Dealmakers Planning for a Successful Integration: Performing Cultural Due Diligence (CDD)

Last month In *MidMarket Talk*, *What Dealmakers Need to Know: Cultural Due Diligence (CDD)* made the case that CDD should be an integral part of making deals successful and sustainable. A quick review of the harsh reality is that most merger or acquisition deals fail. The reasons why are obvious.

Internationally the record of accomplishment of M&A activity results is quite poor. Multiple studies analyzing the last 30 to 50 years of M&A activity have documented a business success rate of less than 30%. One McKinsey study of 30 years of M&A activity concluded that 77% (and some studies show this at 90%) of the acquisitions failed to meet their intended business objective, over half failed to ever recover the documented costs of the acquisition and roughly a third were later divested or completely shut down. Any company's own data, while maybe better than international averages, may still show a less than desirable success rate.

Another series of follow-on studies identified organizational *culture clash* as the primary reason for failure in over half of the thousands of acquisition failures studied. We define "culture clash" as disagreements between people in the merged organizations concerning how to go about engaging in and managing the business. These types of clashes consume increasing amounts of energy and time to get things done and turn the focus of significant parts of the organization from "doing" the business to arguing about how it should or should not be done. Internal issues/arguments consume ever more resource leaving less and less focused upon the customer and performing the work. (Vector Group, 2017)

Culture clash is about the 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:

- What is important
- What should be measured
- How to make decisions
- How to supervise
- How to communicate
- Who is and/or how to best serve, the customer

Once again from last month's article, the question for Dealmakers must be: "Do you care (strategically or personally) how the deal goes after it closes?" Our contention is that Dealmakers can ensure the long-term success of their deals by including CDD. This should build their credibility and enhance their reputation.

Why, how, when?

Questions arise as to not only the rationale of doing a CDD in the first place but also how and when to conduct it. A Canadian engineering and construction company sought out Vector Group a few years ago wanting to make their acquisitions more successful. We developed the *M&A Roadmap for Success©*

(next month's topic) for that specific client to more clearly define and leverage the role of a Human Resources team in driving the success of present and future acquisitions and bringing desired results.

Our original *Roadmap* identified nine phases in the process but this generic model can be easily customized for any company who has a dedicated team for mergers and acquisitions:

- Phase I -Target Identification
- Phase II -Target Evaluation
- Phase III -Pre-Go/No Go Decision Meeting
- Phase IV -Due Diligence
- Phase V -Integration Planning
- Phase VI –Go/No Go Decision Meeting
- Phase VII -Share / Asset Purchase Agreement
- Phase VIII -Integration (First two weeks)
- Phase IX -Integration (First year)

When to conduct the CDD? In a word? Anytime. This can be when considering an acquisition strategy, when selecting a target company, after signing the Letter of Intent, in the post-merger or post-acquisition or even when interceding in full-blown culture clash. Initial high-level assessments of the target can happen as early as Phase I or II of the *Roadmap*. The high-level assessment leads to conclusions about the degree of effort required for successful integration.

Human Resources or a dedicated M&A team can provide this initial assessment of integration strengths, weaknesses, opportunities and threats (SWOT analysis) through preliminary research into available resources (more on this next month). The assessment could also include evaluation of the cultural aspects of (any) country which could influence the organization's management or projected financial results. Additionally, identifying essential/key employees and developing a retention package for technical experts and management is critical, too.

Performing Cultural Due Diligence (CDD)

The purpose of Cultural Due Diligence or CDD is gathering basic data to enable the organization to effectively lead and manage the human aspects of the company following a merger or acquisition. The results provide the foundation for developing strategies and tactics to deal with any dysfunctional organizational behavior that leads to conflict and prevents the new organization from delivering results (financial or otherwise). Our take is that the process is complex but most definitely not complicated and very measurable.

The bottom line here is to effectively manage or avoid the potential of "culture clash." Our constant refrain is that in our 30+ years of dealing with M&A's globally, we have yet to see two organizational cultures that cannot be successfully integrated. 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.*

As I described in November 2017's *MidMarket Talk*, CDD is not a flawless or perfect process; there are inherent issues and challenges depending on how a consultant (the generic for an adviser, an expert or a specialist) conducts the cultural assessment. The caveat is that possibly flawed data can lead to flawed decisions or outcomes.

