YOU’VE INVESTED A LOT IN THIS ACQUISITION,
DON’T LET CULTURE CLASH RUIN IT

Executive Insight into the Impact of Corporate Culture on M&A

M&A is back

More than three-fifths of US companies (61%) are planning deals in the next 12 months – the highest number ever recorded by EY’s semiannual Global Capital Confidence Barometer, now in its 12th edition. And in Europe deal volume is up 22% to $332.2 billion so far this year compared with the same period in 2014, reports the Wall Street Journal. Peter Tague, co-head of global M&A at Citigroup: “The market has high expectations for growth, and it is unlikely that cost cutting and organic investment alone will meet that demand. Certain sectors - such as technology, healthcare, financial institutions and industrials - face acute growth challenges, and as a result we expect accelerating consolidation.” In particular, the technology industry’s situation is compelling. “2014 was a banner year for the technology sector”, says PwC’s Deal Practice in their recently published analysis of the U.S. tech market, and their view for 2015 is equally optimistic: “Alongside broader economic growth in the US, technology set records not seen since the dot com era”, says their report. “$350 billion in cash and securities on hand at the top 25 technology companies, record levels of private equity dry powder waiting to be deployed, and see indications of full pipelines from every angle of the market, 2015 promises to be another exciting year in technology M&A”.

Research firm Dealogic reports that the global merger and acquisitions volume reached over $880 billion in the first quarter of 2015, with over 9,000 deals. This is up 23% from the same time period in 2014 and is the highest first quarter volume since 2007.
Earlier this year, chip maker NXP Semiconductors agreed to buy Freescale Semiconductor, its smaller Texas-based peer, for $16.1 billion. This deal is the 4th largest announced M&A transaction so far this year, 2015’s 3rd largest acquisition of a US company, and the largest tech M&A deal so far this year, according to ThomsonReuters.

And this trend will continue: The various market opportunities in mobile, cloud, data and analytics, and security are expected to drive technology industry mergers and acquisitions in 2015, according to a recent survey from KPMG LLP, the U.S. audit, tax and advisory firm. A study by market research firm Mergermarket, which is based on interviews with over 150 senior executives from both technology corporates and private equity firms, shows a great optimism in the market - an overwhelming majority of respondents (83%) anticipate that the volume of tech M&A will increase over the next 12 months, with Germany promising to be the most active technology bidder in the coming 12 months, and UK and Ireland being the most likely technology targets.

What are the drivers for this development?

According to a study by accounting firm Deloitte, convergence is a key factor: “Large incumbents are looking across the TMT sector to buy start-ups or young proven companies that enable them to add disruptive innovations, expand/enhance their portfolios, or put a foot in a geography, ecosystem, or industry vertical they’re not currently in.” M&A deals provide the speed to market for next-generation technologies, and are also a vehicle for future strategic options: Since the pace of technology change is so rapid, it is getting more and more difficult to predict where the industry may be in two years, let alone five. To hedge their bets, some tech companies are starting to pre-emptively buy start-ups or small-to-medium niche players in case the products or technology they offer become the next ‘hot’ thing.

Technology developments and trends play another role. Software as a Service (SaaS) is particularly attractive to private equity investors because of the increased visibility it provides into revenue streams.
And the favourable overall economic conditions such as a liquid capital market, the strongest equity market in a decade, and low interest rates for well-capitalized buyers as well as slowing growth and higher cash reserves for large technology companies will drive higher deal volumes and valuations.

A survey by KPMG, the audit and tax advisory, finds that access to intellectual property and/or talent is the primary motivator for technology deals (50%), closely followed by ‘bolt-on’ acquisitions to enhance new products (42%), the acquisition of innovative technologies or products (41%), the desire to enter into markets (41%), and the desire to expand existing technology platforms (40%).

**Acqui-Hire – Talent as an asset**

CB Insights, an information services firm, describes this trend: “The ‘acqui-hire’ is a relatively recent phenomenon that describes when a struggling company (generally but not always an early-stage start-up) is acquired primarily for its talent. Instead of buying companies for their products, or even potential financial contribution, acquirers who are leading the ‘acqui-hire’ movement are now purchasing teams of smart people (generally engineers) who have a history of working well together with the hope that dropping in these teams might accelerate and advance their own businesses.”

