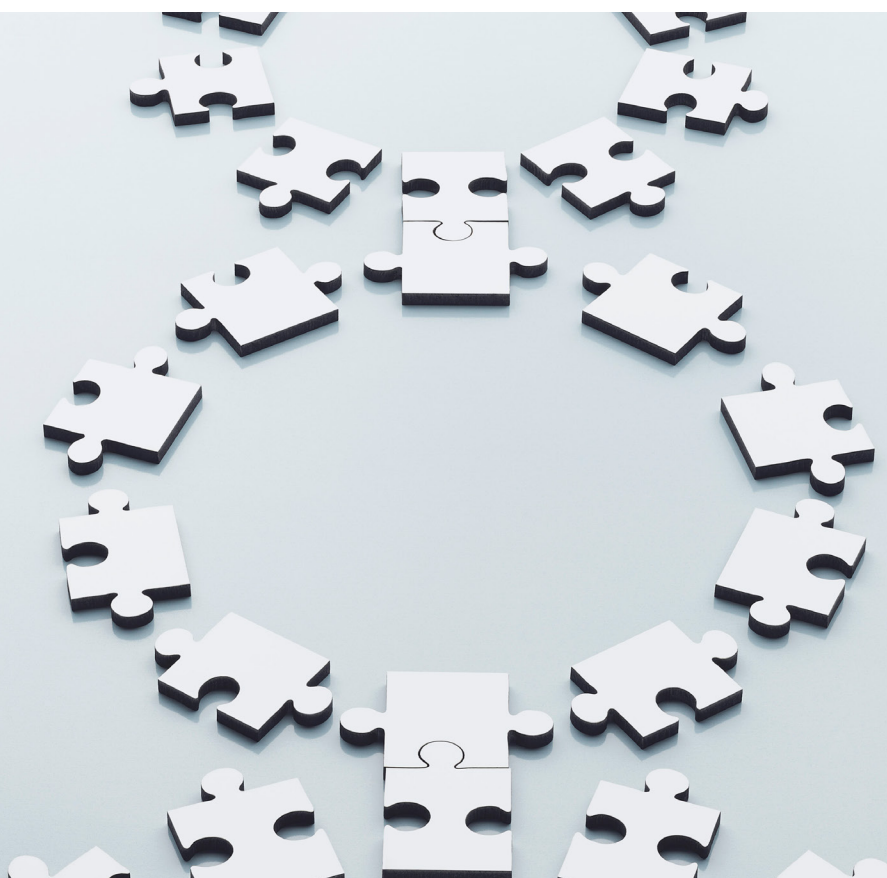


Organization Practice

Organizational culture in mergers: Addressing the unseen forces

Understanding culture, and proactively managing it, is critical to a successful integration. This requires a comprehensive approach.

by Oliver Engert, Becky Kaetzler, Kameron Kordestani, and Andy MacLean



Cultural factors and organizational alignment are critical to success (and avoiding failure) in mergers. Yet leaders often don't give culture the attention it warrants—an oversight that can lead to poor results. Some 95 percent of executives describe cultural fit as critical to the success of integration. Yet 25 percent cite a lack of cultural cohesion and alignment as the primary reason integration efforts fail.

How can companies address culture more effectively during a merger? How can the transformational opportunity a merger offers lay the groundwork for a healthy, high-performing organization?

This article describes our approach to understanding and addressing culture in mergers and focuses on the actions needed to combine operations and deliver value. This approach has been refined over more than 2,800 mergers in the past five years.

What is culture?

Culture is usually defined as one (or a combination) of the following: national cultures (German versus American, for example), artifacts (such as a suit and tie versus jeans), and employee engagement (including satisfaction levels). We believe that these definitions of culture are red herrings and instead take a very practical view, which can transcend national boundaries. We define culture as the outcome of the vision or mission that drives a company, the values that guide the behavior of its people, and the management practices, working norms, and mind-sets that characterize how work actually gets done.

A company's vision and values are almost always clearly defined during a merger, usually by the CEO, with input from the leadership team. The real challenges come in managing and aligning how work actually gets done. At this level, misunderstandings, friction, and tension can make it difficult or

impossible for teams to work together effectively and can jeopardize the success of the deal (see sidebar "Case study one").

Our approach to culture

There are three key steps to understanding and managing culture during a merger:

- Diagnose how the work gets done.
- Set priorities.
- Hard-wire and support change.

