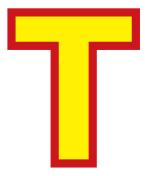
CHEW CAREFULLY

Successfully merging two companies requires a careful examination of the ingredients and how they work together so as to prevent a case of heartburn down the road.

BY SHIDEH SEDGH BINA



en years is a long time to suffer from indigestion. But that's just what the GM of a Hong Kong company says happened to him in the decade that followed his company's several hundred million dollar acquisition by an

international media company based in North America. On paper, the deal promised to open new markets around the world and deliver huge economies of scale for the merged entity. And, yet, after the merger, the combined company struggled to achieve the financial results that had been expected. What went wrong? "The (American) company came in and ate us," says the Hong Kong executive. "But even 10 years later they still haven't digested us."

Plenty of executives who've been through M&A deals can likely relate to that uneasy, queasy feeling. Combining two different firms can often seem like a great idea on paper, but too often - and for far too long - the execution of those deals has failed. Consider the evidence from just a few of the studies of M&A aftermath.

1970s: A Federal Trade Commission study finds that most M&A deals done in the mid-1970s resulted mainly in steep declines in operating profits among the merged firms.

1990s: A study by researchers at Southern Methodist University found that, from 1990 to 1997, in mergers worth \$100 million or more, just 11% of the deals produced their anticipated revenue gains.

2000s: A 2004 Bain & Company survey found 70% of mergers and acquisitions produced only declines to shareholder value. More recently, a 2007 study by Hay Group,

a management consulting firm, and the Sorbonne, found that more than 90% of corporate mergers and acquisitions in Europe didn't meet their objectives. That study, titled "Dangerous Liaisons," concluded that mergers and acquisitions failed, in large part, because the combined

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companies didn't adequately address corporate culture issues.

That's exactly what happened to the Hong Kong executive whose company hadn't been digested properly. The cultural differences between the Asian and western companies were barely addressed prior to the firms' combination. Unfortunately, that, too, is not uncommon in M&A deals. Indeed, Hay Group found that only 27% of the companies it surveyed had bothered to analyze the cultural compatibility of the firms they were planning on combining.

And that was true even though more than half the companies Hay Group surveyed said they believed neglecting to audit "non-financial assets" - including culture - would put any M&A deal at risk of failure.

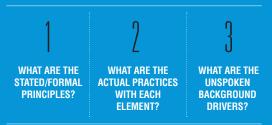
Think about that for a second. Executives are smart people. They know that M&A deals are driven by economics, that they need to provide some kind of scale in operations, or opening access to new markets. But many executives also profess to know that the success of these combinations depend on the work of the people in each organization. In practical reality, mergers and acquisitions have a profound and material impact on the people in both of the combining companies - from the senior leadership to the frontline worker. Written and unwritten rules change, strategy is often dramatically altered, new managers are put into new jobs with new teams, different leadership styles, changes in compensation, the list of variables that impact the mindset, the culture and thereby the performance of people in any enterprise is miles long. Any executive can tell you about these dependencies and ramifications. So why, then, does 85% of the money spent in closing M&A deals go to assessing financial and operational integration, while just 15% is spent on assessing people issues?

The answer may be that executives know how to crunch the data on the value of their hard assets but are often

> uncertain how to gauge their more intangible assets, like their people and their culture. The Hay Group certainly found that to be true. It's survey found that 70% of executives believed it is too hard to get good insight into the corporate culture of companies they're looking to do

Distinctive Elements of Corporate Culture

It is important to assess each of these nine distinctive elements from three dimensions:



S LANGUAGE: Vocabulary, content, and key phrases create a network of conversations that constitute the enterprise.

CUSTOMER ORIENTATION: How is the customer viewed, served and interacted with?

• VALUES: What are the qualitative objectives? What is held in high regard?

• ACCOUNTABILITY: Are people organized for results, processes, or tasks? What are the incentives?

TRADITIONS, RITUALS, AND ARTIFACTS: What are status symbols? What gives a sense of belonging and pride?

LEADERSHIP DYNAMICS: How does the workforce view leaders, and what is the leadership style?

2 UNWRITTEN RULES FOR SUCCESS: What are the taboos, status symbols, pathway to success?

DECISION RIGHTS AND PROCESS: Who makes what decisions, at what pace and by

consulting whom?

• LEGACY: Have there been any close calls or major successes? What were the founders' values and philosophy?

M&A deals with.

And, yes, it is hard. It takes time and energy and focus (and, of course, money) to figure out the cultural concerns of a M&A deal and to get those cultural issues on track before the two firms legally combine. But it's not impossible. And, it's definitely worth the investment.

