The Importance of Leadership and Culture to M&A Success

HUMAN CAPITAL INSTITUTE

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EXECUTIVE SUMMARY

The number of mergers and acquisitions (M&A) continues to increase, with a worldwide 2006 deal volume of 30,000 breaking the previous record set during the dotcom boom. All indications are that this high level of M&A activity will continue in 2007 and beyond. In the past, M&As frequently led to disappointing results in the form of decreased shareholder value. By contrast, today's deals are enjoying greater success at increasing shareholder value, with medium-sized deals often outperforming larger ones.

It's hard to argue with the notion that company leaders play a vital role in successful mergers and acquisitions. As an example, good leaders can be especially adept at overcoming disruptions in accepted ways of doing things and at aligning organizational cultures that may be very different between the merging organizations — both key people-oriented challenges that companies face during an M&A.

But until now, few frameworks have been available for assessing *how* leaders impact M&A success. But recent Towers Perrin research, coupled with experience with more than 400 mergers in 2006 alone, points to specific leadership characteristics that foster successful M&As, such as leaders who:

- set the right priorities and create positive business momentum and discipline
- imbue employees with the necessary level of commitment, engagement, confidence and comfort to work through difficult transitions
- inspire a sense of purpose, coherence, community and trust that allows employees to remain focused and highly engaged on the job.

A recognized, respected leader assuming a prominent, visible role can be a comforting anchor during a turbulent sea of change. Such leaders can be instrumental in creating a shared culture that embodies the business strategy of the new combined organization.

TRENDS IN M&As

M&A volumes reached roughly US$4 trillion in 2006, eclipsing by a wide margin the previous record of approximately US$3.3 trillion set in 2000. The United States was the most targeted country for acquisitions, representing approximately 40% of global M&A activity. As of late December 2006, the value of European M&A deals was US$1.4 trillion, also surpassing the previous record set in 1999, with the U.K. the most targeted country. According to Towers Perrin's Global Change Management Leader, Mark Arian, "We are at the beginning rather than the end of the wave because organizations have gotten better at doing M&A, which in turn has generated still more M&A activity."

CHALLENGES FACED BY MERGED ORGANIZATIONS

Mergers and acquisitions almost always involve some level of transformational change and disruption, according to Towers Perrin Senior Consultant Clair Olson. Successful post-merger integration demands significant change on the part of both the acquiring and the acquired organization. The acquirer creates boundary disruptions — changes in stated goals, strategies, ways of doing things and customs. The acquirer also must deploy control mechanisms to manage transformational change and achieve the strategic goals that drove the M&A in the first place. For its part, the acquired organization must overcome any anxieties about being "absorbed" and learn to integrate itself into new corporate procedures and values. In short, a process of mutual adjustments and acculturation must take place for post-merger integration to succeed.

CULTURE — THE ORGANIZATIONAL DNA

Anthropologists and experts in organizational behavior use the concept of "culture" to describe how members of groups understand their world and their place in it. Arian explains that organizational culture can best be thought of as "the pattern of actions, words, beliefs and behaviors that members of a business organization share," sometimes referred to as the organization's DNA. Because the human capital element is such a large part of any M&A, fostering a positive DNA — one that encourages employee engagement in the business and encourages flexibility during times of change — is difficult to get right. "Nevertheless," says Arian, "it's of great importance since it produces rules of behavior within the new organization."

A highly productive business invariably has a high-performing organizational culture that aligns well both internally and externally to support the overall objectives of the business. This organizational culture shapes the *employee experience*, which in turn impacts *customer experience, business partner relationships* and, ultimately, *shareholder value*. During a merger, two or more distinct organizational cultures must be integrated and fused. "As M&As increasingly become globalized, their complexity increases," observes Olson, "and differences in national cultures need to be taken into consideration."

UNDERSTANDING THE DNA OF ORGANIZATIONAL CULTURE AND THE IMPACT OF LEADERSHIP

So just how do you detect organizational culture? And how can you tell if it is effective and productive? An organization's culture is embodied in what managerial leadership sets as its priorities: what it attends to, measures, rewards and controls. Organizational culture can be seen in how leadership reacts to critical incidents. And it can be found in leadership's role modeling and coaching actions. Experts say that between 80% and 90% of employee behavior is determined by the way leaders attend to these factors.

Other important dimensions of a corporate culture include an organization's:

- criteria for employee recruitment, promotion, retirement and exit
- formal and informal ways of socialization
- recurrent systems and procedures
- organizational design and structure
- design of physical spaces
- stories and myths about key people and events, and
- formal statements, charters, creeds and codes of ethics.

Leaders' actions, words, beliefs and behaviors have to resonate within three contexts, according to Arian: national culture, organizational culture and the individual employee's background, values and beliefs.

