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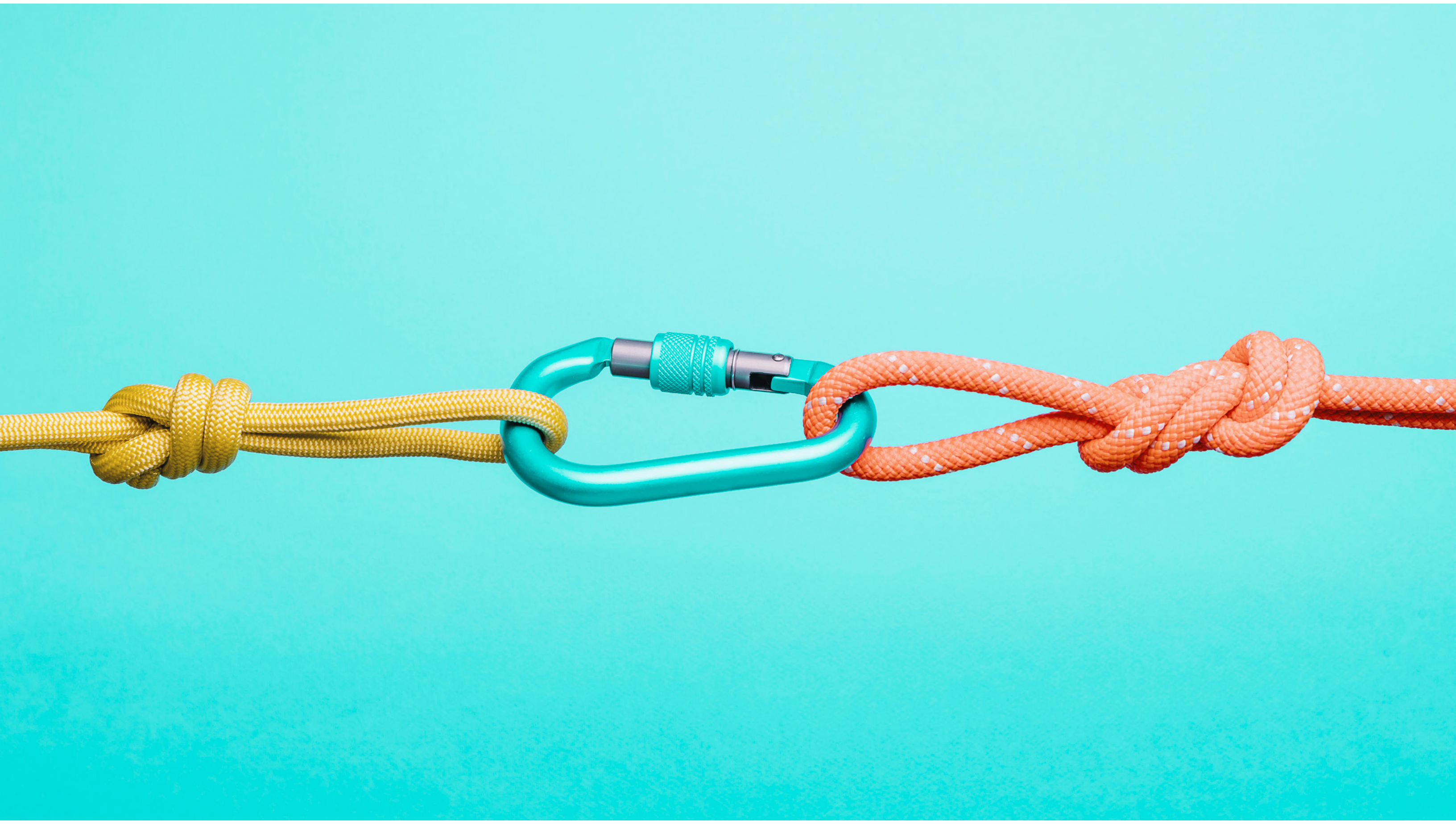
# In conversation: Culture in M&A

Why assessing the cultural fit cannot be an afterthought in deal making.





