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Enterprise Solutions | Strategic Restructuring

Addressing the people issues in a strategic restructuring initiative: The M&A case

Anders Spilling and Jarle Høien, managers in BearingPoint's Business Strategy and Transformation practice, discuss the common people-related pitfalls of large-scale strategic restructurings and how you can avoid them.

In 1998, Daimler-Benz bought Chrysler, a highly profitable U.S. auto-maker enjoying record sales of light trucks, vans and large sedans. By 2001, Chrysler was hemorrhaging money.

Three years after the transaction, market capitalization of the combined DaimlerChrysler had not increased and expected synergies with its new German parent company were nowhere to be found. "What happened to the dynamic, can-do cowboy culture I bought?" asked former Daimler CEO Jürgen Schrempp.[1]

What happened, according to numerous observers, amounted to a textbook case of cultural misalignment. Chrysler had long seen itself as a bold innovator of vehicles for middle-class Americans and a plucky survivor of four brushes with near bankruptcy. Daimler, by contrast, stood for uncompromising quality and disciplined German engineering. The two companies distrusted one another from the start, to the point that some Daimler executives publicly vowed that they would never be seen in a Chrysler vehicle.

[1] "Schrempps Fehler," *Süddeutsche Zeitung*, Munich, Germany, December 7, 2001.

One of the key success drivers of a merger is addressing the people issue—specifically, how cultures can collide and potentially devastate company value.

The cultural divide was reflected not only in the two groups' products but also in their management styles. Daimler-Benz fostered a formal, highly structured work environment; Chrysler took pride in its more relaxed, freewheeling approach. Not surprisingly, as Daimler asserted dominance over the combined companies, Chrysler began a steep downturn, with widespread departures among key executives and engineers, growing discontent among the rank and file, and mounting hostility between Stuttgart and Detroit.

The same sad story plays out time and again in the aftermath of large- and small-scale corporate mergers. Although companies see mergers and acquisitions (M&A) activity as an essential means of growth and innovation, some 55 percent to 77 percent of completed M&As fail to meet the strategic and fiscal objectives that initially justified the deal.[2]

In a survey recently commissioned by BearingPoint, 150 C-level executives in multiple industries were asked about the most significant business challenges they faced during a merger. Surveyed executives ranked cultural integration at the top of the list (Figure 1), yet admit that it's among the last things they consider when deciding whether to attempt a new merger, acquisition or alliance (Figure 2).