The consultant or consultant team needs some highly developed critical skills to conduct effective interviews and secure the necessary data to describe an organization's culture. The practice of interviewing individuals, groups and focus groups takes years of finesse in such areas as:

- Maintaining an absolute neutral position of inquiry
- Establishing rapport and gaining trust quickly / Relationship building skills
- Behavioral sciences
    - Organizational behavior (individual, group, inter-group)
    - Psychology
    - Group dynamics
    - Interviewing / Facilitation skills
- Storytelling
- Assessment of non-verbal behavior
- Systemic view
- Business acumen
- Workplace observation skills
- Ability to change demeanor between the shop floor and the executive suite
- Adaptable language (very proper to "not so proper" depending on the audience)
- Unobtrusive note-taking
- Rigor in asking open-ended questions / Finely-tuned ability to ask the "dumb" questions
- Look for driving problems and not symptoms /Analyze processes, tasks, procedures and systems
- Leveling and confronting skills / Risk taker / Comfort with contentious issues / Persuasive and persistent / Pragmatic / Self-awareness / Self-discipline / Good rational and emotional balance
- Competence in gathering data from a variety of sources (the organizational environment, documents, etc.)
- Synthesize data and report-writing (Craig, 2007 & 2013)

Ideally, any CDD process would include both *quantitative* and *qualitative* methodologies of data gathering.

- Qualitative methodology includes interviews (both individual and group), focus groups, workplace observations and documents review. A critical piece here is gathering verbatim responses from organizational members.
- Quantitative methodology encompasses "CDD surveys developed and administered to a sample of the total population of the two (or more) organizations engaged in the merger or acquisition to develop high-level cultural profiles of each organization." (Carleton & Lineberry, pp. 69-70)
    - Keep in mind that surveys alone will not produce needed cultural information.

Once the data gathering is complete, the data needs to be analyzed, condensed and organized so that it is most helpful to each organization. Organizing the data around twelve domains of CDD (Carleton, 1997). Following is a brief description of each of the 12 domains. These descriptions provide a general sense of each area and are not meant to be definitive.

1. **Intended Direction/Results** - Ascertain, from the top of the organization on down what the company intends to accomplish. What is the business plan about, what is the intent and purpose of the organization, what results are expected from the business activity of the organization, and, most important, how are these things discussed, described, and communicated level by level and function by function?

2. **Key Measures** - What the company measures, why, and what happens as a result. The key measures say a lot about the way the company and its executives and staff are driven, particularly when you also consider the consequences for each measure.

3. **Key Business Drivers** - What are the primary issues driving the business strategy? Is the focus on competitive edge and, if so, how is that defined - price differentiation, quality, market share, service, reliability or what?

4. **Infrastructure** - How is the company organized, what is the nature of the reporting relationships, how do the staff systems interface with the line systems? What is the nature of the relationship between groups and units in the organization?

5. **Organizational Practices** - What formal and informal systems are in place and what part do they play in the daily life of doing the work? How much flexibility is allowed at what levels in which systems? What is the relationship between political reality and business reality?

6. **Leadership/Management Practices** - What is the balance between Leadership and Management approaches with staff? What basic value systems about employees are in place? How are people treated and why? How does the business plan get implemented through the management system? How are decisions made? Who is involved in what, and when?

7. **Supervisory Practices** - What dynamics are at play in the immediate oversight of the performance of work? Supervisory practices have a major impact on employees' feelings about the company and the work they do. The nature of the interaction between the employee and the immediate supervisor is one of the primary tone-setters for the culture of the company.

8. **Work Practices** - How is the actual work performed? Is the emphasis on individual responsibility or group responsibility? What degree of control, if any, does the individual worker have on the workflow, quality, rate, tools utilized and supplies needed?

9. **Technology Utilization** - Both in relation to internal systems and equipment, as well as the services and products provided to customers. How current is the technology being utilized? What are people used to in relation to technological support/resources?

10. **Physical Environment** - How do the workplace settings differ? Open workspaces versus private offices, high security versus open access, buildings, furniture, grounds — all can have a bearing on how people feel about work and the company.

11. **Perceptions/Expectations** - How do people expect things to happen? What do they think is important? What do they think should be important, versus what they believe the company thinks is important?

12. **Cultural Indicators/Artifacts** - How do people dress and address each other? What is the match between formal work hours and actual hours spent working? What company-sponsored-activities exist and what are they like? (Carleton & Lineberry, 2004, pp. 70 - 75)

The data can be organized around these twelve cultural domains or it can also can be organized around what Carleton & Lineberry describe as "the key elements of the business plan or in any other manner that will be of greatest value to the two organizations."

What CDD Delivers

Cultural Due Diligence (CDD) delivers critical information regarding organizational behavior of two or more organizations coming together through a merger or acquisition. The CDD process highlights any misalignments between the cultures of those organizations and provides the foundation for building strategies and tactics to deal with potential culture clash.

As a reminder, Dealmakers should put aside any concerns about costs and time for their clients. Data gathering and generation of report should take less than 30 business days. Integration planning begins early in the M&A process and much of the integration issues can be resolved within the first 30 days following the closing. 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.

Next month: *Dealmakers Planning for a Successful Integration: The M&A Roadmap for Success*

References

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