MERGERS & ACQUISITIONS:
THE CULTURE FACTOR

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Acquiring a company may be the biggest business decision an executive makes in his or her career. The stakes are incredibly high in capital investment, personal and company reputation, and the future fortunes of both acquirer and acquiree.

Metrics of every size and shape are brought into play to calculate an expected rate of return. Targets are embraced according to an acquiring company's strategic needs, such as location, product portfolio and capabilities, and sorted until a final target is deemed the best-remaining entity.

Yet, through all of this, an overwhelmingly important factor is often overlooked. That is the culture factor. How will the acquired company's culture mesh with that of the acquiring company after the deal goes through?

Overcoming the odds

McKinsey & Company reports that up to 70% of acquisitions fail to meet their intended objectives, and Deloitte says that as many as 90% of acquisitions fall short.

These are daunting figures, especially from the buy side, which funds the transactions. Accordingly, mitigating risk is essential. For this reason, professionals with operational experience should be core members of the acquisition team from the start.

Ensuring that cultures match in a merger or acquisition is an almost virgin area of mitigating risk. Culture is generally considered background noise in transactions dominated by owners, CEOs, finance, legal and engineering personnel, and often consultants and investment bankers who help the acquiring company raise capital and advise on the M&A process.

Attention tends to center on sales volume, revenues, profit margins and other variables, ranging from IT considerations to whether a targeted business is unionized.

Each of the above can be categorized, measured, and justified as an absolute determining metric in the decision-making process. This will ultimately include a critical discussion about the asking price. Culture is not so easily calculated. So, let's start with a home-grown definition that positions culture in contrast to other M&A evaluation criteria.

What is culture? It's the chatter of employees, their enthusiasm or lack thereof, how they see and behave in the plant and office, and how management conducts business. Is there a hierarchal or flat management structure? Do workers enjoy coming to work? Are employees eager to adopt new or different ways of doing their jobs, as will be necessary when new ownership arrives?

In short, culture is the values, beliefs, and behaviors that define an organization.

These are subjective factors. But ignoring them can lead to conflicts and difficulties integrating the target company into the acquirer's operations, negatively impacting the acquisition's value. It can also lead to issues with employee retention, as employees may feel that the acquirer does not respect their values and beliefs.

So, how can an acquiring company evaluate a target's culture? Fortunately, there are ways to consider these subjective qualifiers.

Start early!

The concept of culture should come into play as M&A discussions or the research process begins. And there should be a prepared but highly flexible set of actions to guide the process. Experienced integration specialists often have detailed step-by-step procedures that take the acquiring company from developing a strategic direction to contacting a primary target, carefully assessing the target under the acquiring company's ownership, and then seeking a price mandate and creating a post-acquisition integration plan. Too often, acquirers wait too late to consider how they will integrate the new company.

Recent years have seen a surge in acquisitions of small, often family-owned, businesses in the technology, finance, industrial, consumer goods and healthcare sectors. But the below shortlist of culture questions that an integration specialist might share with an acquiring company to evaluate a target could apply to a business of almost any description:

- Company Values—What does the target company hold dear? Are sustainability, innovation and teamwork, for example, at the top of its values list?

- Communications—Does the target company frequently communicate with employees? Does it publish newsletters or blogs or rely more on in-person meetings to cover safety, community service and holiday schedules? Does the company have a consistent message? Does it demonstrate pride in employees' achievements?

- How is compensation handled? Are bonuses a large part of managers' and executives' packages? How companies reward their employees says a lot about the business's culture.

- How does the company go to market, direct sell or through distributors?

- Leadership style—Is it warm or autocratic?

- Is management loyal to its employees and vendors?

A case in point: Not long ago, we headed up a U.S.-based composite materials converter's acquisition of a European materials formatter serving the aerospace industry. The fit was nearly perfect for both parties. It would give the acquiring U.S. business a manufacturing presence in a new region, with access to aerospace industry prospects otherwise unattainable due to the transatlantic distance.

The target's owner was also its founder and longtime CEO with a passionate regard for his employees and suppliers. He expressed concerns about job security for the company's management, employees and vendors.

We agreed early on to work closely with him and the white and blue-collar unions. We hired outside counsel to ensure that we fully understood the cultural challenges associated with an American company acquiring a French-based company. We met with and assured all employees that we wanted to retain their expertise and grow the business.

We surveyed and interviewed employees early in the due diligence process to understand and address concerns. [See The Employee Survey] Additionally, we met with the major vendors to assure them of our intention to maintain existing supply agreements.

- Workplace practices—Does the target company adhere to lean practices?
- Does the target company participate in community services?

Answers to such questions will soon create a fully developed portrait of a company's culture, with obvious areas of alignment and rough spots.