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**Sean Brown:** From McKinsey Strategy and Corporate Finance Practice, I'm Sean Brown and welcome to *Inside the Strategy Room*. There are many aspects of M&A that are on the agenda, many of them familiar to a lot of our listeners. One that doesn't always get connected to M&S is the role that culture can play in successful M&A value creation. Joining us today is Becky Kaetzler, a partner in our Frankfurt office, and a leader in our M&A practice. Becky, welcome.

**Becky Kaetzler:** Thank you.

**Sean Brown:** Well let's start with what might sound like a rather obvious question: Why should we care about culture in M&A?

**Becky Kaetzler:** There are many reasons why we should care about culture in M&A. I think if you look back 15 years or so, people weren't very aware of culture and its role in M&A. But if you look at the deal history, it's littered with examples of deals that either went poorly or well, primarily because of culture. We have data that shows that your likelihood of meeting cost and revenue synergy targets is substantially higher if you effectively manage culture and your integrations.

**Sean Brown:** So, so one question that comes up is, is culture more important in a programmatic M&A approach? Or a big-deal approach? Or both? And when you talk about culture, and M&A, is it the culture of the acquiring company, or the company being acquired, or both?

**Becky Kaetzler:** I believe culture is important in all deal types, particularly when you bring two large groups of people together, that potential cultural friction will be much more visible. But what I would say is to do culture right, you need to understand the culture of both companies. So it's not just saying, oh, is the target company compatible? You need to understand it in a little more nuanced way. You need to understand first about the target company, what are their ways of working? How do they get work done? What is it that makes them successful? What is their secret sauce that makes them actually able to perform well in the industry? And then the same thing for the acquired company: if you don't have like-to-like comparison, then you'll find that one-sided data is not so useful. But based on that, you can then say what are the elements that we really want to protect and nurture? From either the acquired company or from the target company. You need to think about what is our deal rationale? And what are the cultural elements that are most going to support us achieving our deal rationale? So if you don't care anything about, let's say, costs/synergy capture, then maybe trying to work on your operational discipline is not going to be as important as your customer focus when you're in a revenue-focused deal.

**Sean Brown:** Sure. And have you ever seen a situation where opposites attract?

**Becky Kaetzler:** So very often we see companies come together that are quite complementary in their culture. This can be a good thing or a bad thing. It really depends how you manage it. So when you have one company that has a lot of, let's go back to the operational discipline point, that has a lot of operational discipline, and another company that wants it, that can be a great union, you can really bring them together and make a stronger company. But if you don't do it right, you could find that the company coming in that doesn't have the discipline gets quite frustrated with one that does, and vice versa. So you need to be very sensitive about how you bring those two elements together that are complementary, but different.

**Sean Brown:** So are there any specific tips and tricks that you can offer for the example that you just shared, which is a company that is running a tight ship operationally, and one that's maybe focused more on growth or revenues? And, and how they were able to come together? [it] Were there metrics? Like what were some of the objective ways that the two merging organizations were able to identify these differences?

**Becky Kaetzler:** Well how they identified it, we did do a bit of an assessment to identify it. But they realized after they saw the results of the assessment that they'd be sitting in their integration planning meeting, and one of the companies would be measuring everything, literally, what percent of data have you delivered to us? Where are you in your process? Is it a red light or green light or a yellow light? And the other company who didn't work that way got incredibly frustrated and insulted that they were being asked and measured and given red traffic lights in this way. So it was actually quite a difficult dynamic. Now in this situation, they did want to maintain the innovation of that target company. They wanted to grow, based on that. But they had high synergy targets.

**Sean Brown:** And so the, the acquiring company was the one that was uber efficient and really focused on …

**Becky Kaetzler:** Yes, so they agreed on a set of metrics, and a process that was a little bit more palatable to both sides. And they also just put these issues on the table. So addressing these things directly helped the teams work better together, but relaxing some of the measurements and the red and green traffic lights helped quite a lot as well.

**Sean Brown:** And was this a merger of "equals"? Or was this more of a large company buying small? And the reason I'm asking is, are there any differences that you see in terms of the way culture plays out when it's sort of a merger of equals versus a barge, big fish, little fish?