To be successful, companies should start this process early—well before close if possible—and act before cultural integration becomes more challenging. The process must be led from the top, the top team must commit itself to the culture effort, and employees must be strongly engaged. To put it simply, culture is everybody's business; it is not just another item on HR's to-do list. In fact, HR is merely an enabler. Culture is the soul of the business (see sidebar "Five key success factors").

You can't design your "NewCo" culture until you understand the culture you have already.

— Bill Kozy, former executive vice president and COO at Becton, Dickinson and Company

Step 1: Diagnose how the work gets done

As early as possible in the merger process, leaders must learn about the culture of each of the companies involved.

From the standpoint of strategy, several key questions should be considered. What is the "secret sauce" of the target company, and where are its "pearls," or the factors that must be preserved because they are intrinsic to its value for the acquirer? How can the acquirer benefit culturally from the target? How can the target benefit culturally from the acquirer?

As for tactics, it's important to understand how work gets done at both companies: their management practices and working norms. How do they make decisions (for example, are they centralized or decentralized)? How do they motivate their people (say, through financial or emotional incentives)? And how do they hold people accountable—individually or collectively (as teams)?

A scientific approach is required to diagnose culture. The leaders' gut instincts are not sufficient to understand it fully at either company.

One thing I wish we had done was [to create] a culture diagnostic right at the start of our planning

process. That would have eliminated some of the misperceptions about both company cultures. It would have established an objective set of criteria around which we could have had conversations based on facts rather than just anecdotes or beliefs.

—Beverly Goulet, former executive vice president and chief integration officer at American Airlines

A variety of diagnostic approaches, ranging from management interviews to employee focus groups to surveys, are available. Surveys can engage large numbers of employees and give people from both companies a voice. While one-on-one interviews and targeted focus groups can offer more specific insights, they are less effective at identifying

Sidebar

Case study one

“I can think of two examples where we did extremely cursory assessments of the existing organizational cultures. Based on these assessments, we thought the cultures were very similar. Only later did we learn just how different the cultures were, particularly in terms of decision-making style. In one company, the boss made the decision, and the employee's job was to execute. In the other, the style was more democratic. Debate was encouraged on all topics, even outside your area of functional expertise.

“So, you get the situation where the head of finance—who is used to having decisions simply followed—is suddenly challenged by

someone from HR who wants to debate the issue first. The head of finance feels criticized and can't understand why. Half the people watching this incident feel the challenge from HR is normal and appropriate, while the other half can't understand why HR wants to have a debate over something that has already been decided and is none of their business anyway.

“People feel uncomfortable, and they don't understand why. Leaders from the acquiring company, whose ways of working are typically adopted by default, don't realize how uncomfortable the people from the target business are feeling. No one is recognizing their concerns, their wor-

ries, and their fears over this new style of decision making, because executives from the acquiring business don't understand that this is a new style for people from the target company.

“This discomfort can unfortunately develop into unhappiness and to people choosing to leave. This unhappiness can also permeate throughout the organization, particularly if key leaders start to leave. It can have serious implications and affects your ability to both maintain your base business and deliver the value expected from the deal.”

—Aileen Stockburger, former vice president for worldwide business development at Johnson & Johnson

organization-wide trends or “pockets” of differing behaviors. The best bet for a holistic view is using a combination of diagnostic approaches. But the structure and terminology used across these methods must be congruent. The goals are to generate a fact base about the existing cultures and to build a single common language around this understanding. What are the similarities? What are the opportunities? What differences could cause friction?

Step 2: Set priorities

Once leaders understand the existing cultures, they can begin to set the immediate cultural priorities, which should be based on two focal points. The first is on areas where the culture can help maximize the value of the deal (such as moving to a higher-performance culture to achieve ambitious sales targets). The second is on areas where companies must manage meaningful differences in ways of working to build a single high-performing organization. These are often expressed as a series of “from–to” shifts that are easy to communicate. Drawing on inputs from the diagnostic, the top team should develop a point of view about the shifts. This alignment ought to include target-company leaders where possible, since leadership alignment and role modeling are critical for successful implementation.

To really get at the essence of the challenge, the leadership team needs to understand how they have worked traditionally and to consider whether that's the right way to work going forward. It has to be an introspective process that says, “What have we done well? What might we do better? And, frankly, does the culture we want to drive going forward even match the culture we've brought into this?”

—Beverly Goulet, former executive vice president and chief integration officer at American Airlines

The next step is to codify a specific set of behaviors, or management practices, that will further strengthen the new company. Articulating these behaviors is an important step in translating the higher-level from–to shifts into practical and

tactical actions. For example, one shift could involve transitioning the organization away from a performance-management approach with unclear roles and responsibilities to one with very clearly defined roles and specific performance targets for each employee.

