



Irreconcilable differences

By Robert J. Thomas

Despite the penalties for failure, too many merger-bound CEOs ignore a key factor that can make or break an M&A deal: culture clash.

The solution? Cultural due diligence, a systematic method for making rapid, cost-effective assessments of the cultures of both acquirer and target.

Like so many altar-bound executives, Quaker Oats chairman William Smithburg and Snapple Beverage president Leonard Marsh believed that their 1994 marriage had been made in heaven. They were confident that the \$1.7 billion merger had created a mix of people and products that would yield a fountain of profits well into the next millennium.

But the deal proved to have about as much kick as a Gatorade-and-Mango Madness cocktail. By early 1997 Quaker was forced to unload Snapple for \$300 million, assuring for this transaction a place on the list of the worst megadeals of the 1990s.

The reason: a clash of cultures in which Quaker grossly underestimated the differences between its highly focused, mass-market operating style and Snapple's quirky, entrepreneurial and distributor-oriented style.

Unfortunately, in today's mergers and acquisitions game, the Quaker/Snapple

experience is more the rule than the exception. One reason is that most of the big deals of the 1990s, in contrast to the conglomerate mergers of the 1960s and 1970s and the leveraged buyouts of the 1980s, have been strategic, or aimed at producing business synergies. Whereas most conglomerates got into trouble because they were unfocused, and LBOs because they borrowed too heavily, many of today's strategic deals have stumbled because of irreconcilable differences in the way organizations get things done.

The list of recent megamergers dogged by cultural incompatibility is a long and growing one. It now includes the mid- to late-1990s marriages of pharmaceutical giants Pharmacia and Upjohn; automakers Daimler-Benz and Chrysler; and financial powerhouses Citicorp and Travelers Group. Add to that the acquisition of Capital Cities/ABC by Walt Disney Co.

So are culture clashes inevitable? Or is there some systematic way that pro-

spective merger partners can beat the odds that such conflicts will undermine a promising deal? The answer is a resounding yes. It's called cultural due diligence—a practical, step-by-step approach for making rapid, cost-effective cultural assessments of both the acquirer and the target.

Measuring the gap

Because cultural change involves both hard and soft issues, such due diligence necessarily requires both qualitative and quantitative analyses of a corporate culture, including visible manifestations such as dress codes, office layout, annual reports, recruitment brochures and employee interaction, as well as less tangible corporate values and assumptions about how a company does business.

These findings are then indexed to measure the cultural gap between the prospective partners, identify the risks and costs associated with the gap, and formulate a plan for addressing it. Finally, if the deal goes forward, the

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cultural due diligence conclusions will be used in the post-merger integration phase to make the marriage work.

To be sure, there is no database that establishes beyond any doubt that this embryonic technique is a surefire antidote for culture clash and deal failure. But a growing body of empirical evidence suggests that cultural due diligence, begun in earnest in the target identification and screening phase and continuing after the public announcement into the post-merger integration process, can make the difference between deal success and disappointment—as long as top managers take the findings seriously.

Given the make-or-break role that culture can play in deal success, it's surprising that formal cultural analysis has played such a small or even nonexistent role in most mergers and acquisitions. While CEOs have tacitly acknowledged the need for cultural analysis in doing cross-border transactions—those involving, say, an American company on one side of the deal and a German or Japanese company on the other—they generally have given it only lip service when two big companies based in the same country get together. In fact, cultural due diligence may be even more critical when the players are headquartered in, say, New York and Pittsburgh, London and Birmingham, or Paris and Lyons, because the cultural differences may initially be easier to ignore.

In the United States, at least, M&A due diligence has consisted mostly of crunching numbers, examining executive compensation plans, reviewing legal documents and the like. There are several reasons for this. First, acquisition teams are comprised mostly of financial analysts, who naturally focus on financial data. Top managers, too, generally are

more comfortable with “hard,” easily quantifiable issues than softer ones like culture.

Then, too, these same managers may have believed they already understood the cultural differences between their companies and prospective partners, particularly if they operated in the same industry and felt that a formal analysis was superfluous. Or they may have undertaken a kind of implicit or intuitive cultural assessment that lacked documentation and objectivity and therefore defied replication. But for a variety of reasons, including CEO hubris, they may simply have chosen to ignore the potential conflicts even this superficial analysis may have revealed.

Act of courage

Cultural due diligence, in contrast, can be explicit and measurable. It provides a discipline that compels senior managers to recognize culture as a critical ingredient in deal success and to subject their gut perceptions and conclusions to tough scrutiny.

Indeed, it takes a fair amount of courage for CEOs to submit their preconceived notions of their own corporate cultures, or that of their prospective partners, to such a test. Moreover, if conducting a rigorous cultural assessment up front might be regarded as courageous, failing to do so could conceivably be considered a breach of fiduciary duty down the road, particularly if a deal turns sour.

