

A study of 125 mergers suggests that there is a link between performance and tackling the cultural challenge head on.

Merger integration: why the 'soft issues' matter most

by Till Vestring, Brian King, Ted Rouse and Julian Critchlow



Executives charged with integrating two companies after a merger know that success depends on a few key precepts: planning rigorously, making tough decisions rapidly and implementing with discipline. Production assets and information systems must be rationalised, customer lists and back-office functions fused, compensation programmes redesigned, purchasing contracts renegotiated and redundancies of all kinds rooted out and eliminated.

Yet when it comes to the so-called 'soft issues' that surround differences in corporate culture, many executives seem to throw planning to the wind. The rigour applied to other aspects of integration often gets set aside, leaving management teams to choose between steamrolling over the acquired company's customs and management style or letting the two organisations learn about each other slowly and gingerly, taking pains not to impose one culture on the other right away. In either case, cultural gaps take a back seat to strategic and logistical concerns. If integration results in culture clashes or wounded egos, well, those can work themselves out over time.

Greg Lawton knows better. Lawton has spent most of the past year spearheading the successful 2002 merger of America's Johnson Wax Professional and DiverseyLever, a former unit of Anglo-Dutch conglomerate Unilever. That experience convinced Lawton that a methodical plan for confronting corporate culture issues early on is essential to making everything else in a merger transaction run smoothly. "It is rare to have long-term success without a clear understanding of the cultural makeup of people coming into the business," says

Lawton, chief executive of the new JohnsonDiversey. "The cultural component is where many companies get blindsided."

Indeed, the tendency to overlook culture snares experienced dealmakers and novices alike. Jack Welch, former chief executive of General Electric, frequently invokes the story of GE Capital's disastrous 1986 merger with Kidder Peabody as a cautionary tale about the importance of cultural issues. After GE's buttoned-down finance unit tried to remould the freewheeling brokerage into an image of itself, Kidder's core asset – its top brokers – departed for the elevators, leaving a trail of losses and scandal. GE's \$600m investment had produced a scant \$250m of earnings when GE finally divested Kidder to PaineWebber in 1994. "Culture is really hard" Welch told an interviewer for CNBC recently. "And we learned the hard way."

A make-or-break issue

To test the notion empirically that cultural issues can make or break a deal's success, we recently undertook a study of 125 mergers transacted between 1996 and 2000. The deals we examined were valued at more than \$1bn each, and in each case the purchase price exceeded ten per cent of the acquiring company's market capitalisation. We then evaluated the deals using five primary dimensions of culture – differences in language and national norms, management practices and philosophy, organisational structure, compensation and incentive systems, and workplace environment – in order to categorise the combinations as having significant or insignificant cultural issues. Finally, we assessed whether management teams were pro-active in dealing with cultural

integration early, and then analysed relative performance to see if it made a difference.

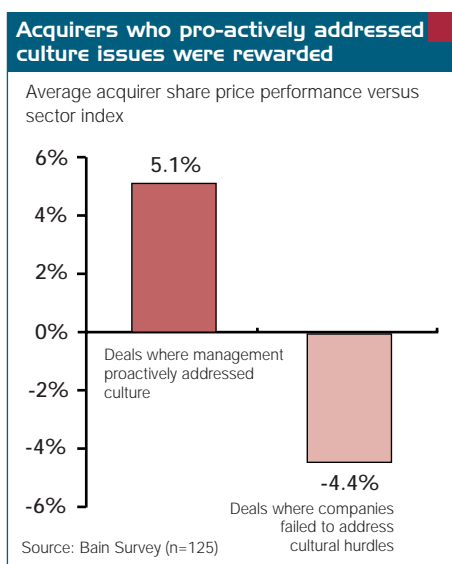
Surprisingly, the overall results showed little difference between deals marked by important cultural issues and those without (a 0.5 per cent decline in stock price performance compared to sector indices versus a one per cent increase). But there was a large and significant difference between the stock performance of companies where executives pro-actively tackled cultural issues during the integration process and those who did not.

A pro-active approach netted 5.1 per cent higher stock price performance versus a minus 4.4 per cent share price underperformance in deals where companies failed to identify and negotiate cultural hurdles.

