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Cultural Integration - The Neglected Foundation of Successful Mergers

Seeking to reposition as competitive landscapes change and headwinds arise, private equity backed organizations across industries are adapting via the pursuit of merger and acquisition transactions.¹ When it comes to successful merger integrations, however, private equity firms and portfolio company leaders are often missing a critical element necessary for short and long-term value creation: organizational culture.

Integrations are complex, requiring clarity of purpose, potential synergies, and future value from the beginning of due diligence to deal close and beyond. Yet leaders driving mergers miss both short- and long-term synergy targets and value creation when they fail to consider the deep impact integrating cultures has on the overall success of the combined organization.

Historically, this oversight by transaction leaders may have been caused by ignorance of the combined culture's overall impact. The good news is that upwards of 50% of leaders now recognize that cultural alignment is critical for integration success and cultural concerns are even reaching parity with financial concerns when it comes to driving successful integrations.² Yet cultural integration is nevertheless indicated as the primary reason for a transaction's failures to achieve promised value, and it is the leading cause of up to 85% of failed transactions.³ With deal costs rising, and growing global uncertainty increasing the risk of newly acquired portfolio companies being unable to achieve growth goals, this failure rate should loom large for both PE investors and portfolio leadership teams.

The statistics tell the story. Lack of successful cultural integration impacts [the number one value driver](#) in the combined firm: the people getting the job done. Successful cultural integrations enable both short- and long-term synergy creation and equip organizations to achieve great strategic value over time. With this in mind, how can executives work together to drive a cohesive cultural vision, integration, and ongoing execution in the midst of a complex merger transaction?

The answer lies in understanding the critical components of both transitional and transformative cultural integration. Cultural transitions and transformations describe the spectrum of guided evolution required to get an organization from point A (unintegrated) to point B (synthesized and unified). Transitional cultural integrations typically emphasize retaining specific elements of one or both merging cultures. Transformational cultural integrations entail deep recoding of the combined organization's cultural DNA. The concepts below apply across this spectrum, depending on the scope of integration desired by leaders. It should also be noted that private equity-backed organizations may require varying levels of cultural integration, depending on acquisition strategy (e.g., a platform seeking add-on acquisitions versus a merger of equals).

CONSIDERING CULTURE

Before diving into what enables successful cultural integrations, it is important to define the term 'culture'. We define culture as the network of observable behaviors exhibited across every part of the organization. These behaviors may or may not be aligned with the organization's overarching strategy or goals (i.e., counter-

¹ Wylie Fernyhough, Stephen-George Davis, and Bryan Hanson, "US PE Breakdown 2Q 2019," *PitchBook*, July 2019.

² Oliver Engert, Neel Gandhi, William Schaninger, and Jocelyn So, "Assessing Cultural Compatibility: A McKinsey Perspective On Getting Practical About Culture In M&A," *McKinsey & Company*, 2010.

³ Dale Stafford and Laura Miles, "Integrating Cultures After A Merger," *Bain*, 2013. See also: "Culture in M&A: We Know It's Important, So Now What?," *Mercer*.

culture versus cultural norms), but they are determined by quantitative and qualitative incentives existing within the organization.³ In short, individuals' behaviors, magnified across teams and functions, define overarching culture.

In the case of cultural integration as a component of a merger integration, leaders must assess the current state, define the future combined cultural vision, and execute to shift behavioral norms and achieve the best results for the combined business.

ASSESS EXISTING CULTURES

To effectively deliver cultural integration, leaders must first voice the obvious: two potentially very different cultures are uniting as a result of a transaction and not a choice. No matter how closely aligned the cultures appear during due diligence, at minimum, each organization speaks its own cultural dialect. These distinct cultural 'languages' must be translated and understood at the leadership level for a baseline, common understanding to occur. This requires conversation, conversation, and conversation as leaders learn to describe cultural values, histories, and milestones.

As this process takes place, it is of value to gather data at the grassroots level via a valid, reliable cultural assessment. The collected data will illuminate both shared and unique behaviors and cultural definitions, as well as opportunities to leverage culture for strategic success.