The explosive growth of eCommerce has created still another compelling argument for cultural due diligence. For many seasoned CEOs, acquiring a start-up eCommerce company peopled by twentysomething software experts will be like taking an ice bath. Merging or acquiring without cultural due diligence when the target operates in the same industry or market is treacherous enough. But the CEO who ven-

tures into cyberspace without this essential assessment is flying completely blind.

Artifacts and values

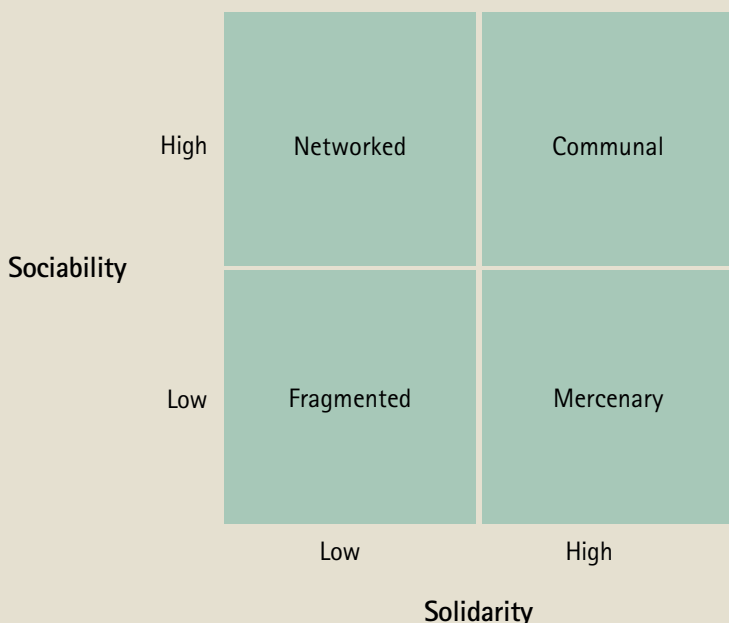
A company’s culture, like an individual’s personality, is the sum of many tangible and intangible features. In a 1988 study, Edgar Schein, a noted authority on organizational culture and leadership at the Massachusetts Institute of Technology Sloan School of Management, observed that organizational culture finds expression in tangible “artifacts,” such as open or closed offices, informal or formal dress and behavior, marketplace reputation, and compensation structure and per-

formance measures. Virtually every artifact contains important information about company values, such as its mission, unwritten rules of behavior and views on human motivation.

In turn, values typically reflect unwritten assumptions about how the company and its employees operate. Though such assumptions tend to be intangible and less obvious determinants of culture than values and artifacts, they are sometimes even more influential drivers of corporate behavior. For example, it may be well understood, albeit not articulated, that a company’s employees aren’t team players but instead work as individuals “out for No. 1.”

Cultural map

In the model below, developed by Rob Goffee of the London Business School and Gareth Jones of Henley Management College, corporations can be placed on a grid, which is divided into four main organizational cultures. Each culture is measured in terms of sociability (the level of warmth and friendliness among employees) and solidarity (the degree to which employees bond with their employer). A “networked” culture, for example, would be relaxed and friendly, where people like and trust each other and feel a stronger affiliation with each other than they do with the company; its cultural antithesis would be a “mercenary” company—internally competitive, high energy and goal-oriented, with heavy emphasis on making money and winning at all cost.



If a company concludes that a hostile takeover won't work unless it completely subjugates the target company's culture, it should probably think twice about doing the deal.

In its initial phase, cultural due diligence consists of identifying and dissecting the artifacts, values and assumptions of the acquirer and target and, on the basis of the findings, placing the two companies on a grid designed to measure the cultural gap between them. A merger-minded company should seriously consider doing a cultural self-assessment and finding its location on such a grid well before it begins prospecting for merger and acquisition candidates. "Knowing thyself" in advance will save considerable time when fast, decisive action becomes imperative.

This grid was described by organizational behaviorists Rob Goffee and Gareth Jones in their 1998 book, *The Character of a Corporation*. For our purposes, the grid consists of four quadrants created by a horizontal axis and a vertical axis. "Solidarity"—the degree to which people bond or identify with their employer—is measured on the horizontal axis, and "sociability"—the level of warmth and friendliness among employees—on the vertical axis. This solidarity/sociability grid implies four principal organizational cultures (see box, page 31).

The explicit approach to cultural due diligence uses the Goffee/Jones grid as a kind of cultural map. In practice, this approach involves five steps.