Spotting cultural land mines

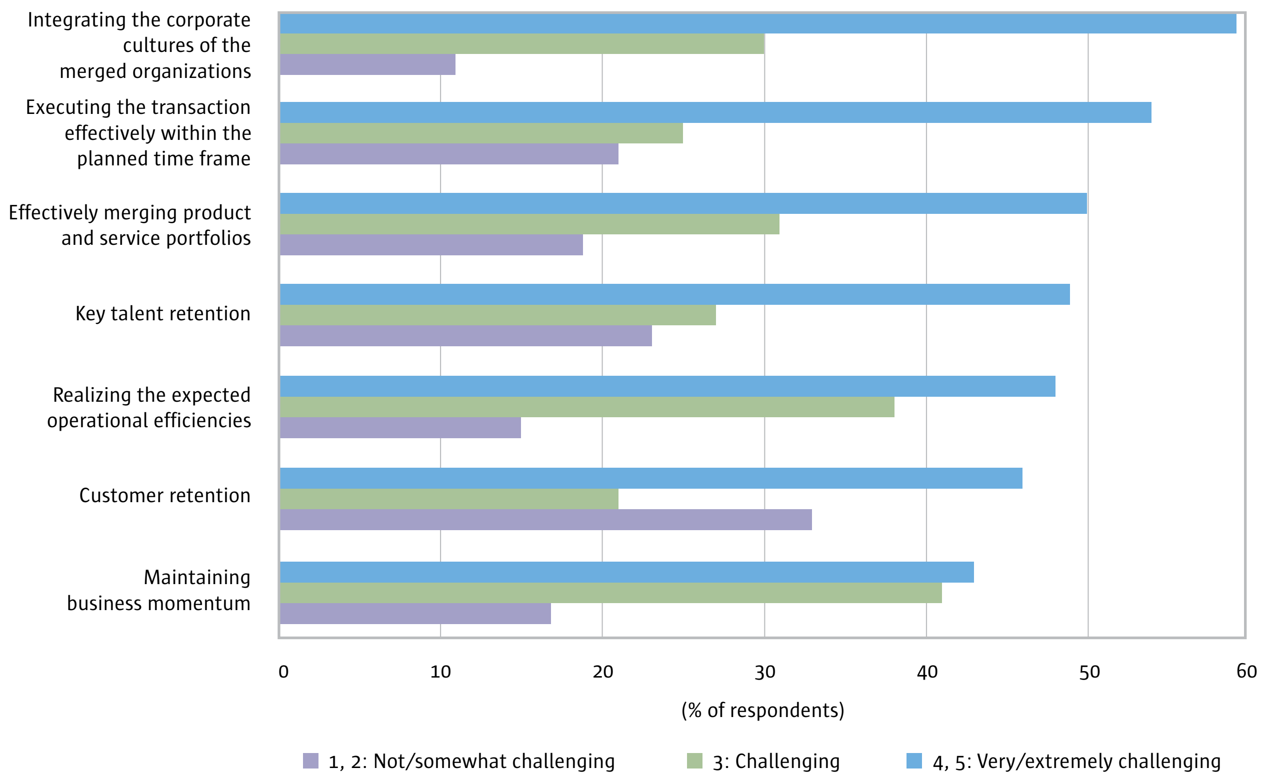
Soon after M&A activities are completed, the integration phase begins. Often during the post-merger period the organizations face many complex challenges. The success or failure will depend on detailed planning as well as the management and integration team's ability to execute the plan. One of the key success drivers of a merger is addressing the people issue—specifically, how cultures can collide and potentially devastate company value.

Cultural differences may appear subjective and difficult to measure, but BearingPoint research and experience suggests that it is possible to identify and analyze them systematically. There are five key areas of potential cultural incompatibility that, left unattended, are likely to create business risk for organizations merging or forming new partnerships. These five key areas of concern are leadership, governance, communication, business processes, and a performance management and rewards system (Figure 3).[3]

Unlike most cultural integration frameworks that focus solely on issues of leadership, communication and incentives, our framework is more operational. It helps leaders specify potential points of friction in business processes and governance models. Organizations that actively manage their corporate cultures should focus on these five areas as early as possible in the merger, acquisition or alliance process. At the same time, they can work with their new partners to develop cultural integration strategies that help both companies resolve key differences effectively, thereby reducing the associated business risks.

[2] J.R. Carleton and A. Stevens, "When Worlds Collide: The Need for Cultural Assessment and Integration," *Performance Improvement*, July 2004.
[3] J. Glantz, "Cultural reflections framework," BearingPoint, 2006.