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Andreas Penna, managing director and founder of Penna & Company, an M&A and investment advisory firm, explains: “At current Silicon Valley prices, valuation per engineering employee is $1 million to $2 million over a four-to-five-year period.”

**Cross-Border Implications and Blind Spots**

In their research, Deloitte points toward an increasing international scope of the transactions: “Faster technology adoption and greater innovation in emerging markets is leading to more cross-border M&A deals as geographic boundaries disappear amid the pursuit of market and revenue growth. An uptick in inbound M&A is expected to continue, with Chinese, Brazilian and, potentially, Japanese firms buying U.S.-based companies. For example, Japan’s SoftBank Corp. finalized its $21.6 billion merger with Sprint Nextel Corp. in July 2013.” On the other hand, technology companies in Israel, Russia, Japan, China, India, and other emerging markets generally are less expensive acquisition targets than those in developed markets. For example, Cisco has acquired several Israel-based companies. These cross-border transactions not only have challenges from a legal point of view, but in particular from a cultural perspective.

Despite these findings, most people involved in M&A transactions focus their priorities elsewhere. According to KPMG, the technology M&A professionals in the survey overwhelmingly said that the most common challenge to deal making in the year ahead was the valuation disparity between buyers and sellers (67%). They were also concerned with the identification of suitable targets (39%) and the buyer/target alignment on post-deal execution strategy (25%). Mergermarket’s study finds that only 23% see: “combining management teams as the main integration challenge.” So let us look at the past to find examples of the implications of culture in a company merger situation.
The Pitfalls of Acquisitions

The 1998 merger of Daimler-Benz and Chrysler was hailed by the two CEOs as a ‘merger of equals’, and the opportunities for both sides looked perfect. Daimler had a high quality brand in Mercedes but wanted to broaden its product line and gain greater access into the huge North American market. Chrysler, on the other hand, wanted access to the famous German technology and global supply chain. And both companies felt that by merging they could successfully enter and gain significant share in the growing Asian and South American markets. Plus by combining their two operations there was an estimated $1.41 billion in cost savings the first year alone.

Easy to fall in love with those numbers and future opportunities. The CEO of Daimler-Benz was subsequently named Business Manager of the Year for pulling off such a ‘perfect marriage’. And all for only $38 billion!

By 2000, just two years later, the share price of DaimlerChrysler (DCX) had fallen from its 1998 high of $97 to $41 and after several years of further losses and falling car sales, Daimler sold Chrysler to a private equity group, Cerberus Capital for just $7.4 billion. From merger heaven to Wall Street hell in a few short years.

The post-mortem analysis of the DaimlerChrysler merger shows a story of greed on one hand and lack of trust on the other, but mostly the sad story of the clash between two very different cultures. Daimler was a German company described as “conservative, efficient and technology driven”, while Chrysler was an American company known as “daring, flamboyant and marketing driven.” The Daimler culture was methodical, with centralized decision-making and a high regard for tradition and hierarchy. The Chrysler culture valued efficiency, equality and empowerment in order to produce cost-efficient, mass-market vehicles. Not exactly equals! And then there was the further complication of German and American national cultures trying to work together.
A similar story of hype and then failure was repeated several years later to great fanfare as another ‘merger of equals’, this time between AOL and Times Warner. And much earlier, in 1968, two long-time railway rivals, New York Central Railroad and Pennsylvania Railroad merged to become Penn Central, the sixth largest corporation in America. What Penn Central did not expect was that years of fierce competition made it impossible for the two corporate cultures to work cooperatively together. The company filed for bankruptcy after only two years.

And more recently there was the disastrous Sprint-Nextel merger. In 2005, in a bid to keep pace with industry giants like Verizon & AT&T, Sprint acquired rival Nextel for $35 billion. By 2008, the company had written down 80% of the value of Nextel, confirming the widely held belief that the merger had been a failure. That failure is widely attributed to a culture clash between the entrepreneurial, khaki culture of Nextel and the buttoned-down formality of bureaucratic Sprint.

Basing an acquisition or merger on business data (balance sheet, PE ratio, profitability, product lifecycles, complimentary product lines, etc.) is like two people getting married based on compatible height, weight and bank accounts and forgetting about personalities and compatibility. Everyone knows the poor statistics on marriages these days and the success of M&A is equally poor. Different corporate cultures and the resulting culture clash has a lot to do with this high failure rate, as does greed and a poor understanding by senior executives of human behaviour.

