Perspectives on merger integration
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Assessing cultural compatibility:

A McKinsey perspective on getting practical about culture in M&A

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Executives know instinctively that corporate culture matters in capturing value from M&A. In a recent survey by McKinsey and the Conference Board, 50 percent said that "cultural fit" lies at the heart of a value-enhancing merger, and 25 percent called its absence the key reason a merger had failed. But 80 percent also admitted that culture is hard to define.

Therein lies the rub. How can you address cultural problems, if you don't know what you're trying to fix? Hardly surprising then, that most executives feel more comfortable dealing with costs and synergies than culture, despite the potential of culture to enhance or destroy merger value.

In addition, CEOs all too often return from the deal table convinced that the companies' cultures are similar and will be easy to combine. They miss the opportunity to use the merger as a catalyst to shift culture – both in the new organization and the acquiring company.

McKinsey has proprietary tools that split culture into specific, measurable components and link those components to more than 100 actions management can take to mitigate cultural risks. Most importantly, companies can apply a version of this tool outside-in, before even announcing a deal.

A practical approach to culture
At McKinsey, we take a practical approach to understanding and tackling cultural issues. Rather than thinking about norms, rites, or employee satisfaction – terms commonly used to discuss culture – we urge executives to focus on management practices: "the way we do things around here."

A company's leadership style, the extent to which it holds employees accountable for their performance, its approach to innovation or building and maintaining external relationships – these are the management choices that define an organization's culture and shape its performance. Merging companies that have incompatible cultures because their management practices drive conflicting behaviors risk loss of the best performers, a messy and prolonged integration period, and, ultimately, failure to capture merger value and synergies.

Viewing culture as the result of certain management practices makes it tangible and actionable. Merging companies can readily assess their cultural differences and find ways to address them, thanks to tools that make cultural due diligence as central to the merger process as financial and legal checklists. This high-level assessment can happen during the deal process, giving executives time to design the merger in a way that builds on cultural assets and mitigates the risks of cultural clash.

Scientific assessment

Many approaches to assessing and addressing cultural issues are flawed. Many rely on leaders' instincts. McKinsey research shows that managers in about 50 percent of merging companies read their organization's culture very differently than other employees do, typically exaggerating the significance of their own leadership style.

Many CEOs of merging firms believe the integration will be relatively easy just because they get on well personally. They underestimate the challenges that different management practices create for most employees.

Other approaches rely on focus groups and employee satisfaction surveys, but these can prove inadequate. Although they can locate conflicting behaviors and may make people feel better for awhile, they cannot reveal the root causes of the behaviors and so do not provide insights into what management can do about them.
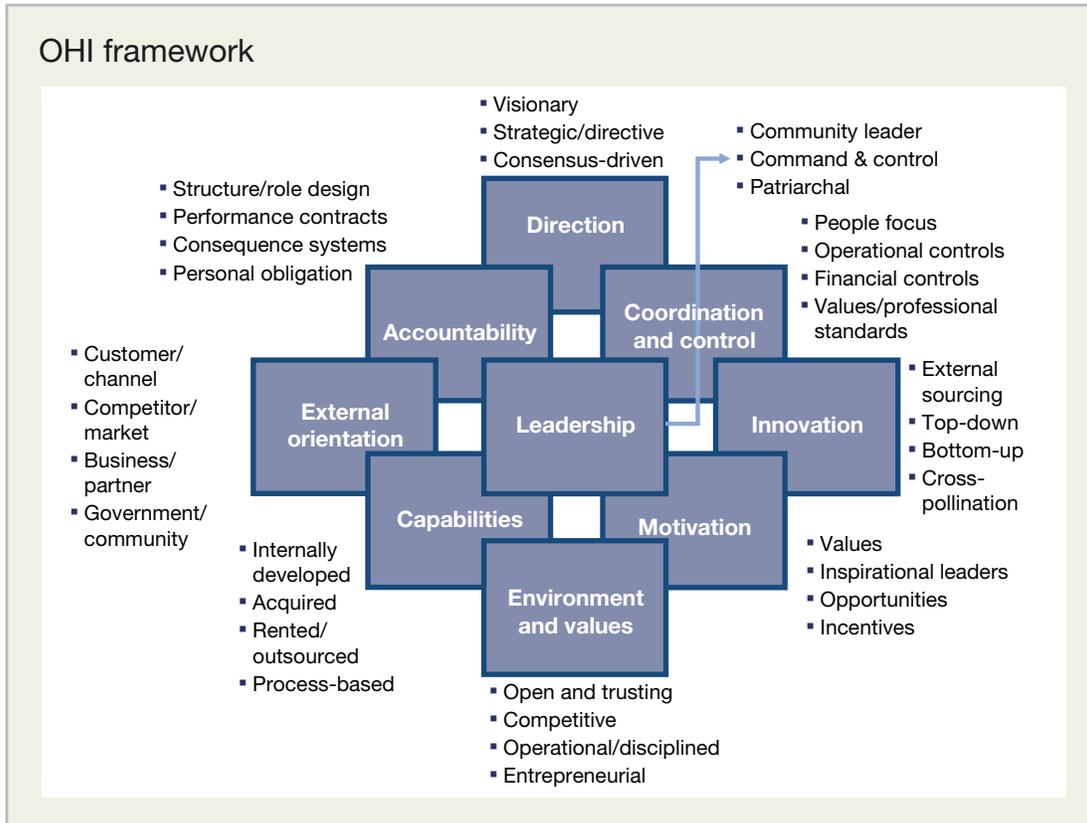
Thorough organizational surveys, like McKinsey's Organizational Health Index (OHI), deliver a more robust diagnosis.