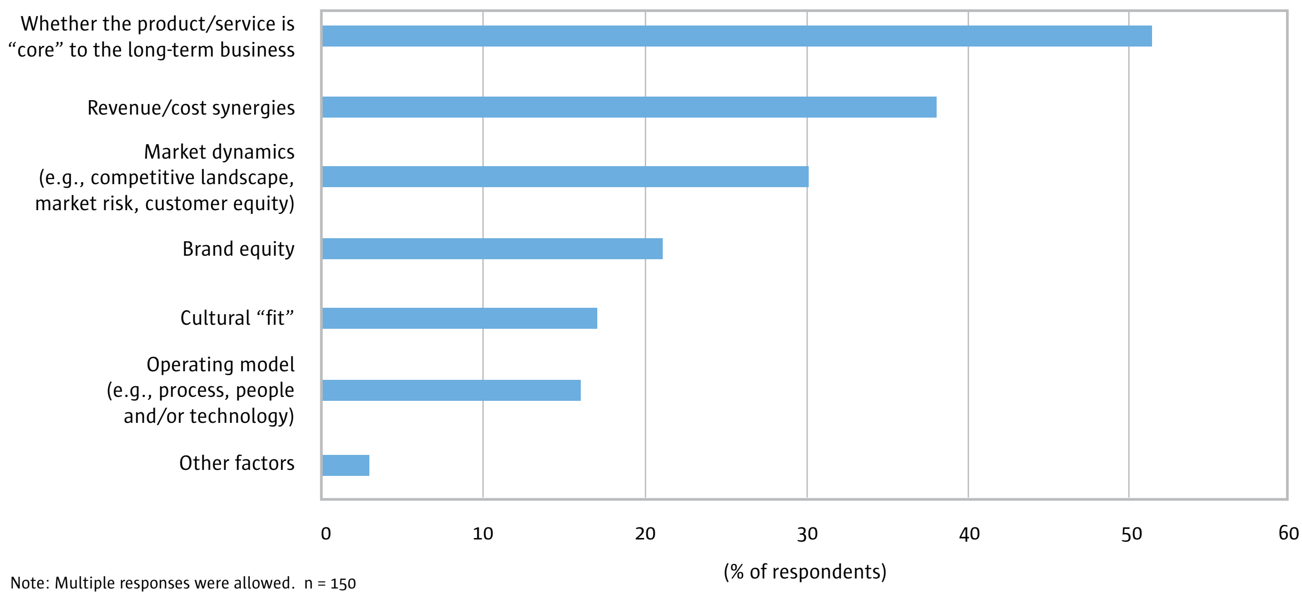
Figure 1. Business challenges during a merger



Note: Multiple responses were allowed. n = 150

(Source: Custom research conducted by IDC, sponsored by BearingPoint, 2006)

Figure 2. Collaboration decision criteria



Note: Multiple responses were allowed. n = 150

(Source: Custom research conducted by IDC, sponsored by BearingPoint, 2006)

By taking a proactive, disciplined approach to cultural integration, companies can accelerate the integration process and realize the transaction's inherent benefits more quickly. In one recent, highly successful example, a large multinational conglomerate entering a Korean joint venture organized a series of executive workshops, beginning with an introduction to Korean business culture. The process culminated in the design and establishment of a carefully structured approach to determining the venture's governance, human resource and communication practices. The workshops provided a critical venue where members of both management teams could discuss potential areas of cultural incompatibility and consider how best to address them. As a result, the venture moved forward with minimal conflicts and exceeded first-year revenue expectations.

Figure 3. Five areas of cultural conflict

Conflict area number 1: Leadership

As with DaimlerChrysler and numerous other less-than-successful business alliances, leadership compatibility issues can be paramount. One company's executives may favor a command-and-control style, whereas leaders at the other organization prefer a more hands-off approach. Indeed, every company's leadership style can seem unique. However, when senior leaders sitting at the same table motivate their staffs and resolve conflicts in diverse ways, the resulting friction often creates additional risks—for example, a lack of commitment to new company goals on the part of middle managers or a high level of turnover among key employee groups.

Despite the qualitative nature of such differences, companies can begin identifying areas of incompatibility in leadership practices even before the deal is closed. They can pose the right questions to company leaders, senior staff and mid-level managers—on both sides of the fence—and then compare the results. For instance, "How do leaders in your organization drive and assess results?" "What types of leaders tend to advance in your company?" "How would you describe the leadership style in your organization?" "When differences of opinion exist among senior staff, how are these differences resolved?"

