Culture shock: Anticipate the risks when companies merge

From due diligence through integration, conflicts in cultures and norms are the biggest threats to deal value

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How culture trips up deals

Increasingly, large incumbents are turning to mergers and acquisitions (M&A) not only for inorganic growth, but also to build the technological capabilities they need to compete in the 21st century. They need to digitize their business processes, fend off competitors with new business models, and tap new sources of growth by harnessing data. At the same time, tech companies and "digital natives" such as Amazon are acquiring established offline companies to expand their businesses.

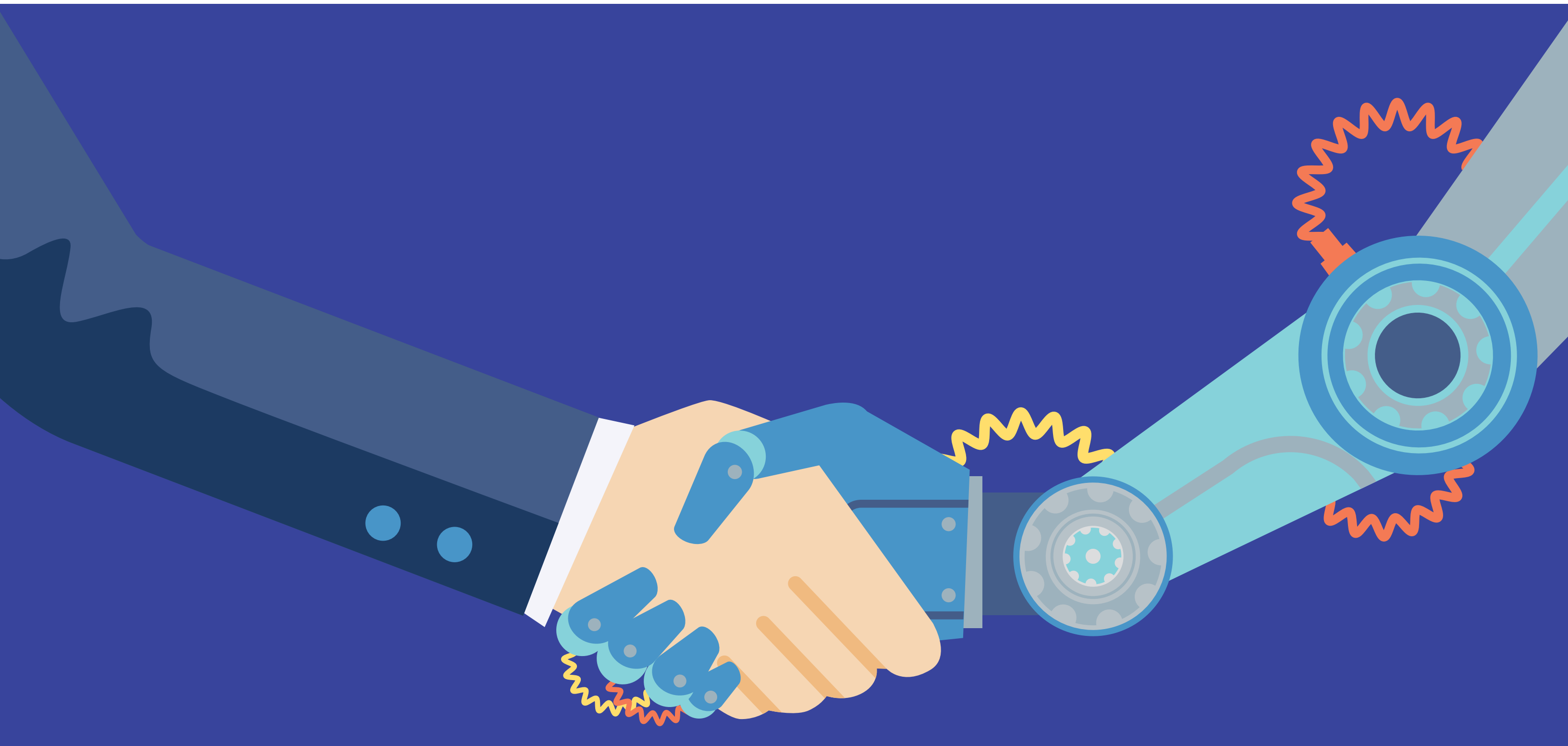
All mergers involve potential culture clashes. But in deals between tech and non-tech companies the risks are far higher. In many cases, the target is a young company, maybe even a start-up. Typically employees may be accustomed to ways of interacting and going about their jobs that are very different from those of the new parent. Leaders of the acquired company may be wary of losing their authority and potential for personal growth. "The people components of a deal are the most difficult and most critical," says the head of HR at a large software firm that has grown through acquisition. And, our research indicates, there are powerful "non-people" factors that work against successful integration, such as differences in decision-making and policy-making.