DEFINE AND ALIGN ON FUTURE STATE CULTURE

Once a shared understanding of the distinct current state cultures is established, leaders can then work together to define the scope and scale of the necessary cultural integration. Does the integration entail a transitional or transformational approach? Are there glaring divergences, or do the cultures have subtler disconnects? What are the commonalities that can be leveraged? Leaders must act in a bold, visionary, and aspirational way to define the future state vision, diving deep into the organizational system across policies, structures, and systems. Leaders must align this vision to the overarching strategy of the combined organization. After all, the behavior of every employee will drive both cultural adoption and strategic execution. Leaders must take the opportunities to define

the desired behavior in the integrated organization so that employees can survive, thrive, and ultimately drive the organization's strategy.

Once the vision is defined, leaders must continually focus on alignment. Culture shaping starts with leaders, and the C-suite must be the first to adopt, model, and communicate a shared vision. If the leadership team is not aligned on the combined organization's culture, overall adoption will fail.

After defining and aligning, leaders can orchestrate the initiatives necessary to drive cultural integration across functions and leadership levels. A major pitfall for integrating organizations is change fatigue, with too many initiatives crushing teams in an already rapidly changing integration environment. Leaders must ruthlessly prioritize the minimum required critical cultural initiatives, recognize there must be commitment to these initiatives, and execute with excellence.

DRIVE KEY BEHAVIORAL CHANGE — FROM THE C-SUITE TO THE FRONT LINES

The culture has been assessed, a vision has been defined, and leaders are directionally aligned. Now comes the actual execution of the prioritized, critical cultural integration initiatives. Successful execution requires the following: communication and education, recognition and rewards, and programmatic execution and measurement.

Communicate

Leaders are tasked with painting the clear picture of the future culture through their words and actions. Everything — from the language spoken on earnings calls to carefully constructed change and communication plans — should clearly convey the dynamism of the new culture. In addition, the new culture's identity should be embedded in ongoing learning and talent management within the integrated organization, with human resources acting as the enabler and educator.

Recognize and Reward

At its heart, cultural integration is an effort to change, and even transform, employee behavior. Behavioral change is best motivated by a network of recognition and rewards designed to shift engrained cultural habits. Consider

⁴ See also: Michael D. Watkins, "What is Organizational Culture? And Why Should We Care?," *Harvard Business Review*, May 2013.

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the cascading system of quantitative and qualitative incentives, from the paycheck to the parking lot, necessary to transform the culture effectively. Human resources is certainly a key function, but successful incentivization transcends one functional silo and should be examined holistically by leadership.

Execute and Measure

Executing a cultural integration requires a programmatic change effort, closely aligned to the visionary work of the combined leadership team. Leaders should focus on driving and measuring the selected, prioritized culture shaping initiatives. These initiatives can be accelerated through change champions: cross-functional, on-the-ground leaders dedicated to building a flourishing new culture. Change champions increase the portfolio organization's change agility and decision making as the cultural integration occurs.

Often, executives are ready to drive cultural integration initiatives but are stymied when it comes to measuring success. How can a culture be measured, when it does

not yet fully exist? We recommend leveraging a cultural assessment tool (like *Ankura's Dialog™*) to define the required culture, establish the actual cultural baseline of the combining organizations, and to measure change over time across the organization. An assessment tool provides the data necessary to tell the transforming culture's story, and to ensure it is being consistently adopted and operationalized throughout the integrated organization.

CONCLUSION:

MAKE CULTURE STICK TO CAPTURE VALUE

Cultural integration is hard work. It is, however, the best means to drive successful synergy realization and long-term value creation for integrating organizations. After all, to paraphrase MIT's Edgar Schein, dysfunctional, separate cultures will eat an integrating organization's value thesis for breakfast. Leaders must step up, dive in, and define a cultural vision, and embrace a shared approach for the newly-created organization. Your employees will thank you by driving value for the long haul, through their very best work.



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