

Creating Deal Success Through People:

Mastering M&A Culture and Integration Issues

As the global economy begins to pick up momentum, companies are turning their attention back to the marketplace and weighing options to grow their businesses faster and more effectively than competitors. For many, organic growth remains challenging, especially with staffing and budgetary cuts hampering their ability to gain scale quickly enough to make a difference in the market. The right merger or acquisition (M&A), on the other hand, presents a potentially attractive path to rapid growth, without sacrificing efficiency. But achieving that growth extends well beyond the strategic fit of a deal. Ultimately, it comes down to how effectively the new entity operates, especially the performance of its workforce over time.

No one would dispute the importance of people and culture issues in a merger, or the value of an effective, engaged and well-integrated workforce in a new organization's success. But the simple fact is, even today, people- and culture-related issues — things such as effectively and openly communicating with employees throughout the transition, creating and implementing strategies to retain key employees, and focusing on cultural alignment between unfamiliar organizations — still don't command the same level of rigor and focus that financial or operational issues do. Rather, they tend to be addressed informally, often without a disciplined approach and, typically, too late in the process to make a measurable difference. And the recent economic downturn has only exacerbated this problem. For companies that have conducted deals recently, many were faced with effecting rapid takeovers, which provided little time or opportunity to adequately address people and cultural integration issues.

Towers Watson research, along with firsthand client experience, reconfirms that when organizations address people and culture issues early, strategically and with discipline, they can achieve significantly more successful deals. In our most recent global

survey of M&A success (see sidebar on page 2), those respondents that rated their company's deal as successful in meeting its primary objectives had recognized the importance of people issues and had brought HR into the deal early. These companies emphasized critical skills and measured the things that matter.

The remainder of this paper examines these success factors in greater detail.

Address People Issues Early... and Effectively

Best intentions notwithstanding, many things can get in the way of an early focus on people integration issues amid the pressures of a transaction and tight time frames. Too often, the people factor is left out of the due diligence process, and this creates challenges later during integration planning, when HR tries to make up for lost time. Dealing with these issues earlier and more effectively is a key step. In fact, our global research shows that one hallmark of overall transaction success is the early appearance of HR in key phases of an M&A deal. When compared with companies reporting less successful deals, companies reporting successful deals involved HR 57% more often in target evaluation and 58% more often in due diligence. HR expertise can be invaluable in understanding the pros and cons of prospective merger candidates from the perspective of cultural fit, and can help organizations anticipate key people integration challenges that might otherwise be overlooked — challenges that can decide the ultimate success or failure of a deal.

“Achieving growth extends well beyond the strategic fit of a deal. Ultimately, it comes down to how effectively the new entity operates, especially the performance of its workforce over time.”

So what actions can an organization realistically take to prepare for an M&A, whether announced or anticipated? And how can it get itself ready when it can't afford the time or resources to do so? Companies need to:

- **Identify what we call “ready now” resources** to help with an accelerated dive into an M&A transaction. For organizations that don't have resources or time to prepare internally, identifying expert “business partners” in advance can help jump start the process, especially in areas the organization may not be equipped to handle. While business and economic realities may make it difficult to justify doing much

advance work, once a deal hits, things quickly get very frenzied, and it can be enormously helpful at this point to at least know where to go for the right resources. For a large manufacturing company with whom we work, having already identified and selected partners to call on in a moment's notice actually enables the organization to maintain fewer resources in place day to day, thereby helping support cost management goals. For another financial services firm, having the M&A HR head serve as part of the corporate development team provides for advance notice and active HR participation in the earliest stages of the deal.

Understanding What Drives M&A Success: A Look at Towers Watson Research

Towers Watson tracks the effectiveness of M&A deals in various ways to help our clients understand key success factors. One way is with our Quarterly Deal Performance Monitor, conducted with the Cass Business School in London, where we examine the quarterly performance of global M&A transactions valued at more than \$100 million against the MCSI World Index. This analysis provides a global perspective on how major M&A transactions are performing relative to the overall market on a quarterly basis. For more information on this survey, please visit: www.towerswatson.com/press/848.