<div align="right">Exhibit 1</div>

Climate/satisfaction surveys vs. OHI

Limitations of climate/satisfaction surveys	McKinsey's enhanced organizational assessment
Do not...	*Does...*
• **Present** an outcomes orientation – rather, they focus on behaviors that the organization exhibits ("I am satisfied with my job")	• **Assess** the breadth and depth of organizational performance – The level of performance across 9 management practices – The methods used to deliver that performance (37 fundamental practices) – The underlying mindsets that enable/hinder performance improvement
• **Enable** direct root-cause analysis	
• **Take** a holistic view of what drives organizational performance	• **Address** the drivers of practices and mindsets by disaggregating root causes of organizational limitations
• **Prescribe** actions – rather, provide long descriptions	• **Link** directly to "what do we do about it"

The OHI produces detailed, quantitative analysis of company performance in nine broad management practices, enabling statistically significant comparisons between companies that establish their cultural compatibility.

Such a rigorous survey requires substantial commitment of time and organizational resources. It also requires access to employees of both the target and the acquirer at a time when they may be feeling anxious or when the absence of public knowledge of the deal makes access impossible. So the question becomes, how can you measure cultural compatibility accurately without a full survey?

Exhibit 2

OHI framework

- Visionary
- Strategic/directive
- Consensus-driven

- Community leader
- Command & control
- Patriarchal

- Structure/role design
- Performance contracts
- Consequence systems
- Personal obligation

Direction

- People focus
- Operational controls
- Financial controls
- Values/professional standards

Accountability

Coordination and control

- Customer/channel
- Competitor/market
- Business/partner
- Government/community

External orientation

Leadership

Innovation

- External sourcing
- Top-down
- Bottom-up
- Cross-pollination

Capabilities

Motivation

- Internally developed
- Acquired
- Rented/outsourced
- Process-based

Environment and values

- Values
- Inspirational leaders
- Opportunities
- Incentives

- Open and trusting
- Competitive
- Operational/disciplined
- Entrepreneurial

The answer is, an outside-in analysis that relies on relevant markers. This analysis uses publicly available information to assess the management of both companies. It can happen before the deal, remain confidential, take less than a week to complete, and does not require access to the target.

Companies signal their management approach to the outside world in many ways: corporate websites, annual reports, speeches, news articles, blogs, stock market filings, recruiting, and mission statements, to name a few. All of this is potential fodder for an outside-in analysis, providing a basis for building a company profile that mimics the results of a full survey. While it cannot match the analytical depth of a full survey, it makes an effective and accurate barometer of company culture.

McKinsey teams have conducted more than 20 outside-in assessments of merging companies where they had no prior knowledge. Many of these companies had already done full OHI surveys. The teams identified the same major areas of potential cultural friction that the OHI survey had found and that later became real issues in the merger process.

To see how an outside-in analysis works, consider the recent merger of two consumer companies. The analysis revealed clear cultural challenges in leadership and coordination/control, potential conflict in accountability, and strong cultural alignment in external orientation.

The analysis showed that:

- Company A had a patriarchal leadership style, driven by the owners and managers of this old, family-run business. Employees looked to the owners for vision and leadership and felt an emotional stake in the company.

- Company B, the acquirer, had a more "community" leadership style. The small corporate center was relatively hands-off, delegating authority and avoiding personality cults built around leaders.