1. *Pre-acquisition screening.* You have one or two targets in sight, teams of financial analysts are crunching numbers, lawyers are poring over documents and you've completed your self-assessment. But you're not ready to approach the target company, which would run the risk of tipping off the media and putting it in play. So for each target, you appoint one cultural due diligence team, whose explicit task is to identify conflicts, risks, opportunities and costs. Each team will undertake an intensive data-

gathering operation, including a search for public documents that may provide insight into the target's culture; this should take no more than three weeks. Team members will collect information on the target's cultural artifacts, values and assumptions. They will seek answers to such key questions as, How do things get done? How are decisions made? What kinds of people and behavior are rewarded? What are the written and unwritten "rules of the game"?

Every potential source of information should be tapped, including regulatory-agency documents, annual reports, articles in the business press, recruiters, business school professors, any of your employees who formerly worked for the target company—even Internet chat rooms. This phase could be compared to a house-hunting expedition in which a prospective home buyer gets a feel for the neighborhood by driving through it, visiting local shops and chatting with residents.

Although the team will not have had direct access to the target's top management, it should attempt, in its report, to locate the target on the cultural grid, measure the cultural distance between the target and the acquirer and estimate the cost of alternative approaches to post-merger integration. Since information at this stage is limited, that estimate will necessarily be a rough one. If the deal proceeds, a more refined estimate will be calculated in step 2.

Finally, top management will collate the cultural audit team's findings with those of the lawyers and financial analysts and make a decision about whether to pursue the target.

As a rule, alarms should sound when the acquirer and the target appear diagonally opposed to each other on the grid. But all is not lost if cultural

due diligence reveals that the acquirer and the target are miles apart or even diagonally opposed. It does not necessarily mean that the deal should be scrapped. What it does mean, however, is that the merger partners must carefully structure the post-merger relationship between the two organizations. Rather than attempt to fully integrate two conflicting cultures, the more prudent decision may be to keep them completely separate.

(Of course, hostile acquisitions, which are becoming less common in the United States and more common in Europe, are antithetical to the whole notion of cultural due diligence. A company that attempts such a takeover should recognize that even if it succeeds in acquiring the target, it will likely fail at blending the two cultures. Indeed, if it concludes that the forced marriage won't work unless it completely subjugates the target's culture, it should probably think twice about doing the deal.)

2. Comprehensive, post-announcement cultural assessment. Having announced plans for a merger or acquisition, the two partners can now proceed together by appointing two teams, each made up of people from both companies. One will examine the acquirer; the other, the target. The teams should include people who later will be responsible for making the deal work, as well as those skeptical about the transaction. Information gathered in step 1 will provide a set of working hypotheses to be tested in step 2.

Team leaders should seek out four to six people for each team who are known to be savvy, articulate and reflective. Team members should vary in age and gender, and they should represent experience across a wide spectrum of each company's divisions or functions.

In performing the assessment, team members should be aware that there is

rarely a true merger of equals, so employees of the target or of the less equal partner are likely to be suspicious and fearful of the motives of the larger or more powerful company. The information they provide may well reflect that reality.

They should also be aware that frequently there is more than one culture in an organization. And, in fact, if it is a global organization, there will be national distinctions as well. In these cases, they should focus on the dominant culture in the units that will be most directly affected by the merger.

At this point, team members will be trained in basic cultural due diligence concepts, data collection and interpretation, and effective interviewing techniques. The abbreviated cultural audit conducted in step 1 will be expanded to include interviews with thought leaders and senior and middle managers at both companies.

The teams will use such techniques as critical event analysis (brief reviews of recent corporate crises), scrimmages (simulations that illustrate how teams from each organization make decisions) and narrative analysis (comparisons and interpretations of tales of success, failure and redemption in the company).

Here again, the aim is to use these findings to locate the two companies more precisely on the grid and measure the cultural distance between them.

3. Identification of conflicts, risks, opportunities and costs. Based on information gathered in step 2, team members will now seek to identify potential conflicts and the risks they present, particularly those that hold the most potential for diluting the value of the merger. Some conflicts present an immediate threat, whereas others may not surface until later.

Cultural distance is all about time and money: The greater the distance, the longer it will take to integrate the two companies, and the less value ultimately will be realized.

For example, if huge disparities in compensation and incentive plans are not reconciled quickly, the combined entity could suffer from defections of valued managers and employees. This issue, in particular, has stymied integration efforts at DaimlerChrysler since the early days of the merger. The bottom line in the merger/acquisition decision is how long it will take to realize the expected value of

the deal. Cultural distance, therefore, is all about time and money: The greater the cultural distance, the longer it will take to integrate the two companies, and the less value ultimately will be realized.