Therefore acquirers need to anticipate the possible sources of tension and address them pre-deal (i.e., during diligence), develop robust mitigation plans to preserve the unique capabilities and culture attributes that made the buyer and target successful, and manage the workforce transition to the new operating model so the new combined company can realize the deal value and work together in a coordinated, profitable manner.

Challenge: align alien cultures

Challenge: reconcile ways of managing and rewarding people

Challenge: workforce transition



Challenge: align alien cultures

We're sitting in the lunchroom of a high-tech company. It's full of twentysomethings, young men with beards and women in sneakers. An old-line industrial conglomerate is hoping to acquire this startup to enable its digital transformation and start applying machine learning to real-time maintenance offerings for the industrial equipment it sells. Surveying this scene, an executive from the prospective purchaser looks apprehensive. Back at her company's Midwest headquarters, her fellow executives have barely adjusted to not wearing ties. Even the engineers dress up when they come to a presentation. Skateboards? Nose rings? Do those headphones ever come off?

Solution: make a cultural assessment standard in due diligence and integration planning

The cultural divide between non-tech and tech merger partners is hard to miss. Yet, in the race to nail down a deal, acquirers often put off dealing with the potential conflicts. "If we had known what the target was like early in the deal, we could have saved ourselves a lot of time and pain by addressing the differences early in the planning phases," says an HR vice president at a large retail chain.

We find that when integrations go well, it's often because the culture assessment was part of due diligence. This gives acquirers an opportunity to think ahead about where they can be flexible, where they must insist on the parent company's values and customs, and where they might even learn new ways of doing things from the target. Taking the time and effort to perform due diligence on cultural issues will greatly improve the chances of realizing value post-deal. Done properly, culture assessments identify key challenges and give purchasers the baseline for building a structured process for assimilation that keeps all employees engaged and minimizes attrition.

What makes a good culture assessment during diligence? Focus is critical. Don't boil the ocean looking for enterprise-wide culture change: focus on the key cultural issues that are relevant to the deal. The mission is to quickly identify red flags and risks to assist with a go/no-go decision. Review public documents, annual reports, social media, and interview target leadership (if access is available). Look beyond obvious sources of human conflict. KPMG's primary research on culture reveals that non-people factors, such as how decisions are made, often have greater effect on culture than how individuals interact.

We studied three culture integrations and found that 71 percent of comparable departments had statistically significant culture differences in decision-making and policy-making. By contrast, 57 percent of departments differed significantly in personal interactions. Identify the unique culture attributes and capabilities that underlie the success of both the buyer and the target. Answer the question: how will the combined company preserve those attributes and unique capabilities in the new model?

Best-in-class companies not only perform culture assessments on possible acquisitions but also take the opportunity to re-examine their own cultures—sometimes with surprising results. The culture that employees experience does not always align with what corporate leadership believes it to be.

Another trap is underestimating how strong the other company's culture is. Buyers quite naturally view their own culture as one of the reasons for their success and tend to believe that what's good for them will be good for the target. But culture becomes part of self-identity for employees, and few things evoke stronger emotional responses than an assault on their personal identity.