**Seeing the ‘Cultural Landmines’ Before It’s Too Late**

Textron Systems Companies (TSC) make, among other things, smart munitions and military Armoured Security Vehicles (ASVs). To expand its portfolio of products, Textron Systems ($1.4 billion) acquired $600 million AAI (a division of United Industrial Corporation) in late 2007, a maker of reconnaissance drones (UAVs) for battlefield surveillance and target acquisition. AAI’s products and engineering expertise fit perfectly into Textron’s emerging strategy for an Intelligent Battlefield.
Plus, both were New England based companies. The financials worked, the product portfolios worked, they were not far apart geographically, and the price was right. Due diligence was conducted with the assistance of McKinsey & Co. and on paper everything seemed to fit together perfectly.

But Textron Systems CEO, Frank Tempesta, wanted to make certain there were no ‘hidden landmines’ in the deal, especially since this was a major acquisition and TSC previously had a relatively poor acquisition track record. Once the deal was agreed, along with the normal integration planning activities, Tempesta commissioned a customized corporate culture assessment of both organizations, filled out by senior and middle managers, the ones who really had the job of ‘in the trenches’ integration. In addition, face-to-face and telephone interviews were conducted to gain a broader perspective of the cultures than could be obtained from just a questionnaire.

“While the numbers added up and AAI was by all accounts a perfect fit for our long term business strategy, I was concerned about how we were going to integrate such a large number of AAI employees into the Textron family and what that influx would do to our own culture.”

~ Frank Tempesta, CEO Textron Systems Companies

What emerged, in as little as two weeks from start to finish, was a graphical snapshot of the differences and similarities of the two company cultures, which showed visually some key culture integration issues that had previously been unrecognized. These corporate culture differences exposed potential risks for the success of the integration.

During a presentation to the senior teams of both TSC and AAI, the information from the Culture Due-Diligence Assessment sparked a lively debate that resulted in a number of key actions that had not previously been in the plans from the traditional business due diligence assessment. These new plans included reviewing and adopting some program management best practices of AAI, a revised integrated senior team configuration, as well as dramatically expanding the acquisition communication process.
The results from the culture due-diligence assessment took me by surprise. It pointed out, in a very visual way, the areas that we had overlooked in our traditional integration assessment. But it didn’t take us long to plug this new information into our plans.

~Ellen Lord, Integration Manager (now CEO of Textron Systems Companies)

AAI is now fully integrated into the TSC family of companies and the acquisition, in the first year, generated new business opportunities where the two organizations were able to combine their strengths to win significant new US Defense contracts.

Culture Influences the Integration Approach

Every single time you make a merger, somebody is losing his identity. And saying something different is just rubbish. ~ Carlos Ghosn

What’s the best approach to acquisition integration? While everyone agrees that acquisitions and integration pose considerable challenges, the real driver behind M&A is that it presents a much faster route to business growth than organic growth, and speed is of great value in this fast moving global economy. But if the acquisition gets bogged down in internal issues, mass defections of talent, and too much focus on positions and politics, then growth can suffer and the benefits of the acquisition are difficult to deliver.
One of the best ways to ensure an acquisition delivers on its growth opportunities is to use an in depth understanding of the cultures of both companies as a guide on how to approach the integration. When the internal ways of working (cultures) are similar, it can make sense to use an assimilation strategy for the integration.

When the cultures are very different, yet there is a good business rationale for joining forces, there is the option of allowing it to maintain its identity as you slowly begin to build trust and understanding of the people and their capabilities and learn how to best leverage this new acquisition for the benefit of everyone. The Disney acquisition of Pixar is a great example.

And every once in a while, an acquisition comes along where $1+1=3$ and there is the ability to take the best elements from both organizations to create a new entity whose combined power becomes a significant competitive force. The successful merger and integration of Exxon and Mobil, to form ExxonMobil, the largest corporation in the world, is a good example.
About Korn Ferry’s Corporate Culture Practice

Korn Ferry, the leader in executive search, talent assessment and leadership consulting has put together a world-class group of former executives and business leaders along with experts in corporate culture, culture reshaping and cross-culture business integration to support senior executives in successfully navigating today’s turbulent and rapidly changing global business environment.