Three converging trends can explain why cultural issues have become so important:

- First, service companies increasingly dominate the largest global economies. That means the chief assets are not factories and equipment, but people – executives who develop client relationships and leverage a certain expertise. Consequently, more mergers involve assets that can walk out of the door when things get tough.
- Second, the sharp increase in cross-border deals between global firms with operations in many different countries has raised the odds that mergers will involve blending both national and corporate cultures. Mergerstat reports that the value of transactions between US companies and those outside the US peaked at almost \$436bn in 2000, up 19-fold from \$23.3bn in 1992.
- Finally, deal rationales have become more complex. Many companies engage in mergers and acquisitions not just to squeeze out value or increase their size, but also to transform their business or industry. Whereas only one of the top ten global deals (by purchase price) in 1988 aimed to change the basis of competition, eight of the top ten deals announced in 2000 did so.

Success in the new world of mergers and acquisitions means elevating cultural concerns to the same level as strategy and quantifying synergies when assessing and implementing an M&A transaction. Integrating cultures requires paying close attention to cultural misalignments,



involving target company executives right away and dismissing those recalcitrant few who bar the way to progress. Most importantly, management teams must often invest in a 'third way' that represents an amalgamation of the best of both cultures. Not surprisingly, this sort of focus requires a major commitment of top management's time. But our experience and the research study indicate that early investment pays off in the end.

Identify cultural misalignments

A pro-active approach to merging cultures begins with assessing where two companies fit together, and where they do not. These can be among the most difficult issues that executive teams confront during integration, in part because their decisions about what to keep, what to blend and what to discard involve people. Invariably, some managers trained to operate by certain principles will find themselves out of step in the new organisation.

When British Petroleum merged with Amoco in 1998, the potential for culture clash loomed large. In the wake of financial crisis in 1992, BP had reorganised itself into an enormous family of smaller business units, each of which was expected to pursue an entrepreneurial course. Amoco, based in Chicago, operated more like a classic pyramid, with ingrained reporting hierarchies and detailed internal procedures.

John (now Lord) Browne, chief executive of BP, moved swiftly to address the cultural misalignment, choosing one culture – BP's – to absorb the other. Within 100 days of closing the deal, he had filled all the top

management jobs and completed most of the cuts, laying off nearly 10,000 employees. He startled some Amoco executives by imposing BP's structure and management style on the new company, an approach that ultimately resulted in the resignation of some senior figures at Amoco. BP's assimilation of Amoco was so thoroughgoing that the running joke became: "Question: How do you pronounce BP Amoco? Answer: BP, the Amoco is silent."

But Browne makes no apologies. Having observed costly mistakes BP made through adopting a hands-off approach to earlier investments, he stated: "I learned you have to have clarity with an acquisition. You can't let these things just work themselves out." The merger process created value for shareholders measured in terms of BP Amoco's stock price, which rose by nearly 11 per cent during this initial 100-day period of the merger.

Aligning the new management team, however, doesn't necessarily mean picking one culture over another. Frequently, cuts are unavoidable. But the process of successfully merging two divergent corporate cultures into one is often an exercise in carefully crafting a 'third way' – a wholly new culture befitting a new company. It can tap the best practices of the two merged organisations and consciously involve both sides from the very beginning.

When Greg Lawton's Johnson Wax Professional took over the DiverseyLever unit of Unilever in May 2002, stark differences existed between the two companies. Like consumer-products maker S.C. Johnson & Son Inc., from which it had recently separated, Johnson Wax Professional had developed a management style that was entrepreneurial, intuitive and unstructured. That flexibility and drive helped Johnson Wax Professional grow to a world leader in floor care and housekeeping solutions, with about \$930m in revenue. S.C. Johnson, noted for its product development, had imbued its unit with a distinct management style – entrepreneurial, intuitive and unstructured. DiverseyLever, meanwhile, operated in 60 countries with 11,000 employees and annual revenues of \$1.4bn. Like its parent, Unilever, the unit was highly structured in both its communications and planning.

The merger held promise as a strong combination, offering complementary products and filling in some of Johnson Wax Professional's geographic white space. Three-quarters of Johnson Wax

Professional's business involved cleaning institutional floors at large grocers and mass-merchandisers in the West. DiverseyLever served the hospitality industry, especially hotel kitchen operations, and had a strong foothold in developing countries of the Middle East, Africa and Asia. When it came to cleaning contracts, Lawton says, "They were in the kitchen and we were in the lobby."