Interestingly, for 2009, the analysis revealed that even amid the global recession, deal makers generally continued to outperform the market, albeit by a small margin. According to Bernstein Research, global M&A activity may rise year over year by as much as 35% in 2010, as improving economic conditions bolster deal making, underscoring the immediate need for companies undertaking an M&A deal to have all the elements in place to get it right. This will be especially important for companies considering transactions outside their home country, since our analysis also consistently shows that domestic deals outperform cross-border deals, in part because of the increased integration challenges the latter present — especially in terms of people and culture.

To supplement this ongoing analysis, we conducted a global survey of more than 400 business and HR executives late in 2009 to better understand how attention to people issues — and HR's ability to effectively address those issues — contributes to deal success. Insights from that survey provide much of the content in this paper. Among our key findings:

- Companies that judged their merger deals as successful focused more heavily and more effectively on change management and communication, in addition to other traditional people issues — and our client experience bears this out.
- These same organizations are also more apt to emphasize strategic people management — for example, influencing leader behavior — during the deal.
- Successful organizations are more likely than their peers to measure key people elements of the deal.

(To view the complete results of this study, *HR's Contribution to M&A Success*, please visit www.towerswatson.com/research/978.)

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- **Build internal relationships with likely integration leaders.** Integration leaders — who typically come from various parts of the organization — benefit from just-in-time education on why culture and people issues matter so much. This means emphasizing in quantitative terms the inherent risks that arise in the areas of business continuity and retaining key talent, and presenting risk mitigation strategies. Partnering with integration leaders helps elevate these issues to the senior management level, where time and resources can be appropriately allocated.

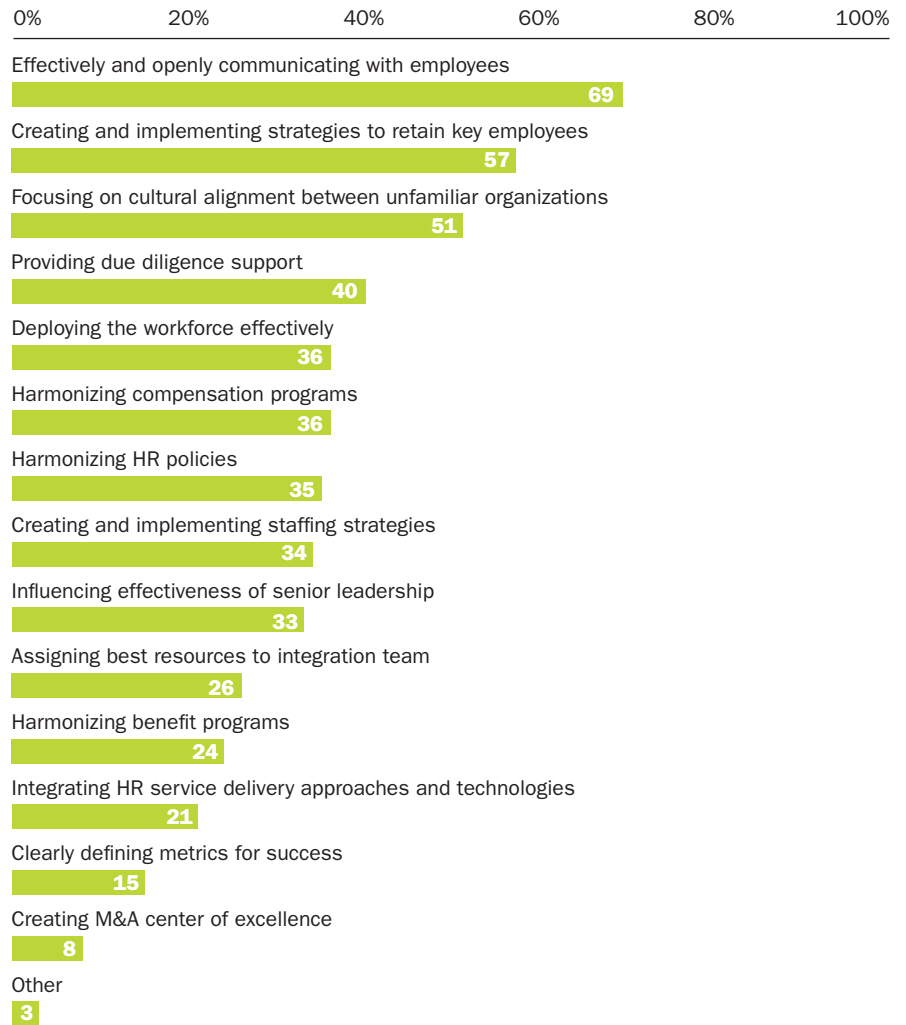
- **Ensure HR’s priorities are aligned with those of the business.** In many companies, HR has taken on an increasingly critical role in driving the people agenda in an M&A. Our research suggests that more companies need to build this into their process as early as possible to ensure a more successful integration effort and more effective outcomes from the deal. As noted earlier, the companies in our study that rated their deals as successful involved HR earlier and more intensely in all phases of their M&A, from target identification (where HR can help assess cultural fit) to integration implementation (where HR can help to ensure the success of the new culture).

