the parties involved in the deal and the culture necessary to deliver the post-deal outcomes
- *drivers* of the desired behaviors are well understood, prioritized and designed appropriately to influence the desired behaviors
- an effective *change-management* program is planned and executed.

An eight-step process as a framework to increase the chances of successful cultural integration is shown in Figure 3.

### AN EIGHT-STEP PROCESS

While the process may appear to be linear, the realities of applying the steps in a given set of M&A circumstances may dictate that they be done out of sequence. In fact, the steps may occur in a different order and likely will be iterative. To be effective, however, each step must embody a degree of rigor in planning and execution.

### OUTCOMES—STEP 1 AND STEP 2

The first, and arguably the most critical, of the eight steps is to articulate a clear

**FIGURE 3** An Eight-Step Process for Successful Cultural Integration

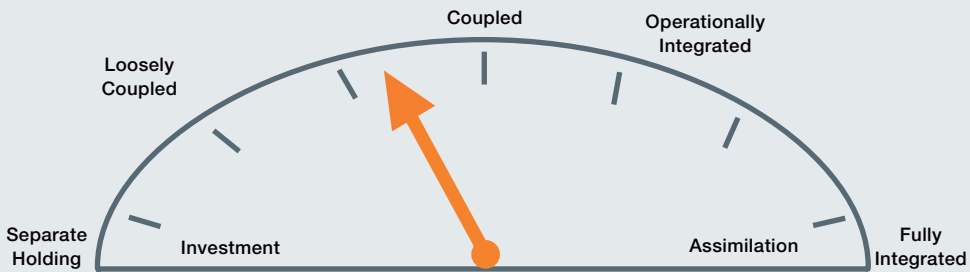


view of the context of the transaction. “Context” means understanding the deal from five perspectives: (1) the external environment (2) the business strategy (3) the business results anticipated if the deal is successful (4) the barriers which create risk and (5) the actions which need to be taken to deliver the business results. Most important is the anticipated business results, i.e., *what do we want out of this new enterprise?* Desirable results are qualitative and quantitative and could include access to new markets, increased market share, increased revenue, cost reductions, improved efficiencies, increased buying power through economies of scale, additional technologies, intellectual capital, specific talent and so on. Having a clear vision of what is expected of the deal provides the basis for creating a common understanding, consistent communication and a shared direction.

Once the business context of the deal and the direction are articulated, the focus should shift to the critical second operational step: determining the degree of integration required to achieve the desired new outcomes. Keeping in mind that the desired outcomes of the enterprise dictate the new organizational structure (in effect, where decisions get made), the required degree of integration is an outcome of that design. And, just as organizational structure may vary below the enterprise level (e.g., at the country, division or department levels), so too will the degree of integration vary.

Degrees of integration range from *minimal integration*, where the interests of the buyer and seller may be only financial (such as in a portfolio holding company) to *total integration*, where the acquired company is completely assimilated into the acquirer. The further along this spectrum toward assimilation, the more work is involved to make the integration successful (See Figure 4 on page 42). For example, in a financial relationship, little work may be required to reassess drivers and develop new ones. But with a complete assimilation, significant work, including more robust change-management and communication programs, will be necessary.

**FIGURE 4** Spectrum of Organizational Integration



### BEHAVIORS—STEP 3 AND STEP 4

Step 3 and Step 4 involve assessing the behaviors necessary to achieve the new outcomes and develop a change hypothesis. To assess behavior patterns in an actionable way, a framework for looking at and understanding organizational behaviors is necessary. Mercer’s approach is based on six dimensions that look at perceptions of culture at the individual and collective levels:

- Achievement
- Environment
- Perspective
- Power
- Communication
- Risk.

The six dimensions are built on the principle that collective descriptions of individual behaviors exist on a continuum between two extremes of contrasting business behaviors. For example, risk can be used to label a range of behaviors which vary across a continuum. On one end are behaviors which might be described as extremely risky, and the other end may be described as extremely risk averse. Somewhere on that continuum are the risk-related behaviors most appropriate for the new enterprise.

With this as a basis, assessments of perceptions of behavioral attributes can be conducted on three fronts: (1) my current organization (2) the “other” organization and (3) the resulting “new” organization. One attribute of this approach is its flexibility. It can be applied before a deal is on the table; at preannouncement with small groups of executives; as a part of due diligence; with different groups to generate insight into integration challenges; and with large groups of employees at post-close. This flexibility allows one or both parties involved to build understanding of themselves, of each other and of the new company as the deal progresses. The more that is known about behavioral alignment (or misalignment) between the organizations

in a deal and alignment (or misalignment) with the new enterprise, the more likely the organization will know where the change must occur and where it does not.

As a practical example of using this assessment, one approach for two companies destined to be totally integrated was to set up one work team to clarify current patterns of misalignment and determine those which were material to short-term objectives, while another team examines the desired future culture and develops longer-term strategies with the necessary drivers.

Once the degree of alignment and the future state are understood, a change hypothesis must be developed. Essentially this means answering the question: What behaviors are necessary for the organization to achieve the business results, short- and long-term, as articulated by the business context? For example, on the risk dimension previously described, the question becomes: Where on the risk continuum should the new business be, and what specific behaviors are necessary for achieving business results?