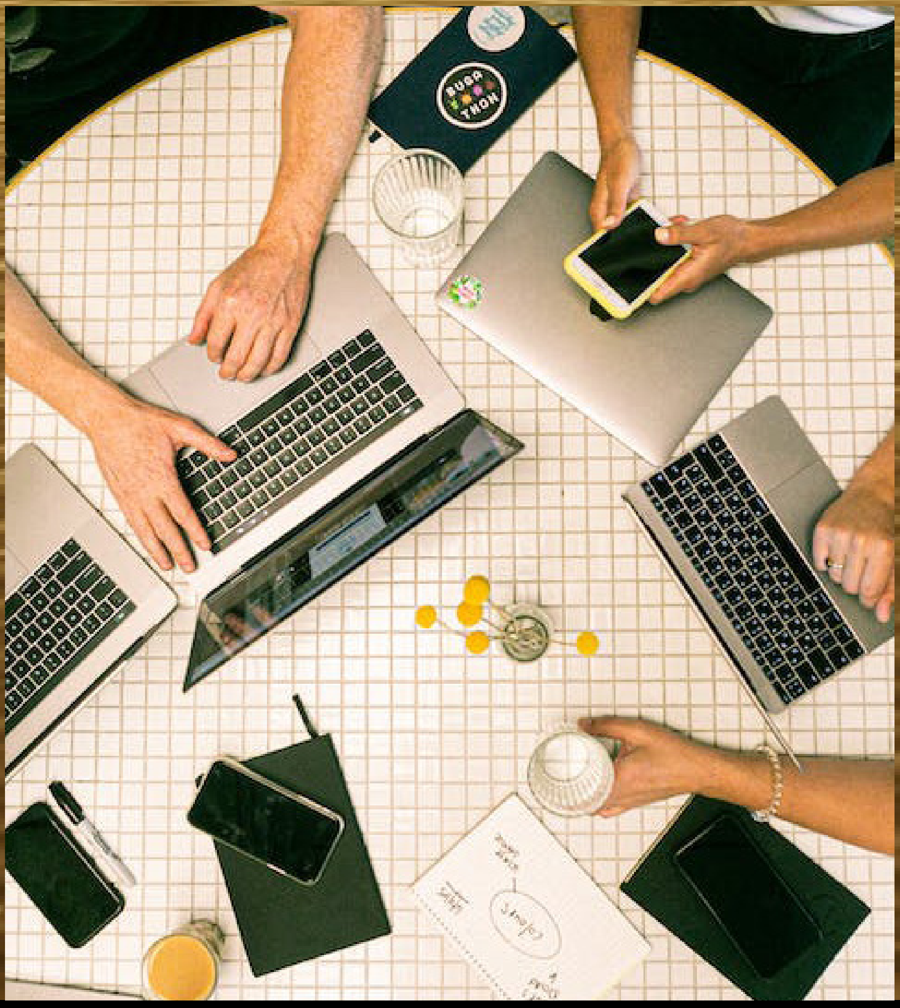
That covers a sampling of what to research.

Some tips on how to research include reviewing company documents, such as minutes of the past year's board meeting and management/employee union meetings.

Beyond this, observe the company's operations and walk the facilities to see workers in action. Look for safety issues. Consider undertaking a complete environmental study.

A word about strategy and goals

No discussion about acquiring a business would be complete without addressing the need for a clear strategy and setting goals from the very outset of an M&A enterprise. Be crystal clear on the strategic plan. What is your north star? Which market do you want to lead? How do you plan to outperform your competition? Goals help keep the M&A process operating systematically and on an objective path. Potential goals are endless. Do you want to broaden your product line? Establish a business in a new region? Qualify for business in an offshore market? Stay in tune with your carefully developed strategic goals to help keep unnecessary risk out of the acquisition equation.



The Employee Survey

An employee survey will generate valuable insights into employee sentiment and help to identify potential areas of concern or improvement. Some typical questions might include the following:

- What do you think about the acquisition, and how do you expect it to impact your job?
- How well do you think your job responsibilities and the company culture align with the acquiring company's goals and values?
- How has communication between management and employees been during the acquisition process?
- Are you concerned about job security or the company's future following the acquisition?
- What do you think about the acquiring company's products or services, and how do you see them fitting in with your company's offerings?
- How do you feel about the level of support provided to you during the transition process?
- What suggestions do you have for the leadership team to help ensure a smooth transition and to maintain employee morale during the acquisition process?

About Ian Smith

A serial entrepreneur, during the past 20 years, Ian Smith has driven the scaling of over a dozen technology and manufacturing businesses in the U.S and has completed over 40 deals with an enterprise value of $1B. He is a multi-company operator and an investment banker. Since 2009, Ian has led his buy-side practice, The Portfolio Partnership. Ian earned his B.A. at University of Strathclyde and his CA qualification with Grant Thornton. His latest book, The Acquirer's Playbook is available on Amazon.

About Kevin Young

Kevin Young is a veteran C-level executive whose experience includes managing M&A at multibillion-dollar companies in the U.S. and abroad. He recently was named a principal at The Portfolio Partnership, which offers innovative buy-side Investment Banking services that integrate seamlessly with and expand its clients' management capabilities for closing and integrating deals. Young holds a bachelor's degree in economics from Boston College and a master's in business administration from Babson College.