As the deal proceeds through planning and execution, acquirers can define the change plan and specify the pace. Culture change doesn't happen overnight and shortcuts often fail. We suggest starting at the top and develop with leadership action plans. Top leaders should understand the values of the target company's culture and agree to a timetable to welcome new employees and integrate them into the organization.

Culture determines results

Culture involves how people think, behave, and feel about the organization. Depending on the organization's strategy and need, we see a continuum from a "why we do things" to "the way we do things" culture. Whatever the culture is, it all starts with employee experience and ends in performance (good or bad).

Employee experience
Creation, reflection, reinforcement of culture

Beliefs
Content and beliefs of culture

Behaviors
Impact on behaviors and interactions

Results
Effect on business results

Challenge: reconcile ways of managing and rewarding people

The team from the acquirer meets with the tech company CEO to ask about compensation and performance management. He shares his concerns about how many employees are starting families, because company practice is to factor family size into salaries. The next stop is a meeting with employees to get their perspectives on performance management. The questions elicit a collective sigh. Nobody's a fan of performance reviews. They seem too corporate, and they're awkward. But a few employees note that raises and promotions sometimes seem random. Some bosses seem able to give people better work and more money and some don't seem to care.

The day ends with a sit-down with the head of HR. He discloses that there is no HR handbook, nor is there a full-time HR department. Benefits administration is outsourced. Standard policies for hiring, promotion, and compensation are nonexistent. Employees can work remotely whenever they want, and time off is unlimited and untracked. But somehow it works. The company has grown rapidly and is increasingly profitable. Turnover is well below average.

How a software maker learned new tricks from a target

A traditional software vendor that sold on-premises (on-prem) solutions was looking at two acquisitions to build its presence in the software-as-a-service (SaaS) business. During due diligence, the potential for culture clash became obvious: the acquirer had a rigid, command-and-control way of managing, while both targets were agile, uber-flexible organizations, with Friday beer parties, ad hoc performance reviews, and no sign of a dress code. The acquirer recognized that simply forcing the target to conform to its ways of working would be unproductive and destroy deal value. By taking a deeper look, the buyer found that part of the "secret sauce" that made the first SaaS vendor so responsive and successful was a collaboration tool that helped sales staff with product development and engineering, allowing near real-time product feedback that drove rapid improvements. The client wound up adopting the communications tool as well as a highly effective customer-service program used by the second target. As a result, the combined company began scoring new key account wins and the hoped-for revenue gains materialized.

Solution: conduct a stakeholder analysis before designing the post-merger integration

Major corporations with large HR organizations have built up comprehensive people systems that are aimed at providing recognition, compensation, and growth opportunities based on merit and documented performance. Policies are clear and applied consistently.

By contrast fast-growing companies may rely more on ad hoc decisions than policy, and some may even put themselves at legal risk. Indeed, basing compensation on family size—a true example—is illegal. So changing that is an easy call. But in most cases, the acquirer has to weigh the risks of undoing a successful formula with the need to eliminate potential liabilities.

Buyers, however, should not assume that employees of acquired companies will not welcome more defined approaches. In our experience, many employees will welcome such change because they recognize that without standard processes and procedures, things fall through the cracks and people may miss out on what is due them.

Often, what stands in the way of a successful integration is simply fear of change. In a KPMG client survey, 25 percent of respondents acknowledged that their companies struggle with change. However, when change is carefully paced, communicated, and managed, it is possible to build buy-in and overcome resistance. "The key is having early communication and engagement," says the global head of talent for a large technology company.