#### **DRIVERS—STEP 5 AND STEP 6**

With the change hypothesis defined, in steps five and six, necessary changes to *existing* drivers and *new* drivers must be defined to influence the desired behaviors. As described earlier, the behaviors that an organization has the greatest opportunity to change are those that *organizational drivers* and *models* influence. Models, of course, are the behaviors of others. So, no matter what approach is taken, it must recognize that “role models”—either individuals or groups such as senior leaders, managers, supervisors and peers—must “get the new behavior” for it to become part of the new company. To engage these role models in the new behaviors, key organizational factors must drive and reinforce the new behaviors.

Through significant empirical and experiential research—begun about 15 years ago and continually validated since then—Mercer constructed a model known as the “Human Capital Wheel.” The wheel identifies six factors proven to be most influential in improving workforce productivity and effectiveness:

- People
- Work processes
- Managerial structure
- Information and knowledge
- Decision-making
- Rewards.

Once a company understands which one or more of these six factors are most critical to driving change, it is possible to choose the specific behavioral drivers most likely to help drive the correct behaviors.

For example, consider again the previously discussed risk behaviors. If a new desired behavior is to comply with safety regulations, what drivers could be developed to drive that behavior? They might include management oversight and review, communication, discipline policies, training programs, etc. And, how these drivers

are designed and implemented will determine the degree to which role models—and consequently, individuals—accept them.

Importantly, and this applies to all behavioral change, rarely will any single driver cause a sustainable change in behavior. Behavioral change requires a combination of drivers repeated over time. The influence of drivers on the behavior of an employee is an individual matter, and it is only the integrated effect of a focused and coordinated set of drivers that will lead to the desired individual behaviors and therefore the collective organizational behaviors. To paraphrase a compensation and benefits executive with a large entertainment company, less than 25 percent of compensation consultants—professionals who get paid to design incentive programs—believe that an incentive program—*by itself*—can actually change behavior (with the exception of incentives which are exorbitant). Blend that incentive program with other drivers such as the correct leadership and management “models” and support it with the correct communication program, and sustainable behavior change begins.

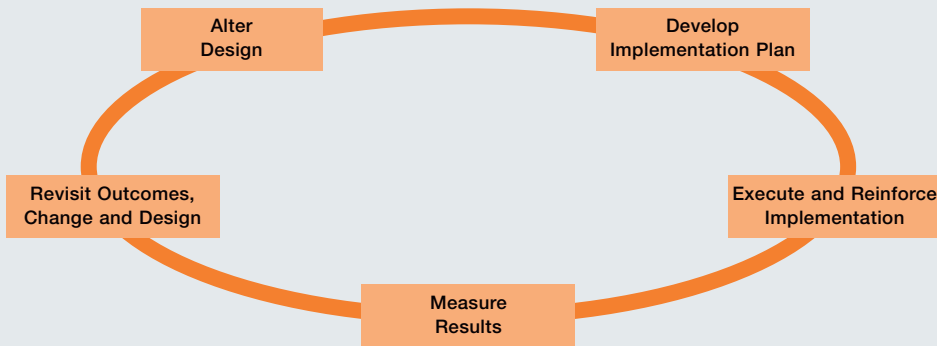
Not all drivers of behavior are HR programs, so it is important to differentiate between those drivers which HR can manage or influence and the drivers which need to be managed by other strategic initiatives. Some elements of the Human Capital Wheel—for example, work processes—require not only the attention of HR but also a complementary skill set from operations and other functional areas to be effectively leveraged.

Once the most appropriate drivers are determined, then the matter of designing and developing the specific programs most likely to drive the desired behaviors becomes significant. In this paper’s example, if it is believed that a training program is an important driver of compliance with safety regulations, then the right training must be designed, implemented and measured for effectiveness. For example, is it compulsory or voluntary; is it one time or repeating; is it high level or practical; will there be recertification; etc.

One factor often overlooked in the design of most drivers is the role that benefits and compensation play. Most often, benefits and compensation are seen as drivers in and of themselves. However, they play a critical “carrot and stick” role in the design of almost any driver. While different individuals value different benefits (in the broadest sense), most modifiable behaviors are influenced by the degree of reward or penalty associated with behaving or not behaving in the desired way. Looking at the example’s training program, are there benefits which will be provided (a bonus? a day off? training in an exotic place?) for taking or passing the program? Will there be penalties (termination? lack of advancement?) for not taking the program? Will the rewards (or penalties) only be during the startup and phased out when the program becomes inculcated, or will they be enduring?

Benefits and compensation programs and policies influence behavior at every level in an organization. It is therefore vitally important that appropriate benefits and compensation elements be considered as part of the design of most organizational drivers.

FIGURE 5 Change Management as a Circular, Repeating Process



## CHANGE MANAGEMENT—STEP 7 AND STEP 8

Step 7 is implementing change. Step 8 is measuring outcomes. Like the word “culture,” change management has many different definitions. In this paper, *change management* is narrowly and practically defined as *the process by which drivers of behavior change are implemented to achieve new business outcomes*.