It’s worth noting that HR’s own views are aligned with this notion. Its self-identified priorities in an M&A include effectively and openly communicating with employees, creating and implementing strategies to retain key employees, and aligning cultures between the merging organizations (*Exhibit 1*).

- **Ensure that HR has the necessary skills to support a merger.** Companies that judge their M&A deals as successful spend more time on, and are more effective at, key change management and communication activities. They excel at communicating with employees throughout the integration, and creating and implementing strategies to retain key employees. Notably, companies that performed very well in these specific areas were over 25% more likely to rate their company’s deal as successful in achieving defined objectives.

A large global wireless provider and longtime client understands the importance of communication in linking business priorities and employee behavior. This company’s stated goal is to align all its messages — whether delivered verbally or in writing — and it acknowledges the difficulty in doing so on a global scale. It credits HR’s ability to deliver effective communication with having a material impact on its business results.

Exhibit 01. Top Priorities for HR Focus on Talent, Communication and Culture



Source: Towers Watson 2009 M&A Pulse Survey

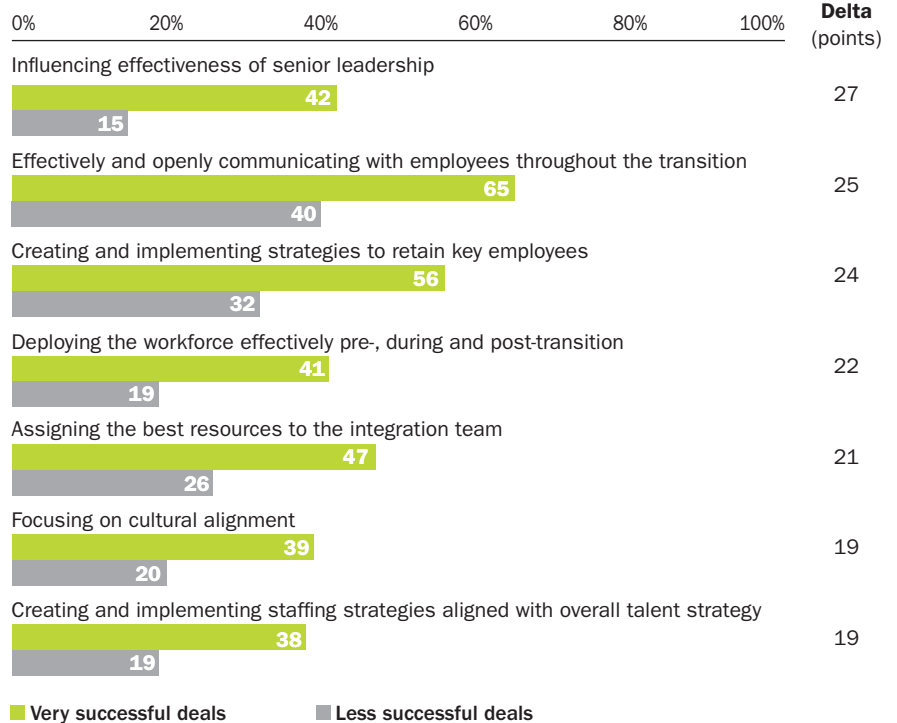
Merging companies achieve payoffs in more strategic people management areas as well. One of the clearest examples involves the extent of HR's influence on senior leadership effectiveness in an M&A. Among those respondents in our global survey judging their M&A deal as successful, their HR team was nearly three times as likely to provide very effective support to senior leaders than was the case in deals deemed less successful (*Exhibit 2*). This dynamic also holds true for HR's performance in staffing and selection, and talent and performance management, where we saw notable differences in HR performance between respondents citing more successful deals versus those citing less successful deals.

