# Cultural Integration during a Merger Transition makes Dollars & Sense

In light of the recent economic challenges, many companies are turning to popular strategic alternatives to help alleviate the pressure on their bottom line or, in the case of many life sciences and consumer goods companies, their innovation pipelines. Merger and acquisition (M&A) activity is a prime example of how companies are re-strategizing. Although M&A deals have a number of associated benefits such as expansion, operational synergies and competitive advantage, there are also many challenges that need to be considered for a successful execution, the most important of which is cultural integration.

In the past couple of years, many of our life sciences and consumer goods clients recognized the importance of cultural integration by highlighting it as a major risk in their annual reports. Charles River Laboratories wrote in their 2008 report that, even after a successful acquisition, there is risk associated with loss of key employees and "of not being able to overcome differences in foreign business practices, customs and importation regulations, language and other cultural barriers in connection with the acquisition of foreign companies." Mylan echoes a similar risk in their 2008 report "of difficulties in successfully integrating the operations and personnel of the former Merck Generics business with [our] historical business and corporate culture".

Unfortunately, a large number of companies still do not identify these risks and, as a result, do not see positive results from M&A activity.[1] A leading study of 700 merger and acquisition deals over a two-year period found that 83% of mergers and acquisitions failed to produce any benefits for shareholders, and more than 50% actually destroyed value. Interviews of over 100 senior executives involved in these deals revealed that the overwhelming cause for failure was "the people and the cultural differences."[2] This hypothesis found support in a 2004 meta-analysis that identified cultural differences as a major contributing factor to unsuccessful mergers or acquisitions.[3] The realities of M&A activity show that cultural integration cannot be ignored if a company wants to succeed.

> "The realities of M&A activity show that cultural integration cannot be ignored if a company wants to succeed."

Companies that enjoy successful mergers have the ability to attain a high level of cultural integration. Consequently, since people are the cultural drivers, cultural integration needs to be properly analyzed and managed as part of the merger transition strategy to minimize this key cause of failure. In this discussion, we talk to experienced change management professionals Yewande Daniel-Ayoade and Pam Windsor about the timing, process, and importance of culturally integrating a newly acquired organization during a merger.

**There seems to have been a lot of M&A activity within the life sciences industry in recent years. Is this a continuing trend?**

Based on our experience, we absolutely believe this will continue. The life sciences industry witnessed about 460 announced M&A transactions in 2007, up from 442 in 2006.[4] This trend is expected to continue, especially with large established pharmaceutical companies looking to biotech and drug development companies as a means to shore up their clinical-stage product pipelines.[5] The consumer goods industry may also experience a resurgence in M&A activity, with some new announcements in early 2010 leading the way.

More recently, the economic downturn has caused a renewed search for potential business synergies and a chance for trimming duplicate operations and staff. For those firms doing well despite the economic turmoil, the timing may be ripe to seek bargains and consider expansion through merger and acquisition opportunities to gain a competitive edge. We have recently seen this with the Pfizer/Wyeth, Merck/Schering-Plough, and Kraft/Cadbury transactions.

Life sciences and consumer goods companies often use mergers to invest in new product innovations and new market penetration. When done right, mergers and acquisitions can also lead to growth in market share, increased stock price, lower costs, and improved synergies. Before the downturn, during an increasingly tough and fast moving market, M&A, rather than organic growth, became one of the quickest ways to respond to market changes and enhance value. Currently, some organizations are taking advantage of their financial strength to grow their business through acquisition.

But, be aware, a negative side effect of the temptation to respond quickly to the market is that many companies rush through the integration process and, in doing so, certain crucial due diligence elements may fall through the cracks.

### What do companies typically focus on during a merger?

The initial focus is usually on the business portfolio—asset rationalization, product line expansion, supply chain integration, customer consolidation, R&D pipeline or even elimination of a competitor. After that, companies tend to look at their IT and attempt to standardize technology and related processes across the organization. These focus areas may be performed either during the merger transition or post-merger.

While some M&A activity may focus cursorily on the human factors at the outset, the effort typically does not receive the appropriate amount of consideration and planning.

### What critical element typically falls through the cracks during a rushed merger?

The impact on the merging organizations' human capital—the people—is often an after-thought. People represent a sizeable investment, not only on the balance sheet but in the key areas of knowledge and experience. They are valuable assets necessary to maintain momentum and provide a seamless merger transition. During hard times, costs related to people may be the first cut from the budget. Companies need to recognize this tendency to cut the "people budget" and that it may not necessarily be the best course of action or provide the expected cost savings in the long run.

Often during the M&A transition, long-term gains are sacrificed for short-term and short-sighted savings. Big capital expenditure projects are many times put on hold or shortcuts are taken to minimize costs. It can be extremely tempting to speed through the cultural assimilation or overlook it altogether. These scenarios can be dangerous and result in a negative impact on the merger success if not carefully balanced from a change management as well as financial perspective.