**Becky Kaetzler:** So, in this situation, the companies were similarly sized. So this made a lot of those differences much more critical to address because it was going to be felt everywhere in the organization. In the situation where you have a larger company acquiring a smaller company, there are different things you can do. In some situations, when you're buying a smaller company in order to build talent, skills, or capabilities, sometimes you don't want to touch that part of the organization. Maybe it's their R&D organization that's incredibly innovative, and maybe you just want to ring fence that and protect that area and ensure that the interfaces to the rest of the company are very good. But maybe in another part of that company, the support functions, you'll fully integrate them because the culture might not be as important to you there. You, you need to pick the areas that you're really going to protect. Because when it's a big and a small company coming together; otherwise, things can get a little lost.

**Sean Brown:** You mentioned an assessment. What are the typical assessments that one might use to sort of measure the culture of two organizations? To try and figure that out?

**Becky Kaetzler:** So we use our organizational Health Index Framework. We have a lot of data points in it. Sometimes we do a full survey, which is one of the means by which we can use this framework. In merger situations, we also find that a simpler approach—given the timing that we usually have—via interviews and focus groups, in order to get a measurement of the frequency of different ways of working or management practices. The comparison of what do we do more of and what do we do less of is much more important than what are we good at and what are we bad at. Because when you get too good and bad and say our decision making is better than your decision making, it can create a very bad dynamic. But when you say one of us is more top down in our decision making, and one of us is more bottom up in our decision making, we're both successful, but this is a difference. We need to figure out how to address it. So, typically, we do … um we can assess this with interviews, we can use surveys, we can use focus groups.

**Sean Brown:** So if you are a company thinking about embarking on a series of M&A deals, do you ever work with companies to sort of help them self-assess before they embark on a journey like that?

**Becky Kaetzler:** We think that that's the right thing to do. Now, usually, a company doesn't have time, because when they want to embark on an acquisition, they want to embark on an acquisition. But even during the diligence process with some companies, we help them do a quick assessment of their culture, and outside in, understand a little bit more about the target company's culture. So they can already have a picture. It won't be perfect, because you might not have access to the target company but already have a picture of where some of the sources of friction or value might be from a cultural perspective that they can plan around, and understand further during the diligence process.

**Sean Brown:** So if you're a potential acquisition target, let's say you're an, you're running an innovative company, and your exit strategy is to be purchased, do target companies think about what their culture is? And . . .

**Becky Kaetzler:** I haven't.

**Sean Brown:** You haven't seen it?

**Becky Kaetzler:** No, I have not seen that. I think it's a very interesting question.

**Sean Brown:** Because if you're shopping yourself, right, you'd want to be kind of a match.

**Becky Kaetzler:** I mean, I guess you can imagine that some target companies might celebrate their culture. Say, "We have a culture of innovation ...

**Sean Brown:** (Sure)

**Becky Kaetzler:** ... incredibly creative. We have great personal ownership in our employees, great passion for the work we do." But I haven't seen it as an explicit, explicit focus before.

**Sean Brown:** And so, you talked about the value of culture in, in value creation for the acquirer. Do you have any actual hard metrics in terms of the impact that that can have?

**Becky Kaetzler:** So we do have data that shows that the health of the acquiring company makes them, um, likely to have a positive TRS [total return to shareholders], two years post close on the deal. Whereas on average, or if you're unhealthy as an acquirer, we'll tend to have a negative total return to shareholders. So that data is based on our organizational Health Index data that we have on acquiring companies. Um. And then looking two years later at the ...

**Sean Brown:** GRS [global registered share]

**Becky Kaetzler:** GRS

**Sean Brown:** And any industries for which this is more important than others, perhaps a human capital intensive? Are there any?

**Becky Kaetzler:** I mean, we do find that companies that are acquiring another company where the people, the talent, the capabilities are large driver of the value proposition of the deal, tend to put more focus on understanding the culture of the company, understanding the employee value proposition of the company, so that they can figure out how to retain those employees and also signal that they care and that they are actually willing to work on their culture to integrate those people into their company, versus just assimilate them.