Understand Culture to Create the Desired Culture

Although many deals fall short of expectations because of cultural issues, too many organizations in our experience still view culture integration as a “soft” issue or abstract concept. The fact is, culture goes far beyond aspects like collaboration and collegiality, which a merged organization may embrace as core tenets of work style and relationships. Culture is nothing less than the basic DNA of an organization. It forms the foundation for the structures, systems, processes and actions that support business strategy, and explicitly or implicitly defines interactions among employees, customers and stakeholders. In short, culture is a key driver of how an organization operates and whether it succeeds or fails in the marketplace.

Culture also produces rules for operational behavior. In the words of an employee, it's “how things are

Exhibit 02. Percentage of Cases Where HR Performs “Very Well” at Supporting the Organization’s Efforts for Organizations Having Very Successful vs. Less Successful Deals



Source: Towers Watson 2009 M&A Pulse Survey

done around here.” When two organizations agree to something entirely new, cultures and rules can change. In an M&A, it's important for the organization and its leadership to model behaviors that support the right culture. That may entail working to create an entirely new culture, though in reality this is not required of all deals. More frequently, the culture integration challenge is one of the acquired company acceding to the acquirer's culture.

While the rapid pace of change in business is now a well-worn cliché, that doesn't make it any less true, especially in a merger, when change can seem foisted upon large groups of people — even at the leadership level — in rapid succession. Organizations that don't define and communicate a clear culture during this period risk letting a new, counterproductive set of values and behaviors develop organically. Following are steps that organizations can take to drive home the importance of culture within their organizations and help to align the disparate cultures of merging organizations.

- **Analyze and assess culture with rigor.** Understanding both organizations' legacy cultures and values can help business leaders determine which aspects of each organization have helped it succeed and which have created challenges. From that understanding, leaders can identify synergies, as well as

Key Questions

Among the questions that leaders should ask as they assess a culture for the new organization are:

- What are the current cultural profiles of each company?
- How compatible are the cultures?
- What are the most likely areas for conflict?
- Which elements are most critical to retain, and which need to be integrated and changed?
- How do the current cultures compare with external benchmarks?
- What do the senior leaders believe the future culture should look like?
- How well aligned is this ideal culture with the strategic goals of the company?
- Is there agreement among leaders of each company on this ideal culture?
- Where are the gaps between the current and ideal cultures for each legacy company?

potential problem areas, and address them long before the merger closes. An outside perspective can be helpful both in thinking through these issues, and challenging long-held values and beliefs. Tools that enable a rigorous cultural assessment can also help with this process, creating a consistent means of capturing input and giving leaders from each organization a chance to assess their similarities and differences using a common language.

For a large technology company known for its innovation and fast-paced culture, retaining leaders from the acquired company was critically important. We worked closely with the legacy organization to understand its concerns about the acquirer’s culture and how the acquired company would fit in, as well as what was key to retain of its legacy culture. This was important because if employees of the acquired entity perceived their leaders becoming disengaged and disenfranchised, they were likely to follow suit and become skeptical of the opportunities created by the deal. For this client, we took a pragmatic approach to integrating cultures — including using online surveys, focus groups and executive interviews — and treating it as the critical aspect of the deal that it was. This helped us identify areas of similarity and difference, and develop integration strategies accordingly.