Our senior staff have many years of executive experience dealing with the cultural aspects of M&A integration and can advise and support your management team on everything from cultural due-diligence to developing a top to bottom integration approach. We use a small team of senior advisors and work with your existing HR and operations teams to transfer our skills and technology, leaving you stronger and more capable to carry on a successful integration process.

About the authors

Dave Eaton is the leader of Korn Ferry’s Culture Transformation Practice. International Mr. Eaton's focus addresses the human side of any culture change or business transaction, while the company works to ensure efficient and effective execution and sustainability of desired change via cultural integration and individual and team performance, which can have a direct impact on bottom-line results.

An experienced global consultant, Mr. Eaton specializes in the areas of cultural integration, multinational team building, global leadership development, mergers and acquisitions, joint ventures, outsourcing/offshoring, and other large-scale corporate transactions. He is a frequent author and speaker in public and private company forums, having facilitated more than 500 workshops, team sessions, and 1:1 coaching sessions for a broad range of clients across multiple industries and functions within the Fortune 1000.

In 1993, Mr. Eaton founded Eaton Consulting Group, which merged in 2005 with Meridian Resources (creators of GlobeSmart) to form Aperian Global, the world's largest, privately-held, cross-cultural training, consulting, webtools company, where he held the position of founder/owner/practice leader through 2009. He is a member of, and speaker at, a wide array of professional associations in human resources (SHRM, ASTD, HCI, HRLF), and other industry conferences (Conference Board, NASSCOM, and Project Management Institute). He has been a guest lecturer at major business schools and universities, including Harvard University, Emory University, Boston University, and Babson College.

Mr. Eaton has a master's degree in intercultural management from Lesley University in Cambridge, Massachusetts.

John R. Childress is a senior executive advisor with more than 35 years of experience working with senior executive teams and global organizations on the role of culture, performance, leadership and strategy execution. He is considered one of the foremost experts globally on culture transformation, having helped pioneer the first ground-breaking work on codifying corporate culture and understanding the impact of culture on business performance. John has authored 11 books, with his latest book, LEVERAGE – The CEO’s Guide to Strategy Execution being hailed as a must read for all chief executives. John’s books are largely based on his experience delivering cultural change spanning over 30 years with Fortune 500 and FTSE 250.
Between 1974 and 1978 John was Vice President for Education and a senior workshop leader with PSI World, Inc., a public educational organization. In 1978 John co-founded The Senn-Delaney Leadership Consulting Group, the first international consulting firm to focus exclusively on leadership development, senior team alignment and culture change, and between 1978 and 2001 served as its President and CEO. His work with senior leadership teams has included companies in crisis (GPU Nuclear – owner of the Three Mile Island Nuclear Plants following the accident), deregulated industries (telecommunications and the breakup of The Bell Telephone Companies), mergers and acquisitions and classic business turnaround scenarios with global organizations from the Fortune 500 and FTSE 250 ranks. He has designed and conducted leadership workshops in the US, UK, Europe, Middle East, Africa, China and Asia.

John is a Phi Beta Kappa scholar with a BA degree (Magna cum Laude) from the University of California and a Masters Degree from Harvard University.

Hagen Schweinitz is a Senior Client Partner in the Frankfurt office of Korn Ferry International. He joined the firm in 2000 and is a member of the European Global Technology Markets Practice and the CIO Centre of Excellence. Mr. Schweinitz is also coordinating the Korn Ferry activities for the Non-Profit/Education/Government sector in Central Europe, advising clients such as universities and research institutions. He works in close cooperation with the Global Life Sciences Practice and leads the Korn Ferry Lifesciences IT Initiative across EMEA.

Mr Schweinitz is a member of the European Corporate Governance Institute in Brussels and a regular contributor to the Korn Ferry Institute. He has published several whitepapers on the convergence of the Healthcare and Technology, on leadership imperatives for CIOs, on corporate governance and non-executive directors in fast-growing technology companies and, most recently, on corporate governance as a growth driver for transition economies, based on Iran as an example.

Prior to joining Korn Ferry, Mr. Schweinitz was a management consultant at Pricewaterhouse Coopers.

Mr. Schweinitz holds a Postgraduate Diploma in Strategy and Innovation from Said Business School/University of Oxford and a Master of Business Administration degree from the University of Wales. He is a graduate of the Said Business School/University of Oxford High Performance Management programme.