AVOIDING INDIGESTION

When an M&A deal doesn't completely address cultural issues during due diligence, just about anything can go wrong. For instance, one merging entity may simply impose a new strategy onto the other. When that happens, the merged entity may find itself with groups of employees working with conflicting principles and frameworks for operating and, therefore, unable to execute on common business objectives.

Something similar happened when Quaker Oats Co. bought Snapple for \$1.7 billion in 1994. Both firms wanted to make money by selling beverages to consumers. But Quaker valued a sales channel that focused on big volume sales in supermarkets. Snapple derived practically all of its success from its agile and entrepreneurial network of independent distributors. In managing for economies of the new, larger scale post-merger Quaker discarded Snapple's independent distributors. This led Snapple products to disappear from the shelves of convenience stores and other small retailers that had been diligently serviced by the independent distributors. And that just happened to be where most Snapple beverages were sold. No surprise, then, that a little more than two years later, Quaker dumped Snapple back onto the open market for just \$300 million, taking a \$1 billion write-off, the largest by any business up to that time and virtually destroying the career of then Quaker CEO William Smithburg. Quaker never recovered it's footing and was eventually bought by PepsiCo.

There's a way to get better alignment around shared values in a post-M&A environment. Start with a team of key stakeholders — not just C-suite executives — from both companies and task them with creating a new company

with a newly constituted culture. The process works in five phases. In brief, they are:

PHASE 1: STRATEGY / LEADERSHIP CULTURE ASSESSMENT

Gather input from a wide range of stakeholders

Quaker Oats' purchase of Snapple is a perfect example of how to not execute an M&A project. The failed merger cost Quaker more than \$1 billion.

SUGGESTED RETAIL PRICE

SOUTHERN

SWEET TEA

(who can be interviewed confidentially and with online surveys) to understand the distinctive elements of the culture of each legacy company. [See box at left] The report should include the high value, high impact cultural assets of each firm. This assessment of both company cultures can also be done during due diligence to ascertain fit.

PHASE 2: MERGER LEADERSHIP COALITION

Create a coalition of leadership from both companies, including leaders from different levels, broad geographies and a variety of functions. The charge of the leadership

coalition is to lead, monitor and execute the cultural integration. Using the assessment and the assets identified in the assessment as a tool and together with executive management, the leadership coalition should come to a shared understanding of a vision for the new enterprise both in terms of strategic objectives and aspirations. Based on that, the leadership defines coalition the broad elements of the corporate culture that can support the execution of that strategic plan and intent.

PHASE 3: CULTURE IMPLEMENTATION AND ACID TEST

The Leadership Coalition drafts the cultural framework for the vision, including a mission statement, a statement of values, and principles. It sketches out the key culture and implementation initiatives needed to accomplish the breakthroughs that the new organization wants to achieve. The cultural framework can be something completely new; it can borrow from elements of the legacy companies or can completely adopt the framework from one of the firms. The key point is that this framework has been derived in the context of the future of the new company and not as an allegiance to the past. Once drafted, the coalition leads a process with various stakeholders to refine and ratify the cultural framework for the new company.

PHASE 4: CATALYTIC PROJECTS

Start implementing the new culture through a series of short-term projects involving people from both of the companies. The projects produce important measurable

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results that would not be predictable without the combined enterprise but can only be produced by reinforcing the new culture. Some of the projects can be "people oriented," such as building new processes; some can have objectives that realize the opportunity for enhanced value that instigated the combination, such as capturing new markets or new product development.

PHASE 5: ENROLLMENT CAMPAIGN: EMBEDDING THE NEW CULTURE IN DAILY PRACTICES

The leadership coalition commissions a grass roots

team to launch a campaign to engage the work force into the new corporate culture. People will need to know the new organization's values and how it addresses their personal needs. The most effective teams have membership from all the key constituencies in the enterprise and represent different geographies. Each member of the team designs and executes a campaign that they know would be most effective with the group they represent. In our experience, these team members always come up with more creative, low cost activities than any corporate group can conceive of. They

know how to engage the hearts and minds of their peers and have credibility with their constituency. This is an essential part of the process and will require constant monitoring. But it ensures that, in the end, a truly new company with a new understanding of its mission has been formed.

All of that may not sound much like the typical M&A. But, remember, the typical M&A doesn't generally work. Often M&A deals are put together by teams of investment bankers and top-level executives who are so focused on making the numbers behind the deal attractive to investors that they don't adequately address the people inside the organization who have to make the deal work. But guess what we've found in mergers and acquisitions where corporate culture issues have been made a top priority? In those deals, the overall success rate of the M&A shoots up by a third. And that's a bottom line number that should make the bankers, the investors, the executives, and everyone at the *new* company happy.