The Johnson family of companies had taught Lawton the importance of a cohesive culture. For 116 years a document entitled 'This We Believe' has articulated corporate values for Johnson employees. But having studied the literature and tapped the expertise of outside consulting companies, Lawton concluded that blending cultures was the right approach for the merged companies. And he knew that crafting a new culture for JohnsonDiversey would require his direct involvement in building bridges and selling integration, especially to a newly formed executive team.

Get on the leadership agenda

Organisational psychologist Daniel Holland says this sort of immersion by top management is crucial. He identifies a 'critical mass threshold' phenomenon in cultural integration, a point where enough senior leaders take the issue sufficiently to heart to warrant their personal attention and leadership. "That's when you see serious dialogue take place and solid traction develops to address challenges," says Holland. "Two thirds of the battle is simply getting the topic on the senior team agenda."

Lawton took pains to set up a programme office to focus on the merger and freed other senior executives to run the day-to-day affairs of the merged company. He led the steering team personally. Several months before the deal announcement, while the negotiators on both sides hammered out an agreement, Lawton and his counterpart at Diversey, Cetin Yuceulug, developed a vision and values statement to convey the goals of the merged organisation.

Lawton also spent more than 100 hours with Diversey executives, getting to know them well in advance of announcing the transaction. From their ranks he selected members of a new management team, assuring balanced representation from both entities and using in part the culture and values attributes as selection criteria, which set high standards for building employee loyalty, delivering customer service, fostering innovation and reliability. Lawton

'Communication is mishandled constantly. CEOs either communicate nothing, because there are so many moving targets, or they delegate communication two or three layers down, which ends up causing more confusion.'

felt the early announcement of the top team was crucial to helping the rest of the company understand what was about to happen. "Surprise number one," says Lawton, "was the personal time investment that I had to make to pull off the selection and shaping of the team."

Integrate where it matters

Lawton and his new team planned to integrate deeply and quickly, but only where they had to. They focused efforts across the four most critical areas: merging back-office supply chains; harmonising product lines and sales forces; creating new, combined regional organisations; and integrating management systems, including bridging a wide gap between the approaches to decision-making at the two firms. The cultural gulf between Johnson and Diversey became apparent at the very first meeting of the integration team. "Surprise number two," says Lawton, "was how differently the teams executed."

Diversey dominated the early discussions with its formal briefs, written proposals, and confrontational style. The structured and combative decision-making process caught Johnson executives off guard. Says Lawton: "Johnson team members seemed to be much quieter and reflective in the face of a decision-making bull-dozer that was coming at them from the DiverseyLever side."

Lawton committed himself to guiding the development of a 'third way' for the companies to work together. The first step was to help members recognise their different approaches and talk about them without judgment. "These differences weren't good or bad, just different," Lawton says. Next, the leadership group began to work through decisions in a way that both teams could accept, combining the entrepreneurial, delegating style of

Johnson with the structure, discipline, and organisation of DiverseyLever. The final step was to 'cascade' this new approach down the ranks at both companies, with top team members encouraging others to follow.

Once Lawton and Diversey's Yuceulug had melded their visions for the new company, they made a video together that profiled the new entity's guiding principles and direction. Psychologist Holland says this is a key step. "Communication is mishandled constantly," he says. "CEOs either communicate nothing, because there are so many moving targets, or they delegate communication two or three layers down, which ends up causing more confusion."

The day Lawton announced the merger to investors, he rolled out the guiding-principles video to the company's staff worldwide. Next came the critical period between the deal's announcement and its close. During this time, Lawton put the new team on one compensation and incentive system that linked directly back to the success of the new company. He took executives offsite to review the strategic intent of the deal and the historic values of both organisations, and set out to build a common purpose.

Following the close of the deal, Lawton made sure the bridges were in working order. Immediately, joint sales teams began to share data previously off-limits and made visits together to key global customers. Joint supply-chain teams began preparing plans for which facilities to close. Lawton himself spent a concentrated few days with leadership teams in each of five global regions, reviewing progress and celebrating successes.

Just five months into the effort, Lawton could point to early signs of success, even in the face of a challenging business environment. He had retained most of his key executives and major accounts. The integration process had moved forward smoothly. And the expected synergies had materialised. Privately, Lawton says he judged the merger a cultural success when he saw how animated executives were at company social gatherings. "If you closed your eyes and listened," he says, recalling a celebratory team dinner, "you would have thought you were back in a single company."

Till Vestring is a director in Bain & Company's Singapore office. Brian King is a vice president in Atlanta. Ted Rouse is a managing director in Chicago. Julian Critchlow is a vice president in London.