Conflict area number 2: Governance

As recent events have illustrated, effective corporate governance requires much more than a system of checks and balances to protect stakeholder interests. It must encompass the way decisions are made in each part of the company and across organizational boundaries. This includes the work of such governing bodies as program management steering committees, councils that oversee the work of support functions, corporate governance boards and even new product development committees. At the same time, however, corporate governance is about people and the way individual leaders make and carry out decisions within each organization. A merger provides a golden opportunity to evaluate whether the new organization should adopt one merger partner's governance model and processes or define a different, industry-leading approach.

Conflict area number 3: Communication

Communication, an essential task of leadership in any organization, is critical during a merger given the inherent uncertainties on the part of employees and customers. However, communication styles vary widely among companies, and what has worked for one may not work for another. Attitudes about confidentiality, preferences for formal versus informal channels and the frequency of communications may all come into play. By anticipating these risks well in advance, the acquiring company's leadership can develop communication tactics that best support the merger objectives.

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Conflict area number 4: Business processes

Besides different leadership styles, governance models and communication preferences, most companies also have distinct ways of developing, updating and enforcing core business processes, which must be understood and respected during the integration phase. Changes in the way companies handle these tasks require strong leadership, supported by careful and frequent communications to verify that employees, customers and vendors understand and accept them. If changes in core business processes and process interdependencies are not deliberately and systemically thought through during the integration planning phase, organizations risk internal breakdowns in the quality of products and services and may provide incorrect or untimely data to customers, suppliers and service providers.

Conflict area number 5: Performance management and reward systems

Merger integration plans should include efforts to harmonize performance metrics and compensation systems where possible, while explaining important differences when necessary. Newly merged companies must help employees understand that their different recognition and reward systems are fair, even if not always uniform across the organization.

Disparities in sales incentive systems can create particularly sticky problems. The issue warrants close attention because the loss of key sales staff can also mean the loss of important customer relationships, which can immediately affect the company's value. Even outside the sales group, however, incentive systems are tied closely to employee retention. If a design engineer working on product development receives incentive payouts less frequently than his new co-workers, he may decide quickly that the grass is greener at a competing firm, taking his great ideas — and some of the firm's intellectual capital — with him as he walks out the door.

Determining the scope of your cultural integration effort

Most companies pursuing growth through M&A activity understand that the success of each deal depends on numerous factors — such as business drivers, relative size of the target, prevailing market conditions and financial considerations. They also know that different approaches to growth entail different organizational integration challenges, each with distinct cultural implications. As the scope of the integration effort increases, so do the potential incompatibilities in each of the five areas identified.

For example, if a company is being purchased solely for the purpose of obtaining its intellectual property (Figure 4), the transaction may require limited cultural integration or none whatsoever. However, if the acquiring company's goal is to expand its portfolio of products and services, the extent of the integration effort will be broader in scope because of the potential for cultural conflict in multiple areas. Given the high probability of cultural derailment during the merger integration process, corporate leaders should begin to assess the scope of the cultural integration effort as early as possible.

The pharmaceutical industry is a good example where inorganic growth through mergers and acquisitions (M&A) has increased significantly in the last two to three years. In March 2007, Schering-Plough announced its decision to acquire Akzo Nobel's health care division, Oreganon, for $14 billion.[4] The acquisition gained Schering-Plough access to a very strong women's health portfolio to supplement the existing product line. For Akzo Nobel, on the other hand, the deal made significant capital available to continue its own growth through M&A in other areas.

[4] http://www.biomarketgroup.com/content/view/114/7/.

Evaluating cultures before the deal closes

Opportunities to complete a meaningful cultural assessment during the acquisition strategy phase are often limited. However, openings to pursue this work during the due diligence phase are frequently overlooked. To take advantage of this window effectively, the executive team initiating the transaction should complete a self-assessment before due diligence begins, using a questionnaire designed to capture organizational information around each of the five areas identified. With this self-assessment in hand, executives can use the due diligence period to solicit the potential new partner's responses to the same questions. This step is critical because most important cultural information cannot be gleaned from documents or spreadsheets; it can only be elicited through dialogue with members of the other company's leadership team.