"National culture is broader, of course, than just what happens inside the organization. But it is important not to overlook the impact of national culture on organizational culture says Olson. "When a multinational goes into another country, local managers become more nationalistic," falling back upon national culture for awareness and understanding of values and behaviors. For example, if an American company goes into Germany or Japan, the German manager who now works for an American company becomes more German and the Japanese manager becomes more Japanese. According to Olson, while core cultural attributes are generally consistent from country to country within a single organization, national cultures can influence how organizational culture is manifested — for example, how people within the organization solve problems. Sometimes disconnects occur among national cultures that upset organizational practices. And sometimes differences in national culture can be used as an excuse when inappropriate behavior occurs in the organization.

At the organizational level, culture is shaped by national cultural characteristics; it is also based on business drivers — what the organization seeks to achieve. Finally, at the individual employee level, organizational culture influences what is perceived to matter and the actions individuals take accordingly.

ADDRESSING ORGANIZATIONAL CULTURE IN M&As

Culture was ranked as *the* most challenging "people" issue in M&As according to respondents to a 2004 Towers Perrin survey whose organizations had completed at least one M&A deal during the past three years. Particularly challenging was achieving successful alignment between old and new organizational cultures. This was followed, in order, by effective leadership from the top; a well-executed employee communication program; integrating benefits, pay and other rewards programs on a global basis; and correct selection of the top management team.

LEADERS MAKE THE DIFFERENCE IN M&As

The greater the frequency and magnitude of change, the more important leadership and culture become. "Leadership holds it all together," says Arian. "It is a make or break function."

Towers Perrin research confirms that leadership is the most important driver of employee engagement.* During periods of transition and disruption, employees look first to leaders for guidance about how to react and behave, for motivation, and for focus. Experience shows that what leaders do during mergers and acquisitions has a significant impact on how employees of both organizations react and promote a sense of community and purpose. Positive employee perception of leaders is crucial to successful change. Employees want to believe that leadership cares about them. When employees are convinced that leaders genuinely do care about them, they become more open and willing to make necessary transitions, says Arian.

And companies that foster a high degree of leadership visibility and involvement during M&As instill a supportive organizational culture with a better than average chance of success, Olson adds. Leaders set the priorities and create the positive business momentum and discipline required during M&As. They instill in employees the necessary level of commitment, engagement, confidence and comfort to work through difficult transitions. Leaders, who by their statements and actions inspire a shared sense of purpose, coherence, community and trust, enable employees to focus and to remain highly engaged during M&As and post-merger integration.

Establishing and sustaining cultural alignment during the first 100 days is particularly important, says Arian, in shaping the newly formed organizational culture and employee perceptions of it. Leadership intervention is "a critical symbol" of the new organizational culture, adds Olson.

*Towers Perrin defines employee engagement as employees' willingness and ability to contribute to the company's success — or, put another way, the extent to which employees put discretionary effort into their work.

ALIGNING STRATEGY, LEADERSHIP AND CULTURE

Placing leaders into the correct roles and ensuring a fit between leadership and the desired organizational culture and business strategy is another key priority in M&A integration, Arian and Olson point out. It is very important to engage and develop new leaders early in the integration process, through executive coaching, ongoing feedback and through formal onboarding activities. Properly engaged leaders will be able to focus on three key areas of a merger and acquisition:

- Due Diligence (leadership research)
- Integration Preparation (leadership strategy, assessment and selection)
- Integration (executive onboarding).

CONCLUSION

Success in aligning strategy, leadership and organizational culture(s) can lead to profitable growth after a merger or acquisition. Effective leaders who instill a new organizational culture and values in their HR program design and internal and external communications can engage employees to deliver the brand promise to customers, shareholders and the community, in turn leading to profitable business growth.

In mergers and acquisitions, leadership creates and drives the combined organization's culture — the organizational DNA. It is the "forcing function" of a new organizational culture, says Arian. "Leaders' actions, words, beliefs and behaviors need to be acknowledged and understood at three levels: national, organizational and individual," adds Olson. M&As are more successful than in the past in part because of greater attention being paid to leadership's role in organizational culture creation, and are now creating, rather than destroying, shareholder value. Companies can increase the success of M&A deals by focusing on aligning leadership "fit" and actions with organizational cultures and business strategy. The examples of GE's acquisition of Marquette Medical Systems and Prudential Financial acquiring CIGNA Corporation's retirement business show two highly successful M&As in which the active involvement and visibility of leadership created the conditions for measurable business success. (See Case Studies on page 6.)

CASE STUDIES OF TWO SUCCESSFUL M&As

Case Study: GE Medical Systems

Under the leadership of Jeffrey Immelt, General Electric (GE) Medical Systems acquired Marquette Medical Systems (MMS), a privately held company, from the Cudahy family in late 1998. Both organizations were headquartered in Milwaukee, but they had a history as bitter rivals. ("'GE is our enemy' was the MMS mentality," Arian says.) Each company had very different organizational cultures. Marquette Medical projected a strong entrepreneurial culture as defined by its founder, who did not tolerate much bureaucracy. GE was part of a multinational corporation, heavily embarked on Six Sigma, and with a high degree of process orientation. Serious union avoidance issues and concerns about change in benefits and rewards structures existed at Marquette Medical.