Cultural artifacts—for example, a new vision, mission, and values, reinforced further through symbols, emblems, and branding—can help signpost and encourage these behaviors. Such artifacts, important prerequisites for getting culture right, must be developed with a clear idea of exactly which behaviors they are designed to reinforce.

The top team should also quickly begin role modeling the change in behavior. A compelling, consistent change story should be developed centrally and collectively, and all top-team members should personalize it with their own experiences. They should then use this story to engage with their employees at every opportunity.

The fun thing about a “NewCo”: it's a new company. So you're building it.

—Bill Kozy, former executive vice president and COO at Becton, Dickinson and Company

Once the leadership team agrees on the desired behavior, a comprehensive change plan structured around cultural themes must be developed. Each theme can then be cascaded into concrete initiatives: activities and actions that constitute the change plan and are monitored through defined key performance indicators (KPIs). The target state could, for example, be to create a more agile and performance-driven sales force that works together to cross-sell (exhibit). This can be translated into supporting culture themes, such as working together well and making decisions quickly. For each theme, specific initiatives and metrics can then be developed. Taken together, these themes and their constituent initiatives encourage the desired behavior and promote the overall goals of the merger.

Accountable business leaders must drive all the initiatives instead of delegating them to HR or communications groups. Initiatives should contain a mixture of hard measures (such as structured incentives) and soft measures (including communication and celebration). It's important to remember that changing a company's culture often requires a lot of incremental and mutually reinforcing gains. Many of the initiatives will—and should—be very tactical. For example, introducing a disciplined approach to the way meetings are run can help embed a culture of respect for other people's time. Defining decision rights clearly can directly increase the sense of empowerment and

streamline decision making. But the real power lies in the cumulative effect of these individual actions, which must therefore be part of a structured approach.

Step 3: Hard-wire and support change

Once a series of coherent themes and initiatives has been identified, they can be hard-wired into the new company's operating model and daily practices (see sidebar "Case study two"). The redesign of policies, processes, and governance models must reflect these important cultural aspects if change is to stick. For example, nurturing a culture of respect might be reflected in company policy and values

Sidebar

Five key success factors

Leaders in merging companies can establish a clear, structured culture by following these action items:

1. Create a fact base and a common language:
 - Work to gain insight into existing cultures and to recognize differences, but don't exaggerate them.
 - Understand the similarities, the differences that could cause friction, and the joint opportunities.
2. Set the cultural direction early and use it to support the deal's goals:
 - Focus on the culture elements that drive economic value in the deal and
3. Align the top team around the planned cultural direction:
 - Leadership alignment and role modeling are critical to success.
 - The top team must be responsible for leading the way.
4. Deliver a clear, coherent program woven into normal integration activities:
 - True behavioral change requires both rational and emotional intervention throughout the system.
5. Measure cultural integration during and after integration:
 - Don't view a cultural program as a separate "Friday-afternoon job" for HR; it must be woven into all integration initiatives.
 - Hard-wire the desired culture into the new company's operating model.
 - Track metrics on retention, productivity, and employee satisfaction.
 - Use the metrics to monitor progress.

statements. It could also become an assessment criterion in individual performance reviews and compensation calculations. And at the end of every governance meeting, participants might reflect on how respected they felt by others during the conversation. Cascading and reinforcing the desired cultural changes through a series of such mutually reinforcing initiatives helps companies to change behaviors quickly and establish the new normal.

To manage cultural integration properly, the merger team must also ensure that the right messages and behavior cascade throughout the new company. That requires more than just passing messages down through the ranks. Formal structures are not always the best way to influence an organization, and executives do not always understand who the real influencers are. By identifying the most influential employees, leaders can recruit them as change agents and give them the training and skills they need to be effective in this role. This would include instruction in how to communicate the