Based on the information gathered from both organizations, a cultural compatibility profile can be created, identifying both similarities and differences between the two organizations in each of the five areas. This profile can highlight areas where significant differences exist, along with the business risks that might arise if incompatibilities are left unaddressed. These risks can vary greatly and may include executive turnover, faulty internal decision-making processes and the loss of key customer relationships.

Key findings from this preliminary cultural assessment should be included in an initial due diligence report and circulated for review and comment among members of the executive team initiating the transaction. It's important to note that these findings will need to be validated further with a broader audience, should the deal close, when the overall integration planning process begins.

Figure 4. Organizational integration situations by business driver

Integration situation	Characteristics	Business drivers
1. Intellectual property only	• Acquire intellectual property (e.g., patented technology) • Entrepreneurial culture • Small company	• Innovation
2. Increase market share of existing services	• Within same industry • Within same geographic region • Similar customers and distribution channel	• Add new customers • Eliminate competition • Cost savings
3. Add new products/services	• Different industries • Different geographic coverage (international) • Different customers and distribution channels	• Expand product and/or service portfolio
4. Full integration	• Larger company • Elements of 1, 2 and 3 • Large, sophisticated IT systems	• Growth of existing products and/or services

Looking out for cultural integration issues at the earliest stages of the deal process, however, can help business leaders greatly improve the odds that the transaction will create, rather than destroy, shareholder value.

Moving from assessment to action

Once both organizations get the green light to move ahead with integration planning, their tasks become more daunting. Typically, the process includes executive-level work sessions where results of the initial cultural assessment can be shared in confidence with senior team members. Key outputs from these facilitated discussions should include:

- Possible revision and, ultimately, validation of the cultural compatibility profile.
- Confirmation of the associated business risks.
- Risk prioritization and definition of related business impacts.
- Identification of the core team responsible for leading the development and implementation of the overall cultural integration strategy.

The approach taken by a defense electronics company that recently oversaw business unit integration in multiple European locations provides a good example of how these sessions can work. Through a series of carefully crafted executive workshops, members of the new leadership team created a shared vision for the organization, including a common platform for new product development. They explored differences in leadership style and strategies to manage them, no small task given the different nationalities seated at the table. Finally, they worked together to create and deliver a set of key messages for their new organization, a step that was immediately visible to employees and helped pave the way for subsequent integration efforts.

Once a team has been named to lead development of the overall cultural integration strategy, work can begin to define and implement the initiatives needed to address areas of significant cultural incompatibility. These might range from establishing processes to delegate responsibilities clearly during the integration phase to defining how to transition effectively to a common sales incentive plan. Regardless of the initiative, make sure it's designed to help the new organization mitigate an identified business risk effectively. Each initiative's results should be measured by this standard as well.

Cultural integration issues pose significant business risks in any merger, acquisition or joint venture. Looking out for these risks at the earliest stages of the deal process, however, can help business leaders greatly improve the odds that the transaction will create, rather than destroy, shareholder value. Through careful planning and prioritization, they can better manage the human side of business integration—a risk that will probably never go away completely, given the complex dynamics of people in every organization.

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For more information on BearingPoint, please contact us at nordics@bearingpoint.com.

BearingPoint Denmark AS
Ørestads Boulevard 69
2300 Copenhagen S
Denmark
T +45 32 88 88 88
F +45 32 88 88 00
www.bearingpoint.dk

BearingPoint Finland Oy
Porkkalankatu 20
00180 Helsinki
Finland
T +358 10 80 22 88
F +358 9 321 46 21
www.bearingpoint.fi

BearingPoint Norway AS
Oslo Atrium
Christian Frederiks plass 6
Postboks 22
0051 Oslo
Norway
T +47 24 06 90 00
F +47 24 06 90 01
www.bearingpoint.no

BearingPoint Sweden AB
Sveavägen 21/Box 3033
103 61 Stockholm
Sweden
T +46 8 410 116 00
F +46 8 410 116 99
www.bearingpoint.se

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