- **“Create” a new culture.** For an organization to execute its strategic priorities effectively, leaders must first agree on those priorities and then define a culture that supports achieving them. When adapting the acquirer’s culture is not an option, perhaps in cases where the dominant legacy culture is at odds with the strategic priorities for the new organization, building a new, realigned culture is a critical step.

Through Towers Watson’s employee survey work for clients — which forms one of the world’s largest normative databases of employee attitudes — we have built a taxonomy of cultural attributes that align with the competitive priorities that high-performing companies use to differentiate themselves.*

Exhibit 3 shows how these various cultural attributes support different competitive priorities. For example, if an organization goes to market around innovative products or services, its culture needs to support experimentation and calculated risk taking, and be open to new ideas. If, by contrast, employees perceive zero tolerance for failure, no support for risk taking, and hypercriticality or skepticism when new ideas are aired, it would not take long for an innovative spirit and related behaviors to dissipate, quickly eroding the company’s reputation for innovation. The same logic holds true for the other strategic priorities profiled in Exhibit 3.

“Culture generally refers to the shared set of values, principles, assumptions, beliefs, symbols and behaviors that reflects how work gets designed and executed. Of course, no two organizations’ cultures are exactly alike.”

Exhibit 03. Cultural Profiles by Strategic Priority

Strategic Priorities				
Efficiency	Quality	Innovation	Customer Service	Company Image
Cultural differentiators by strategy in financially high-performing companies				
<ul style="list-style-type: none"> • Comprehensive training in basic work processes • Precisely defined job roles • Disciplined allocation of resources and workload • Clear and effective organizational structure • Data-driven assessment of work processes • Coordination of efforts across work groups 	<ul style="list-style-type: none"> • Effective exchange of best practices • Empowerment of people to correct/improve work processes • Disciplined use of data-based feedback on product/service performance • Disciplined focus on long-term objectives • Focus on advanced training for superior products/services • Focus on processes to ensure superior products/services 	<ul style="list-style-type: none"> • Support for diversity of thought and opinion • Encouragement for risk taking • Bias for action • Anticipating customers’ emerging needs and expectations • Consistently recognizing new ideas and their application • Leadership clarity on future priorities 	<ul style="list-style-type: none"> • Information sharing to improve customer service • Positive team working relationships • Strong customer orientation • Regularly adopting customer perspective • Focus on talent retention • Local authority and empowerment 	<ul style="list-style-type: none"> • Embedded understanding and acceptance of brand promise • Strong belief in product or service provided • Deep pride in shared company values • Integrity guiding all business practices • Work environment explicitly reflects external brand • Leadership that inspires confidence and respect