Immelt and his leadership team spent significant time meeting with employees of both companies — through town hall meetings, small focus groups and regular two-way communication — to explain their vision for the new combined organization. They worked to create a shared vision for the future that everyone could embrace. GE leadership personally addressed concerns that were the underpinnings of the unionization campaign. They did not apologize for, or run away from, the strong GE culture and the control requirements required by GE. Instead, they explained why these control requirements were necessary and how they would drive stronger business results for the combined organization. They sought to build a shared desire for greatness by raising expectations and expressing enthusiasm and confidence. This merger was a great success and helped catapult Immelt into the top job at GE.

Case Study: Prudential Financial, Inc.

To strengthen Prudential Financial's position as a global provider of retirement services, the company acquired CIGNA Corporation's retirement business in April, 2004. The new combined business had 2,600 employees. "Leadership was heavily involved in every aspect of the integration and highly visible to employees of both organizations," says Helen Frye, Vice President of Human Resources for Prudential Retirement and a member of the joint leadership team that oversaw the acquisition. Prudential Financial's president led a "command center" comprised of eight business leaders (half from Prudential and half from CIGNA) who met daily to set direction and track progress. The leadership team was announced and in place three months *before* the deal was consummated. The team immediately focused on building an aligned culture, including a strong internal and external brand. Prudential Financial stock outperformed the Morgan Stanley Capital International index by over 50% eighteen months after the deal closed, demonstrating the key role of leadership in providing positive direction and focus for the new institutional identity and culture.

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PRESENTERS

Mark Arian, Global Change Management Leader, Towers Perrin

Mark Arian is the Global Change Management Leader for Towers Perrin. Prior to joining Towers Perrin, Mark was the co-leader of the Solutions & Strategies team (the Consulting R&D function) and the Global Leader for Corporate Restructuring and Change (CRC) for a large consulting and outsourcing company. Mark has conceived and led the development of unique, outcome-based frameworks, diagnostics, and tools that address critical people issues in business transformations. He has developed long-term partner relationships with clients that accelerate the development of a committed, productive workforce capable of achieving clients' growth and synergy targets following business transformation initiatives. Mark is a frequent speaker on business transformation and merger integration topics. He recently was the lead speaker at the American Chamber of Commerce in Hong Kong and co-chaired a National Foreign Trade Council Symposium on People Issues in Global Mergers and Acquisitions. Mark is an attorney and a member of the Bar of the State of New York and the District of Columbia. He earned a B.A. degree from Duke University (summa cum laude) and a J.D. from the Columbia University School of Law, where he was twice awarded the Moe Berg Scholarship and won the Thomas E. Dewey prize. He is also a graduate of the Columbia University Graduate School of Business Executive Education Program.

Clair Olson, Senior Consultant, Towers Perrin

Clair Olson is a senior consultant in the Towers Perrin Global Consulting Group based in London focusing on Mergers & Acquisitions and global clients. Clair has substantial international consulting and M&A experience working in the United States, Asia, Europe and the Middle East. He worked as a Client Manager for major global corporations in a variety of industries.

He transferred to the U.K. in 2004 after spending four years in Japan where he was Client Management Practice Leader-Asia, establishing the client management practice and M&A network for a global human resource consulting firm. Prior experience includes Japanese business unit head in San Francisco for a large multinational financial firm and industrial market research and consulting in Japan and the U.S. Consulting activities included risk management, strategic alliance facilitation, Mergers & Acquisitions due diligence and implementation, and intercultural organization assimilation projects. He has authored Japan market studies and business guides for publication, and various M&A-related articles.

Clair attended Sophia University in Tokyo as a study abroad student focusing on Japanese language, sociology, and history. He holds a B.A. from the University of Utah and is an MSc candidate studying Organizational Behaviour at The University of London's Birkbeck College. He is fluent in English and Japanese.

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As Director of Talent Development and Leadership Communities at The Human Capital Institute, Joy brings 25 years of experience in multiple facets of organizational development, human resources and business management with an emphasis in customer satisfaction, service quality, process improvement, and applying the Malcolm Baldrige Criteria for

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The HR Services business of Towers Perrin provides global human resource consulting and related services that help organizations effectively manage their investment in people. We offer our clients services in areas such as employee benefits, compensation, communication, change management, employee research and the delivery of HR services.

ABOUT THE HUMAN CAPITAL INSTITUTE

HUMAN CAPITAL INSTITUTE

The Human Capital Institute is a catalyst for innovative new thinking in talent acquisition, development and deployment. Through research and collaboration, our programs collect original, creative ideas from a field of top executives and the brightest thought leaders in strategic HR and talent management. Those ideas are then transformed into measurable, real-world strategies that help our members attract and retain the best talent, build a diverse, inclusive workplace, and leverage individual and team performance throughout the enterprise.

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