What Dealmakers Need to Know: Cultural Due Diligence (CDD)

At the Miami AM&AA Winter Conference, two of us presented the topic, *Dealmakers: Heads in the Sand or Dealing Effectively with Culture Clash and other Human Capital Challenges.* We shared some insights, experiences, and best practices on how to prevent critical deal value from being destroyed by cultural and organizational issues.

Cultural Due Diligence or CDD should be made part of every deal to help insure its long-term success. The numbers remain staggering insofar as upwards of 90% of deals fail due to cultural issues.

Our efforts will continue to create dialogue surrounding Dealmakers and their needs (both stated and unstated). We see Dealmakers as wanting to make successful deals that last but the M&A failure rate and other impediments to success get in the way of that. Our point about "heads in the sand" is just that; many Dealmakers deny the challenges of culture and human capital issues or hope the problems just go away.

We see this as normal but certainly fixable. There is still a great deal of misunderstanding and misconceptions about organizational culture and human capital issues in general. Usually, this is not part of a Dealmaker's repertoire. Dealmakers focus almost entirely on financial aspects and leave the "people issues" to someone else. We need to make Dealmakers more aware of the criticality of conducting an effective *Cultural Due Diligence* (CDD) process to help enable their clients to avoid the biggest cause of failure.

We continue to promote discussion among the membership of the Alliance of Mergers & Acquisitions Advisors (AM&AA) regarding the issues and challenges surrounding potential culture clash and its impact on longevity of mergers or acquisitions. Our contention remains that in our 30+ years of dealing globally with M&A's, we have yet to see two organizational cultures that cannot successfully align and integrate in a relatively short period of time.

Dealmakers have many misconceptions about CDD and other human capital issues. The belief that any sort of change in the culture "is too expensive and would take years" is one of those misconceptions. Another fallacy is that culture clash only applies to the largest organizations. Not true. Culture clash occurs within medium to very small companies including family-owned businesses. Finally, there is the belief this is only critical on the "buy-side;" it is equally critical on the "sell-side." It helps to "know thyself" when positioning a company for sale.

We believe that M&A failure due to "culture clash" is just a way of describing management negligence, arrogance, ignorance or some mix of the three. Dysfunctional *culture clash* need never occur.

The question for Dealmakers must be: "Do you care (strategically or personally) how the deal goes after it closes?" We know that many Dealmakers simply care about closing the deal and moving on to the next deal. We also know that some Dealmakers care about ensuring successful deals that build their credibility, enhancing their reputation for being "serially successful" in putting deals together and develop more advantageous relationships with clients for repeat business.

In researching current trends in Mergers and Acquisitions, *Deloitte's The State of the Deal M&A Trends*, 2018 and their *M&A Trends End-of-Year Report* (2017) reveals:

- 68 percent of executives at US-headquartered corporations and 76 percent of leaders at domestic-based private equity firms say ***deal flow will increase in 2018***

- 63 percent of corporate survey respondents expect ***deal size to increase***

- For the second straight year, respondents cited ***effective integration***, accurate valuation, and economic certainty as the three most important factors for a deal's success.

Deloitte's *M&A Trends* report also says:

- 55% of all respondents said that ***a quarter of all deals fell short of expectations***

- This year, respondents cited the speed of decision making and ***added aligning cultures as key areas of concern.***

- Deloitte surveys consistently show that ***well-planned, carefully-executed integrations yield transaction success.***

Considering those critical trends, it is easy to make the case that Dealmakers know the risks and know what needs to happen to ensure deal success. Whether they choose to take those next steps remains the question. Part of the reluctance may be a misunderstanding of the nature of *culture clash*, a lack of knowledge about the CDD process and perhaps, some lack of clarity on how to plan and design an effective integration strategy.