### What should companies consider when thinking about employees in relation to a merger?

Cultural integration is often misunderstood to mean reproducing the culture of the parent company in all acquired companies. This is not necessarily the case. The objective of the transitional integration process should be to retain the best of both companies.

> "Merger transition plans should include a thoughtful and purposeful due diligence process to carefully analyze and integrate the cultures of the merging organizations."

Because culture is such an important element, merger transition plans should include a thoughtful and purposeful due diligence process to carefully analyze and integrate the cultures of the merging organizations.

### So what is cultural integration and why is timing critical?

Cultural integration means having consistency in the organization's values, structure and management practices across the board. The same core values should guide all the entities within the organization, because having different philosophies will ultimately get in the way of moving forward. Recently one of our clients acquired a business that had a conflicting project execution approach; one firm focused on deadlines while the other was more concerned with providing the best quality solutions. Issues surfaced immediately during their first joint project—the misalignment could be seen clearly when the priorities were so different between the two groups.

Sometimes the smallest detail can stimulate negativity and undermine the transition process. For instance, a difference in dress code may not seem important to management but can be very important to employees (example: "Friday casual" policy). Employees at the newly acquired company may be used to wearing jeans on Fridays; if this cultural norm is stripped away, new employees could push back impacting morale, productivity, and potentially employee loyalty.

Our clients have found that it is important to acknowledge the importance of these cultural details. To ensure a positive outcome, firms need to acknowledge and manage potential cultural policy inconsistencies early on to minimize resistance and maximize the success of the integration.

> “Transitional, rather than post-merger, timing is critical to success.”

### What are the benefits for companies who have successfully integrated their cultures?

Before we talk about the benefits or consequences, there's a preliminary step to consider—how do you know you are successful if you don't set parameters and keep score? Successful cultural integration requires companies to define how success will be measured and rewarded, how conflict will be managed, and what reporting roles and relationships will be in the new organization.

While these may be perceived as soft issues, in reality, corporate culture exerts a strong influence on how employees behave at work. Studies have shown that employees who work for the same corporation, no matter what their jobs, are 30% more likely to exhibit similar leadership competencies – defined as the way a person learns, deduces, envisions, engages, and executes – than people who do the same job but who work in different companies.[6] This highlights how important it is to acknowledge these similarities and take them into account when planning any M&A activity.

Consequently, cultural integration presents a set of complex transitional and management challenges that can undermine and disrupt an otherwise successful merger. Companies need to carefully consider and methodically plan a cultural integration to institutionalize common goals and values that best represent the picture of the new company and will be the foundation for positive organizational change.

Transitional, rather than post-merger, timing is critical to success. People, their behaviors, experiences, styles and attitudes, determine the culture. Consequently, you must engage them in the transitional process. Early and frequent communication of a common corporate message will help instill confidence and start the internal adoption process. Setting and managing expectations are also critical elements in that process; "doing it with them" will maximize chances of a more positive outcome than "doing it to them".

### What are the consequences for companies who do not focus on cultural integration?

Conflicting cultures make it difficult to establish a 'common language' across the organization, leading to inefficiencies in merger situations. Common sources of inefficiencies during mergers include new leadership styles that do not take into consideration the local culture, unrealistic team structures, unclear roles, responsibilities and reporting relationships, and an 'us' versus 'them' mentality. Employee dissatisfaction or uncertainty about the future also leads to enormous losses in key personnel, their knowledge and experience, as well as loss of productivity. All of this underscores the need to focus early on these organizational issues in order to minimize the impact on the company's profitability.

> A few *years ago, when a California-based company was acquired, the parent company wanted to retain the highly specialized talent but insisted they move to the east coast, so they could close the west coast site. Because they had not been diligent in considering the California location culture, they quickly discovered the talent was not willing to leave the west coast. Consequently, this became a critical integration decision for the parent organization. Ultimately, the company decided to keep the California site in operation to preserve the talent investment. Although this was satisfactorily resolved, this example highlights the need for proper attention and scrutiny of cultural aspects as part of the transition planning.*

Another potential consequence when companies merge but simply keep the existing organizations' structure, is they fail to realize the anticipated cost savings from merging similar functions across the organization. Organization structural redesign and consolidation of functions such as finance, marketing, customer service, information technology and human resources should eliminate redundancies, but will also provide the management team with visibility and information required to manage the company's assets and human resources.

### How should merging companies approach the process of cultural integration?

Experts agree that in most successful business combinations, neither company's corporate culture survives completely intact. Instead, a new, blended culture takes the place of the original two.