Based on these assumptions, it's possible to estimate the cost of the cultural gap (see box, below). This, in effect, is the moment of truth, the fail-safe

A \$50 million gap

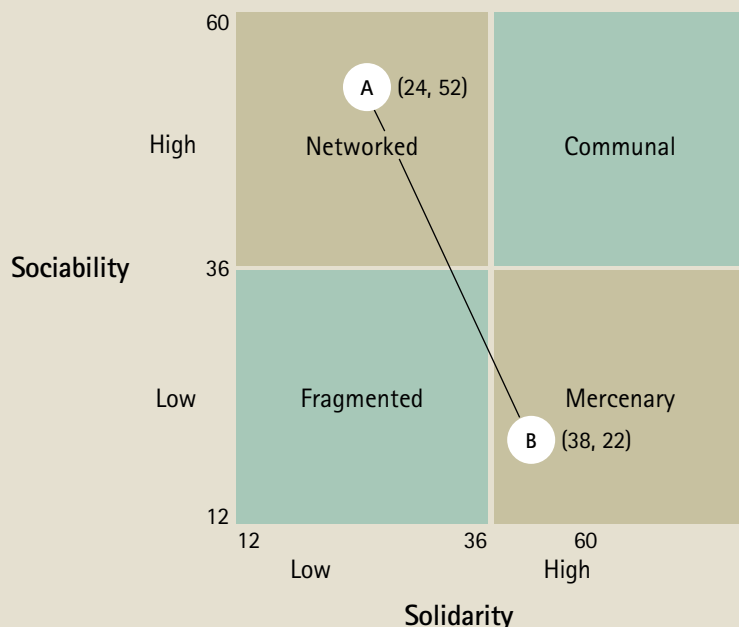
Cultural distance scores are used to discount a merger's expected value as follows:

Risk level	Cultural distance score	Discount*
High	50 +	up to 50%
Moderate	25-49	up to 25%
Low	0-24	up to 10%

*Based on analysis of the performance of 125 mergers

Therefore, cost of gap = (expected merger benefits) x (risk discount)

In the illustrative case shown below, financial analysts have determined that a merger between Company A and Company B is likely to yield benefits of \$200 million to the combined company. Meanwhile the cultural due diligence team, using the formula, concludes that the cultural distance is 44 and the risk discount is 25 percent. Hence the cost of the culture gap is \$50 million: $(0.25) \times (\$200 \text{ million})$. Expressed another way, the real benefits of the merger are likely to be less than \$150 million.



SOURCE: ROB GOFFEE, GARETH JONES; ACCENTURE ANALYSIS

point in cultural due diligence: Are the risks and costs of the cultural gap too great to consummate the deal?

4. *Design and implementation of post-merger integration action plan.* The role of culture in post-merger integration could itself be the topic of an entire article. Suffice it to say that if the decision is to proceed with the deal, team members join with their other colleagues to develop an action plan and form post-merger integration teams.

Their conclusions will be used to structure the relationship between the combined entities. Depending on whether the culture gap is small, medium or large, top management will opt to create a new culture by fully integrating the two cultures, allow the target company to exist as a subculture of the acquirer, eliminate the culture of the target completely or keep the two cultures entirely separate.

The goal at this stage is to determine whether the cost—in time, money and management attention—of narrowing the gap between the two companies is reasonable, or whether other alternatives, such as running the businesses separately, make more sense.

In addition to infrastructure costs (which can be estimated with a fair degree of confidence), there are more elusive expenses. These include socialization costs (related to addressing the emotional, psychological and trust issues associated with change) and reorientation costs (related to the formation of new work roles and relationships, an identity for the new organization, and new operating principles and policies). The sum total of these less tangible expenses will vary, of course, depending on how completely the two organizations will be integrated.

5. *Post-merger monitoring and validation of findings.* In traditional M&A due diligence, a legal sleuth who uncovers fraud or potential legal liabilities, or the financial analyst who turns up accounting irregularities, can simply write up the findings and move on to another assignment. In contrast, a cultural due diligence team member at this point will have become the living institutional memory of an entire organization.

Consequently, it's essential that this person continue as a cultural troubleshooter and validator of the process. This can help build a kind of cultural information warehouse, and thereby further refine and test the cultural due diligence methodology for possible use in future deals.

For executives, employees, customers and shareholders, the costs for deal failure in the M&A arena will be far greater as we move into the next century than they have been in the past, in no small part due to the unknowns of eCommerce. And the repercussions will be felt far sooner.

It will be essential for CEOs to make sure that mergers and acquisitions make sense in the first place. In this brave and unforgiving new world, the benefits—and urgency—of using cultural due diligence will become even more apparent. ■

A special series of articles on M&A appears in Ideas, which is published twice a year by Accenture's global Financial Services practice.



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