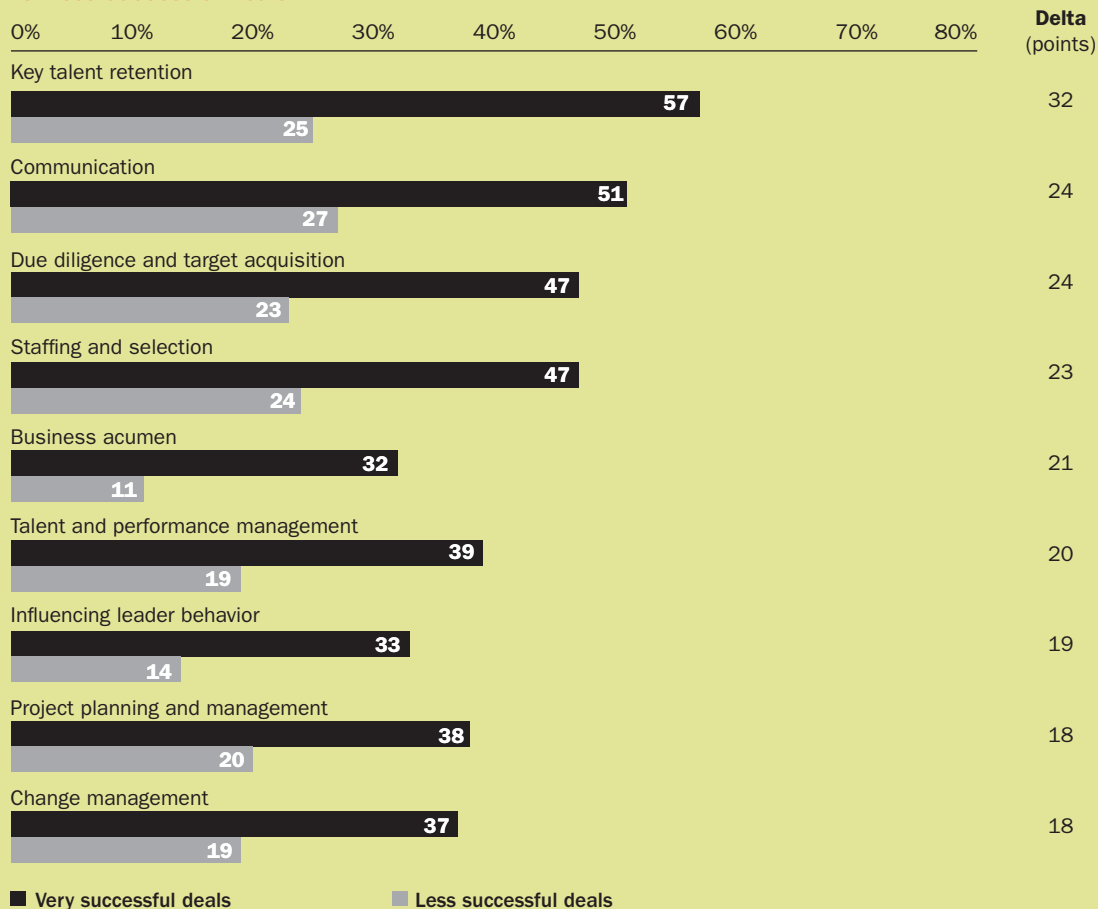
*Derived from Towers Watson’s employee normative database, drawing on a high-performing company data cut

HR — Stepping Up to the M&A Plate

In terms of managing the key people issues and practices in an M&A — those things that can make or break a deal — our global research confirms that HR is a critical resource. Respondents judging their deals as successful tend to have HR functions that are much more effective at helping the organization retain talent and communicate with employees, and support the organization in due diligence and target acquisition (*Exhibit 4*). The same

holds true for HR performance in staffing and selection, business acumen, and talent and performance management, where we also saw notable differences in HR performance between respondents citing more successful deals and those citing less successful deals. On a broad scale, it appears that companies with deals deemed successful have an HR function that is stepping up to the M&A plate in a big way.

Exhibit 04. Percentage of Very Effective HR Functions in Organizations Having Very Successful vs. Less Successful Deals



Source: Towers Watson 2009 M&A Pulse Survey

“HR is a critical resource in managing the key people issues and practices that can make or break a deal.”