Exhibit 3

Sample outside-in analysis

Legend:
- ■ Clear challenges
- ■ Some key differences
- ■ Strong alignment

Dimensions	Target's cultural practices	Acquirer's cultural practices
Leadership	Strong indication of patriarchal leadership	No dominant practice, but indications of a community-oriented, delegating style
Direction	Company direction set top-down, both laying out a vision and offering specific guidance	Dominant practice: clear, top-down specifics for achieving company direction
Environment/ values	Open, trusting, and collaborative environment for employee interaction	Some weak indications of a process- and efficiency-driven environment
Accountability	Implicit personal obligation drives accountability, backed by clear roles and responsibilities	Strong performance culture, with positive and negative consequences
Coordination/ control	Clear indications that company manages via people systems and a values-based code	Some signs of a management style focused on targets and metrics, along with a values code
Capabilities	Little indication of a dominant style for ensuring needed talent base	Dominant practice: company acquires key skills and capabilities externally
Motivation	Strong indication that employees are motivated by company values and leaders	Indications that employees are motivated by a balance of factors, including company values
External orientation	Company engages externally with a strong customer focus, plus some government focus	Strong indication of a clear customer focus, but also signs of focus on competitors and government
Innovation	Weak indication that management generates new ideas and innovation top-down	Management-driven ideas for change dominate innovation practice

With the former owners of Company A no longer involved, the merged entity risked Company A employees distrusting the new leadership and feeling uncertain about who would provide direction. The merger needed appropriate "interventions" to sustain employee motivation, especially among former employees of Company A, and organizational momentum.

Analysis of management practices around coordination/control and accountability found that Company A lacked the strong performance measurement systems of the acquirer, relying instead on employees' sense of duty and loyalty. This potential cultural conflict cut both ways.

- Company A employees might resist strict measurement, perceiving a loss of personal involvement in a company that only cared about "making the numbers."

- Company B employees might feel disgruntled if the performance management system became less robust and, in their minds, unfair.

This conflict might lower productivity and lose the most valued employees.

The analysis also revealed an opportunity in the way both companies thought about and managed external stakeholders. Both had a strong customer focus that could support integration and value creation. Employees from both companies were likely to respond well to the idea that the merger benefitted customers, and building cross-functional integration teams around customers could integrate and motivate all employees.

Intervention

With accurate data on cultural compatibility, what action should leaders take? In extreme cases, they might cancel the deal, as two industrial transportation companies did recently. The acquirer understood that the incompatibility posed too great an obstacle to performance and pursued other opportunities.

The outcome of a compatibility assessment is usually less dire and informs planning of a targeted approach to changing the management practices that produce cultural conflict. The leaders of the merging companies have two intervention options: standard integration interventions and tailored cultural interventions.

Standard integration interventions apply in any merger. They tend to focus on integration structure and alignment of the top team on "the way we do things around here." How leaders handle these interventions influences the organization's culture because their actions demonstrate strong cultural intent.

Take organizational design, for example.

- A broadly inclusive process, where senior management just provides design principles and multiple management levels develop the design, signals consensus-oriented leadership.
- A top-down process, where senior leaders design the entire organization with little input from others, signals a command-and-control leadership culture.

Talent assessment and selection offers another example. The criteria used – hard performance metrics or more subjective metrics like employee willingness to collaborate with colleagues – shape the organization's culture going forward.

No culture is "right," and different choices fit different circumstances. But choices must apply consistently so aligning the top team around cultural choices is a critical standard integration intervention. Unless senior leaders are excellent role models, the rest of the organization will not internalize the change.

Tailored cultural interventions address the specific findings of the outside-in analysis and focus on changing targeted behaviors. Many organizational actions can influence each fundamental element of culture. For example, more than a dozen interventions can affect management of accountability within a company.

In the merger of the two consumer companies, where the organizational compatibility assessment flagged accountability as an issue, the acquirer (Company B) decided to bring its strong performance measurement ethos to the new company.

The creation of regional manager roles with broad decision rights and strict P&L accountability pushed accountability much lower in the organization than Company A had done, sending a clear cultural message to employees. Corporate leaders made accountability a theme in most top-team communications from the start of the integration process. And the company conducted training – for all employees, but aimed at the former employees of Company A – in how to assess performance, conduct a performance dialogue, and deliver a performance review.

In another example, two merging pharmaceutical companies discovered major differences in the impact of leadership style on decision making during integration planning. The new company embedded decision-making rights and rules in high-level governance processes and highlighted the changes to major company committees as a sign of broader cultural change.

Ultimately, such choices have far greater impact on a merged company's culture than any number of focus groups or mission statements can achieve on their own. But whatever interventions a company chooses, leaders must make them mutually reinforcing. Otherwise, conflicting signals negate the intended impact.

Cultural interventions must also be woven into the larger integration effort. Too often companies approach culture as a separate, HR-driven integration activity. This frequently makes line employees resist cultural efforts, perceiving them as a distraction from the real, value-capture-oriented work of integration. By weaving culture into core integration activities like organization design, communications, and value capture, leaders forestall these objections.

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Thinking about cultural conflicts and opportunities in terms of management practices makes culture easier to define, identify, and tackle. Managers should avail themselves of tools that can help perform these tasks, whether an outside-in analysis that surfaces cultural issues even before deal close or a more thorough, fine-tuned OHI survey.

These tools offer a systematic way to diagnose and address cultural issues in a merger. Every integration action, from announcement to combination, has impact on corporate culture and therefore value. Executives need to understand the cultural compatibility of companies planning to merge as early as possible.