



THE HUMAN SIDE

by William Schiemann and Jeff Zilka

During the M&A heyday of the 1990s, there was little appetite for evaluating the real impact of transactions that failed to reach their full potential. Capital was plentiful, most people seemed to be winning and opportunity cost seemed to have become an academic construct. This uncritical will to complete transactions has vanished, however, in the face of research that quantifies the M&A failure rate at between 50% and 80%.

One of the reasons for the longer wait and lower returns on investment is failure to complete effective cultural due diligence before the deal is consummated. So, departing from past practices, the smartest buyers are taking the extra effort to assess the human factors that correlate with success.

First, they plan for transactions using an integrated assessment tool that includes not only financial and market factors but also the culture, leadership match and people capabilities of the target company.

Second, they conduct broader cultural due diligence to more effectively determine the likelihood the combination will achieve investor return in the required period.

Our analysis of many deals that have failed shows there is insufficient focus on the full set of factors that determine successful integration. Almost without exception, financial factors, acquiring market share or critical accounts or acquiring technology were the determining factors in these transactions.

In our experience, acquirers can mitigate risk and significantly affect the likely return on the deal by using a more integrated assessment approach. One way of identifying the "right" target profile is to define the most important values that are essential for strategy realization and then assess potential targets on these dimensions.

A target profile for leadership can be created on such dimensions as communications style (for example, open versus closed), decision-making speed, level of bureaucracy, accessibility, centralized versus decentralized decisions, reward and recognition style and policies, growth and development philosophy, technology approach, flexibility and adaptability, innovation and learning. These are not comprehensive, but they are the dimensions we have used effectively to differentiate management teams.

For example, during his transformation of **Monsanto Co.** from a chemical manufacturer to a life sciences corporation, then-CEO Robert Shapiro initiated a process that targeted companies compatible with Monsanto's own emerging culture. Shapiro was committed to developing an organization with minimal bureaucracy, strong values, collective decision-making and open communication, and he rightly believed that searching for these qualities would bring forward acquisitions that would fit the Monsanto model with minimal integration risk.

What, then, is cultural due diligence? It is the systematic assessment of the human factors — including organizational dynamics, values and leadership and communications styles — before completing a strategic transaction.

The first step, strategic profiling, sets the stage for action in the due-diligence phase. When deals are in play, there is little time to make these decisions. With a profile in place, as Monsanto had, an acquirer is ready to gather as much critical data as available in due diligence.

Preconceptions to the contrary, it is remarkably easy to gather this valuable information. One of our clients makes the majority of its purchases in auctions, and it is difficult to require companies in the auction to play ball. Even in these circumstances, however, much can be learned quickly through secondary information scans.

One such check for a large manufacturing client identified enough information for it to walk away from the deal. In that situation, we discovered the potential target company operated with very different values and practices than the acquiring company.

Information from public sources — such as executive speeches, National Labor Relations Board elections and lawsuits — can tell a lot about what is important.

Information from third-party entities such as suppliers, customers or regulatory groups can fill in another segment. Another possibility is prior relationships with alliance partners, joint ventures and other affiliations. These sources will usually have a keen insight into the style, policies and practices and culture of the organization.

In friendly deals, of course, much more is accessible. Employee and customer survey data often has a wealth of information on brand loyalty, commitment and strengths and weaknesses. This should provide a good window into a company's strategic assumptions and the critical factors in its business results.

Supplier or partner information is also very telling about the approach to supply-chain management. Other information about regulatory and environmental issues can also be matched against the desired profile.

If it is possible to gain access to the potential acquisition, interviews or focus groups conducted by an unbiased third party are extremely informative. They can provide a profusion of information about the way the organization really works and where any warts are.

CIT Group Inc.'s commercial services group has acquired several competitors over the past five years. Its scorecard provided the focus for integrating the new acquisitions by providing clear guidelines for the values that CIT espoused; the critical operations metrics that defined how speed and other delivery characteristics enable them to win in the marketplace; and customer metrics that defined the critical characteristics the employees must strive to meet to increase client retention.

Smart acquirers have found they can do much to improve the odds that their deals will succeed and to reduce the barriers to successful post-merger integration. Cultural due diligence, beginning with strong target profiles and information gathering, is the way.

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