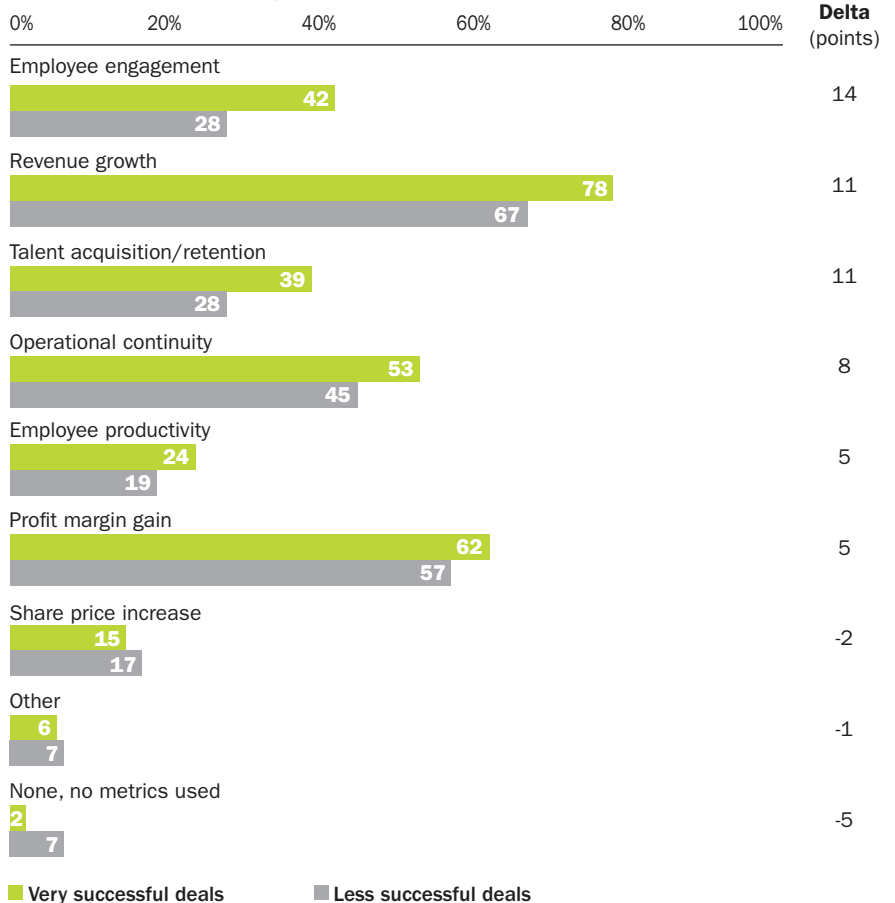
- **Measure results to ensure success.** Another notable finding in our research shows those companies that rated their deals as successful measured key “people indicators” — employee engagement, talent acquisition and retention — much more frequently than did those organizations rating their deals as less successful (*Exhibit 5*). Specifically, companies with successful deals were 50% more likely to measure employee engagement levels, and 39% more likely to measure talent acquisition and retention, than were companies that rated their deals as less successful.

It makes sense that focusing on these key people indicators is especially critical in a period of tumultuous change, such as is characteristic of any merger or acquisition. Anxiety and uncertainty levels almost always rise, making it that much more important and challenging for the organization to ensure it not only has the key talent it needs, but that this talent is engaged at the level needed to drive business performance. And measuring these critical components is the first step toward ensuring success. It's no surprise then, as our research shows, that those companies that look beyond the financial measures of deal success to include these types of key people indicators are more likely to be successful than their counterparts that bypass this critical step in the process.

Positioning for M&A Success: The Bottom Line

Since business performance is driven largely by an organization's people — their skills, competencies and contributions — the success of any merger or acquisition is ultimately just as much about people and culture as it is about the financials of the deal. Savvy companies understand this. They keep employee-centric thinking top of mind and effectively execute and measure key people practices throughout the transition. To that end, they recognize HR's role as a strategic partner and have come to rely on HR — earlier, and more often during the process — to drive strategic thinking and help leaders focus appropriately on all phases of a transaction. By fully understanding their company's primary M&A objectives, HR can help effectively manage the people side of a transaction, especially in terms of leadership behavior and actions, communication, retaining key talent and building the right culture — one that aligns with, and supports, strategic goals.

Exhibit 05. Metrics Companies Use to Measure Deal Success



Source: Towers Watson 2009 M&A Pulse Survey

It is in these ways, through focusing on the critical people and cultural issues, that organizations conducting a deal can best position themselves in the marketplace. As the global economy heads toward recovery and M&A activity begins to rebound, now is the time for organizations to take a step back and make sure they do not overlook the increasingly important human side of the transaction.

To learn more about Towers Watson M&A research or our M&A services, please contact your local Towers Watson consultant or visit us at www.towerswatson.com/services/Mergers-and-Acquisitions.

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