Considering the complexity of the changes typically sought in transactions, change management must be viewed as a circular, repeating process containing the following steps: design an implementation plan; execute and reinforce the plan; test to see if the desired results were produced and, if not, determine why; revisit the premise (the outcomes, behaviors, drivers); make the appropriate changes; and develop a new implementation plan (See Figure 5). So change management is a closed system (at least until another transaction occurs).

What complicates change management is the number of moving parts. In major organizational change, stakeholders are engaged in the change, either because they are impacted by it, they are the agents of the change or, most likely, they are both.

### RESOURCES PLUS

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- Type in this key word string on the search line:  
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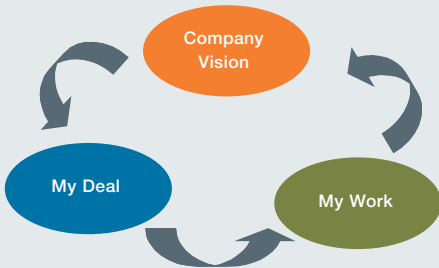
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- W4: Organizational Culture Change—A Work-Life Perspective
- T4: Strategic Communication in Total Rewards.

**FIGURE 6** The Perspectives of Stakeholders in the Change-Management Process, from the Individual Employee's Point of View to an Organizational Vision.



Communication to/from stakeholders is necessary at every step and content and delivery are crucial. Implementation, measurement and reinforcement must be an active part of the process and are predicated on having effectively developed the business outcomes, identified the desired behavioral change and designed the drivers expected to deliver the change.

### STAKEHOLDER ENGAGEMENT

In any effective change-management project, it is important to realize that

while there are many stakeholders, there are essentially three perspectives—that of employees, that of the companies they work for and that of the shareholders of those companies. These three perspectives proceed from certain perceptions and represent different levels and needs for stakeholder engagement in the change-management process (See Figure 6).

In an M&A situation, employees' focus is almost always on how they are personally affected. They begin with Item No. 1, "My Deal," questioning whether they will still have a job and what will change for them. Once those questions are answered, they progress to Item No. 2, "My Work," questioning what their new work will be like and who they will report to, directly and indirectly. With those questions answered, ideally, they end at Item No. 3, "Company Vision," questioning where the company is headed and how it will get there. Mapping this line of sight is crucial to getting the right behaviors from the workforce.

### COMMUNICATIONS

Ultimately, the success of an organization's implementation of drivers to change behaviors will depend on three factors (See Figure 7):

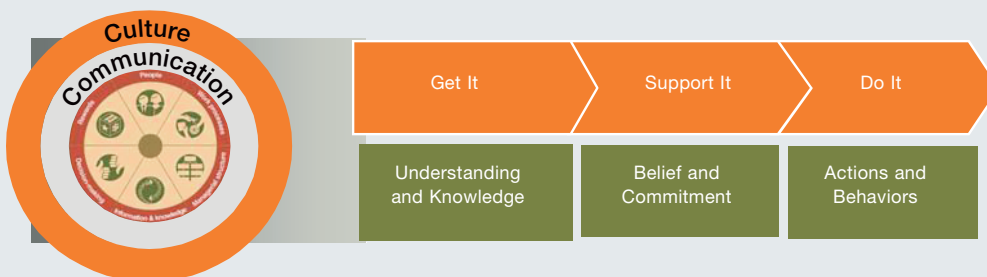
- How well individual stakeholders understand the change and the need for the change, i.e., do they "Get It?"
- Whether stakeholders buy into it and embrace it, i.e., do they "Support It?" and,
- The degree to which the stakeholders do something different, i.e., do they "Do It?"

Change communication is a critical factor in creating, managing and delivering the messages at each stage that ultimately result in behavior change.

Planning under this mantra—Get It, Support It, Do It—should include setting measurable goals. For example, what exactly are people supposed to understand? How will changes in behavior be assessed?

In the end, change management must use a variety of tools, approaches and processes to repetitively get the message across. Aggregations of behaviors become

**FIGURE 7** Effective Change-Management Communications Assure that Workforces Move from Understanding the Deal to Commitment to Making it Work to the Necessary Behaviors Required to Sustain It



culture by persisting over time. To change them, the methods used must be equally persistent, as well as consistent and motivational.

## CONCLUSION

The reality of large-scale M&A projects in today’s global business world is that they are complex and made more difficult by each party’s unique patterns that define its culture. These patterns are aggregations of individual behaviors and are shaped by personal attributes, the uniqueness of social structures, the organizations within which employees work and the behaviors of others.

For a business transaction to achieve the outcomes expected, acknowledgement of the impact that behavior patterns have on the probability of the transaction’s success is the necessary starting point—but only the starting point. Mitigating the negative impact of culture on a deal or accelerating the development of the culture necessary for success requires adhering to a process. This process must include clarifying the deal’s context and the desired outcomes, identifying the correct behaviors, pulling the correct levers to drive those behaviors and managing the change required. ■

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