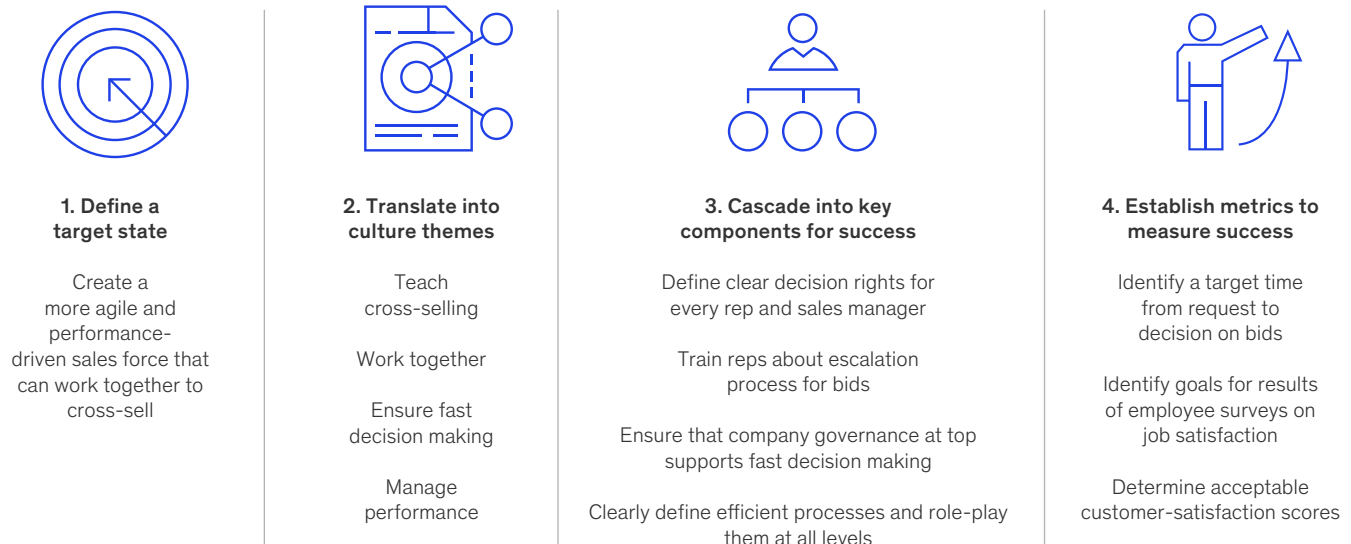
change story and how to role-model the behavior required in the influencers' parts of the business. Signature initiatives involving the top team can also help underline its commitment and create a sense of shared endeavor. This could include changing the company dress code, to match that of the acquired company, to signal the change on both sides.

Companies often fall short when they try to realize their cultural aspirations during this third step. They should track the implementation of themes and initiatives with the same rigor they use for financial targets. Leaders should develop clear milestones, incorporate them into a centrally monitored master plan, and track them closely. KPIs should also be monitored regularly to measure whether the goals of cultural integration are being met, and leaders should take corrective action when needed. Additional employee surveys and focus groups can monitor the effect on workers. The top team should own the process, holding theme leaders accountable and proactively addressing pain points.

Exhibit

To implement culture more effectively, base changes on the new organization's target state.

Example based on transforming a sales force



Source: McKinsey analysis

Case study two

“To the credit of our CEO and senior-management team, they decided, as this process started, that ‘NewCo’ needed a new purpose. Of course, everybody on the buyer’s side said, ‘You can’t change the purpose of a 117-year-old company.’ But our CEO and our board said, ‘Yes, we can, and it’s in the best interest of the new company to do so!’ They changed the purpose, and they recrafted the values to fit together nicely with this. This was thoughtfully done by our senior-management team. And the organization, particularly on the buyer’s side, was really taken by this. You could

hear people saying, ‘This really is going to be a new place.’

“As an individual, you therefore had two choices. Do I want to be a part of this and really get out in front of all these new expectations? Or is this just not for me? And people engaged with this challenge enthusiastically. You quickly saw a series of very practical initiatives grow up, led by business units and regions, including work to really define what we mean by being more agile and to completely redesign a series of key processes.

“When people know exactly what’s expected of them, right from the very early stages, they are more comfortable changing things and moving faster to make improvements. That clarity releases positive energy. You see leaders championing change, communicating broadly, and getting their organization more engaged on what we are trying to do.”

—Bill Kozy, former executive vice president and COO at Becton, Dickinson and Company (who led the CareFusion integration)

A merger provides a unique opportunity to transform a newly combined organization, to shape its culture in line with strategic priorities, and to ensure its health and performance for years to come. By establishing a clear fact base and understanding of the existing company cultures, leaders can use a common language to set the cultural direction for a high-performing new company. An aligned top team can begin to role-model the specific behavior needed and to lead a clear, coherent program

of initiatives that communicate and embed the behavior more broadly. By tracking the effect of these initiatives, companies can take further action to correct the course as required.

As we have seen, over the longer term, companies with aligned corporate cultures and strong organizational health deliver, on average, total shareholder returns three times those of companies whose cultures and organizational health are not closely linked. Given the magnitude of the benefit, cultural alignment should be central to any merger integration.

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