Integrations, like any change program, start with on stakeholder analysis. Find out what is changing for each stakeholder group and how will it impact their daily roles in the organization, from signing into technology platforms in the morning, receiving feedback from bosses and peers, to understanding how their roles connect to the strategy people need to know what is changing, why, and how it will impact them. Stakeholder analyses typically start with interviews of high-and mid-level managers who can identify which employees or employee groups will be most affected by changes in policies and procedures. In addition, conducting stakeholder surveys can help let people know that the new management wants to learn about their concerns and can be expected to address them. Surveys and interviews can also be used with other stakeholder information—leading companies often speak with selected vendors, customers, and other external stakeholders because there's considerable deal value to be conserved in these relationships. External stakeholders are often overlooked. Casting a wide net to capture the changes for all stakeholders is key to successful integration planning, and even ties back to the unique culture capabilities and attributes identified during diligence as integration teams can really start to understand the unique ways of working during the assessments.

A stakeholder analysis, when planned in concert with a culture assessment and assimilation plan, can be a powerful experience for employees and, critically, help avoid erosion of deal value through unwanted attrition.

The culture divide at a glance

Start-ups

- Tendency to determine salaries and bonuses informally
- Team spirit and community often achieved through inexpensive, sometimes creative, ad hoc perks and freebies
- Generally informal mentorship. Learning and growth through frequent changes in jobs and employers
- May have performance management programs. May not
- Direct access to company leaders
- Flexible work schedules prevail
- Employees tend to value growth, change, or risk-taking
- Inexpensive perks often used to compensate for lower salaries

Large companies

- Structured processes to compensation
- Team building through structured events
- Formal mentorship. Clear hierarchical course for growth and advancement
- No question of performance management programs
- Indirect access to leaders
- Both flexible and inflexible work schedules
- Employees generally place higher value on job security
- Tendency to higher salaries

Challenge: workforce transition

Back at client headquarters, the executive meets with top leaders to brief them on her findings. They quickly come to share her concerns. How can they convince people who dislike hierarchy and seem allergic to all kinds of structure that, as a result of the merger, they will be better off? Sure, the bigger organization can offer better benefits—everything from backup daycare and tuition reimbursement to a generous match on retirement plans and low healthcare premiums. But, the executives fear, that may not be compelling for employees whose most cherished perks are beer Fridays and taking their dogs to work.

Overcoming a culture gaffe by focusing on winning together

Too often, post-merger integration proceeds according to a standard play book that focuses on high-level synergy goals and overlooks the details that are critical to success. In a recent merger of two tech companies, a standard stakeholder survey turned up some significant differences in how employees interacted with company resources, such as HR and technology services. One company was high-touch and the other self-serve. That was important intelligence. However, what the survey did not uncover was how fiercely employees of the target company identified with their branding, including the color scheme, which was used in their offices. When the offices were repainted with the acquirer's brand colors, employees were dumbfounded. How could they ever work with these people? The solution was to focus on ways that the two organizations could succeed together. The M&A team took a deep dive and examined functions in both companies in detail, looking for places where there were similarities they could build on and scale up as well as opportunities for the organizations to learn from one another. The result was a significant client win that neither company would have achieved on its own. Winning did not eliminate cultural differences, but helped the new company move forward as a cohesive team.

Solution: overinvest in managing the transition

The workforce transition must be planned with exceeding care. Mistakes can be expensive and erode deal value, particularly if they encourage key talent to leave. KPMG estimates that it costs 100 percent of salary to replace individual contributors in technical roles, and 200 percent of salary for executive and top leadership roles.

Turnover costs are one reason why buyers should overinvest in managing the transition. Buyers should go the extra mile to ensure that there are absolutely no glitches in moving the new employees onto a new payroll and benefits system and making sure that any commitments to employees—pending promotions or raises—are not broken. It takes time and money to transfer personnel and payroll files and complete testing to make sure everything is working. This should occur well in advance of the close. Buyers must be sure to avoid glitches that would lead to errors in assigned roles, salary, and benefits. The information must be 100 percent correct. Anything less is failure.

Acquirers can also improve the chances of a successful integration by getting help from employees of the acquired company. "Leverage the target to build community," advises the head of corporate development for a tech company. "Let them be part of the process to foster a sense of ownership."

There are many ways to enlist employees of both organizations in community building. Several corporations have sponsored hackathons, where coders and developers from both sides of a merger participate. In addition to bringing together employees with common interests, the hackathons helped management identify organizational capabilities and plan new teams to tackle problems or pursue innovations.