What is *culture clash* anyway? Culture clash is no more than differences in opinions and assumptions as to the "proper" manner and behaviors involved in pursuing the business plan. Culture clash occurs when two (or more) groups have different beliefs about:

- Observable differences between the companies involved in a merger about: *What is believed; what is important; what is valued; what should be measured; how people should be treated; how people treat one another; how decisions are made; how to manage and supervise; and how to communicate.*
- The disruption that occurs when the way one company conducts its business and treats its people is folded in with another company's way of doing business.
- Differences of opinion, disagreements, arguments, and different assumptions regarding the internal process of implementing the new business plan and strategy.
- *Perceived* differences in organizational beliefs, values and practices.
- *Perceived* differences between the two companies in degree of formality in style of dress, language, work space, communication and so forth.
- "Winner-Loser" language used by either organization's people. (Carleton & Lineberry, 2004)

Carleton and Lineberry went on to raise the central question. "Since speed in implementing the integration and achieving post-merger effectiveness is absolutely critical, and culture clash is the biggest obstacle to achieving the clarity and focus necessary for rapid implementation, then what is generally being done to anticipate and manage culture and management style integration issues?"

The answer is *very little or nothing at all.* (Carleton & Lineberry, 2004)

Our *Dealmakers' Guide: Ten Things a Dealmaker Needs to Know About Cultural Due Diligence©* provides answers to the very basic questions about human capital challenges during a merger or acquisition that Dealmakers need to know.

Ten things a Dealmaker should know include the following:

1. *Culture clash* is the most common cause of eventual M&A failure including failure to achieve financial targets or prolonged inefficiency.

2. There are no two or more corporate cultures that cannot effectively align and integrate.

3. People behave differently when in groups than they do when acting individually. Corporate culture is a group behavioral norm that is not based upon individual beliefs but on organizational group norms.

4. Managing change for individuals is fundamentally different from managing change for groups. Cultural Due Diligence (CDD) is a process for gathering necessary data to design a focused group change effort in achieving overall strategic alignment.

5. Strategic Alignment assures that people (and functions) in an organization are generally approaching customers and the business in a strategically consistent and cross-functionally supportive manner.

6. CDD and strategic alignment can be successfully undertaken at any point after making the acquisition decision. Even if full-blown culture clash happens post-acquisition, the organization can still achieve successful alignment and integration.

7. The number of people and locations involved in implementing an alignment effort drive the costs for a CDD. Effectively, the costs for a CDD and achieving alignment are irrelevant in the overall cost of an M&A. In our experience the combined costs have never exceeded 1% of the overall M&A costs and are often considerably less.

8. Off-the-shelf (prepackaged) culture surveys will not generate data useful for developing and implementing strategic alignment. Because every organizational situation has unique elements and ways of talking about the business, consultants must meet face-to-face with people in interviews and focus groups to capture those unique and nuanced bits of information.

9. CDD's should take no more than 30 days to complete. Change efforts should begin delivering observable/measurable results within 90 days of starting the change effort.

10. Go or no-go decisions regarding target acquisition should be based upon traditional issues of revenue generation, technology acquisition, competition, market, products or services offered and potential synergies. Don't worry about the people. Get the rest right and the people can always be successfully aligned.

CDD is simply a diagnostic process to ascertain the degree of alignment between two or more different groups of people and the business plan. CDD provides the base data to develop an alignment and integration plan. It is a mandatory step if anything involving the people and their behavior in the organization needs to change to achieve success.

In short, CDD provides an actionable report that would enable a Dealmaker's client to align and integrate successfully. It would also allow the Dealmaker to focus on the rest of the business and not worry about the "people issues."

Considering its relatively low cost and minimal time commitment, shouldn't Cultural Due Diligence (CDD) become a routine component of deal making? Think about it.

Next month: *Dealmakers Planning for a Successful Integration: Implementing Cultural Due Diligence (CDD)*

Reference

Carleton, J. Robert and Lineberry, Claude S., Achieving Post-Merger Success: A Stakeholder's Guide to Cultural Due Diligence, Assessment and Integration, Pfeiffer, John Wiley & Sons, 2004, pp. 13 -14.

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