**Sean Brown:** So do you, do you recommend almost a cultural diligence as part of the, you know, the, the deal process?

**Becky Kaetzler:** Yeah, I mean, if you'd asked me five years ago, or 10 years ago, we weren't doing much of this. We were doing culture support during an integration, but not so much during diligence phase. The last couple of years, a lot of our clients are coming to us and asking for support in understanding the culture of potential target companies, sometimes before they even embark on a diligence. Sometimes during a diligence. It'll never be as granular as the diagnostic you can do once you have full access to the company. But you can build a bit of a picture based on advanced analytics, publicly available data, LinkedIn, Glassdoor, those types of sources.

**Sean Brown:** So when an acquirer looks at the culture or their initial assessment of the culture of a potential target, are they looking at it with the same kind of lens as you might look at underutilized assets, for example? Like, is there a metric to say, there's huge value creation opportunity here because of culture?

**Becky Kaetzler:** We believe that companies should use the same rigor when they think about culture as they do about the financials, when they're planning a deal and doing the integration. We don't yet see that companies are doing this to that level.

**Sean Brown:** So when you meet a new client that's thinking about embarking on an M&A program, if they, um, sort of see the light, in terms of the importance of doing cultural diligence, what are some of the first steps that you take with them to get them comfortable with the process?

**Becky Kaetzler:** So the very first step is for them to take the deal rationale—what they're trying to achieve with the deal, and then figure out what are the cultural elements that they think are going to be most important to reaching that deal rationale. So it could be we're gonna be all about cost efficiencies. We need extreme financial management, operational discipline. But it could also be, you know what, this acquisition is all about innovation. We are acquiring a company that has heavy duty, but totally different, innovation processes, ways of working around innovation, and we need to think about how we would bring a company like this into our company without destroying it, but also potentially even using it to spark better innovation in our broader or R&D organization. And so those are the types of questions we try and set out first to prioritize what are we really looking at? Again, if it's about talent, making sure we're really focusing on talent and the employee value proposition for talent, while we're doing the diligence. When you start having interactions with the target company, you can pick up a lot of understanding of a culture of the company, based on quite short discussions. Do they always refer to needing to talk to their boss before they can come back to you with information? Or are they empowered to make decisions themselves? You know, are they mentioning customers more often than any other stakeholder? Are they mentioning shareholders more often than stakeholders? Or are they mentioning employees and care for employees as their key stakeholder? What are the topics that they worry about the most? Are they asking about what the processes by which the diligence will be run? Or are they focused on the opportunity? Those are all the types of things that you can pick up in a diligence. It'll never be as rigorous as having full access to the organization, but it can give you cues as to what might be going on from a cultural perspective.

**Sean Brown:** Thanks, Becky. One of the other things that we as a firm have talked a bit about is the importance of having an M&A blueprint, basically a rationale for whatever M&A program that you might implement. What's the role of culture in the M&A blueprint?

**Becky Kaetzler:** Culture should be as much a part of the M&A blueprint as the financials, the operating model, anything else you're going after, and thinking about what you're trying to achieve with your M&A, and thinking through what kind of company you want to acquire and how you would integrate it.

**Sean Brown:** Great. Any final thoughts you'd like to share, Becky, before, before we close out the session?

**Becky Kaetzler:** The one thought I have for people to leave them with is they should really start early in assessing culture. Do it in the diligence. Do it at the very start of integration planning. Don't wait till after close. Don't wait till late in planning, because you lose your opportunity if you don't start soon in understanding the culture and setting your cultural priorities.

**Sean Brown:** Becky, thanks again for taking the time with us.

**Becky Kaetzler:** Thanks, Sean.

**Sean Brown:** Thank you also to our listeners for joining us. And if you'd like to learn more about the role of culture in M&A, we encourage you to go to McKinsey.com and to search for articles by Rebecca Kaetzler. If you'd like to receive, receive updates featuring our latest insights on strategy, corporate finance, and M&A, you can also sign up for email updates on our website, and also at the bottom of every one of our articles. We encourage you to follow us on Twitter @McKStrategy and to connect with us on LinkedIn via the McKinsey Strategy and Corporate Finance Practice page. Finally, if you'd like to read Becky's latest articles, you can also find her on LinkedIn via her profile on the McKinsey.com website. Thanks again for listening. We look forward to having you join us again soon *Inside the Strategy Room.*

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