The onboarding process itself is another opportunity to make an integration succeed—or fail. It's not just about getting employees of the acquired company to find their workspaces and learn how to file expense reports.

People need to know where they fit into the future of the combined organization. They need to know who their boss will be and how their roles and responsibilities may change. Opportunities for growth and advancement should be clearly defined—and employees need to hear this information directly from their new bosses. New employees also need to be introduced to the strategy, mission, and vision of the new organization.

Openness, honesty, straight dealing, and strong communications all count for a lot. Perhaps most important, employees need to hear all of the information as soon as possible—every day that slips by where unknowns exist is potentially another day that critical talent is looking for another job. Employees need to feel engaged in shaping the future state of the organization and feel their voices are heard through two-way communication.

Find opportunities to bring people together, give them opportunities to look each other in the eye and get clear answers. But also use social media and other digital channels to keep the dialog going and monitor progress. Such tools might include chat forums, hang-outs, or blogs where employees can speak freely (within appropriate guidelines) about the deal. Games and quizzes can engage employees and show management their understanding and commitment. These tools can generate excitement and help employees come to understand that different can be better.

For a successful integration...

Consider the art and the science

It is common to assume that HR integration is merely mashing two HR functions together. However, since HR programs touch every employee, changes to the function will have implications for employees and their daily routines. Changes in titles, comp, benefits, hiring practices, performance and rewards, learning and leadership development, all impact the lives of employees. This is why HR integration must combine the art of managing employee expectations and experiences with the science of delivery to maintain business continuity.

Create a good employee experience

Today's workplace is digital. Employees and other stakeholders expect to be engaged in thoughtful, meaningful ways via apps and online platforms that encourage two-way communication. Digital onboarding tools can provide a rich social experience to help employees become ready, willing, and be able to perform successfully in new roles.

Never forget that culture remains king

We recommend looking at culture throughout all phases of the deal to support awareness early and to inform integration planning. Culture mismatches can be uncovered in many ways. Cultural assessments can be conducted during diligence, integration planning, and close to identify key barriers that need to be mitigated. Issues can show up differently in different stages of the deal.

Integrate, then transform

Unless market pressure demands transformational change, it is not recommended to attempt a business transformation and an integration at the same time. The demands on resources are simply too great to do both well. Better combine first, then optimize.

Learn and adapt

Capture lessons learned. Build time into the process for sessions to share what worked and what did not and bring those lessons forward for future integrations.

Conclusion

When companies combine, often the default approach is for the buyer to "assimilate" the target company—essentially swallowing it whole. When that happens, the culture and unique capabilities that made the target successful can get lost entirely. Culture, values, policies, and the unique ways of working are all important intangible assets that should be assessed during diligence, factored into integration planning, and reinforced during integration execution. Buyers should give serious thought to finding ways to allow the target's unique culture attributes and capabilities to continue to thrive, even as they take the necessary steps to bring the companies together.

of M&A deals do not involve HR early enough in the deal. This leads to surprises later, including departures of key talent, additional integration costs, or significant integration challenges that require additional resources and potentially cause delays in the deal, or erode deal value.

How KPMG can help mitigate culture risk

KPMG's M&A HR Center of Excellence combines rapid analytical capabilities, leading-edge tools, and deep HR, human capital, and industry knowledge to produce valuable insights for our clients. Many of our practice leaders have served as both consultants and in internal HR executive roles. We have the experience to resolve complex HR issues and define clear steps to address culture and human capital challenges that stand in the way of performance.

We are uniquely positioned to help you:

01 Understand and identify the key financial drivers and risks related to human capital

02 Create alignment across workforce job structure, pay, and benefits

03 Prepare employees and HR function for Day 1

04 Create an organization design and operational structure with the appropriate talent to lead the next phase of growth

05 Produce an engaging, positive onboarding experience to help transitioning employees succeed in the new company

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