Culture is a complex issue, but taking the time to understand it can tell you how well people will work together and how certain compensation programs and benefits structures may be received. The desired organizational shifting and molding that take place during a cultural integration are contingent on a business strategy that incorporates a diligent analysis and plan to manage those changes. Creating a new culture involves broad change management as well as individual transition management. Developing a transition plan is vital to helping employees address the psychological transitions they must complete before they can fully align with the new organization. It is important to create and maintain routine connections with employees, help them interpret the information they are receiving, and have them engaged in the evolution into the new organization. This connection may begin in some forms before the merger announcement but effectively starts on day one—the day the new acquisition or merger is announced—and should be the first task in a comprehensive communication plan.

One of our U.S.–based clients successfully managed an international acquisition by assigning an on-site manager at each of the affected country sites to facilitate the transition process. These managers were utilized to identify important cultural details, such as communication style, and serve as the local liaison between their site and the U.S. office. This upfront effort paid off as it minimized potential conflicts due to the significant cultural differences.

## Is there a structured approach to how I can think about transitional cultural integration?

To ensure a comprehensive approach, Clarkston has developed the Holistic Organization Model (HOM™), a diagnostic tool that uses well defined and highly targeted initiatives to improve organizational efficiency during cultural transitions. The Clarkston model will help companies continuously improve organizational efficiency with a focus on achieving quick, measurable benefits and has successfully been applied for high-powered global project organizations executing critical M&A initiatives.

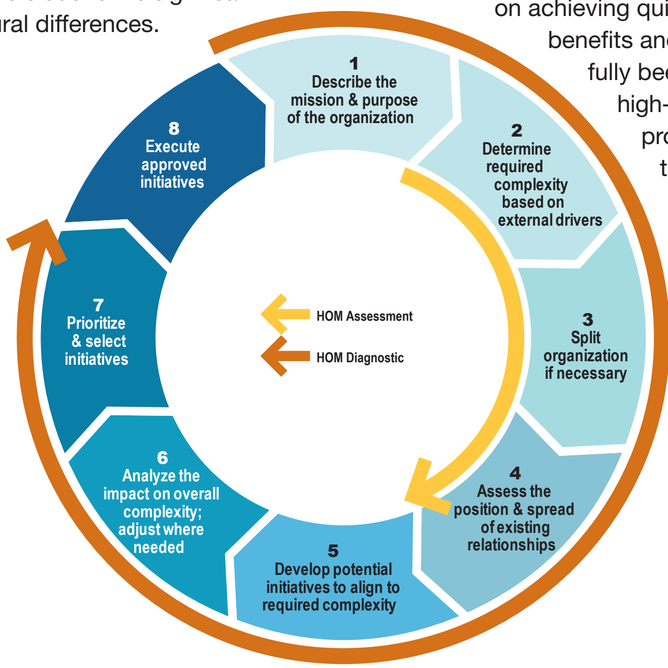


Figure 1: **Holistic Organization Model Assessment and Diagnostic Cycle**

## Call to Action

- Study the competitive landscape; look for M&A opportunities to support your business goals.
- When merger/acquisition opportunities present themselves, remember to include a cultural integration plan in your strategy.
- Consider using an experienced and qualified partner to help you work through the challenges - call Clarkston for more information on the Holistic Organization Model to maximize chances for cultural integration success during a merger/acquisition.

For more information on the HOM or post-merger cultural integration, please contact Rob Klein at 877-362-3649 or rklein@clarkstonconsulting.com.

## References


1 "Meta-Analysis of Post-Acquisition Performance" King, et.al, 2004.

2 "Six Key Factors for Successful Mergers and Acquisitions", KPMG, Nov 2000.

3 "Meta-Analyses of the Performance Implications of Cultural Differences in Mergers & Acquisitions" G. Stahl and A. Voight, 2004.

4 "Market Update 2007", P & M Corporate Finance LLC.

5 "Pharmaceutical Manufacture", Hoovers First Research Industry Profile, 2009.

6 "Culture Matters Most", Thomas Kell and Gregory Carrott, Harvard Business Review, May 2005.


CLARKSTON CONSULTING


Headquarters
Research Triangle Park
1007 Slater Road, Suite 400
Durham, NC 27703
Phone: 800-652-4274
Fax: 919-484-4450

**www.clarkstonconsulting.com**





0435_0710


### *About Clarkston Consulting*

*Clarkston Consulting is a different kind of management and technology consulting firm. We deliver a unique experience for market leaders within the Consumer Products and Life Sciences industries. Considering professionalism, expertise, and value as prerequisites, we take service a step further through our unyielding commitment to the success of people as individuals, both our clients and our employees. By combining integrity, adaptability, and a whatever-it-takes attitude, we have achieved an extremely high rate of referral and repeat business and a 7-year average client satisfaction rating of 97%.*