The Effect of Cultural Fit in Mergers and Acquisitions

by David F. Brauer and David B. Brauer

Most mergers and acquisitions (M&A) fail to meet their objectives, often due to cultural incompatibility, or differing organizational values and operational styles. This article examines the critical role of cultural compatibility and the use of quantitative cultural assessments in M&A transactions.



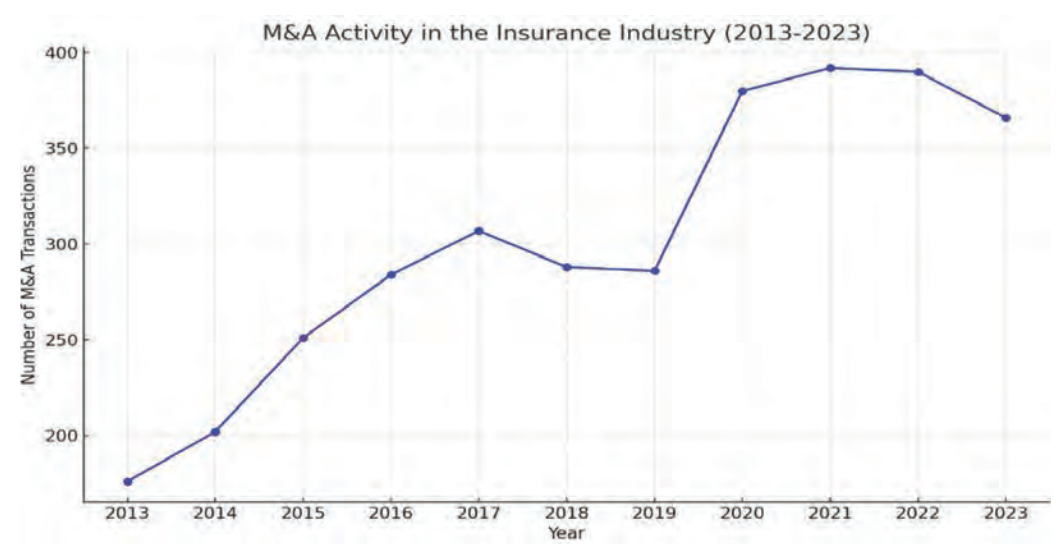
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Over the past decade, the 2,000 largest organizations across the globe spent over $8 trillion to merge with or acquire other organizations—even though up to 90 percent of mergers and acquisitions (M&A) fail.[1]

The insurance industry was among those that experienced a mostly upward trend in M&A activity during that time. (For more information, see "M&A Activity in the Insurance Industry.")

expertise, and key employees. But such deals don't always play out the way investors intend.

Cultural incompatibility is one of the top five reasons that M&A deals fail. When two organizations with different cultures, values, and styles of operation come together, they may experience conflict and lack of cooperation, decreasing the likelihood that they will achieve the goals of the deal.



Source: Refinitiv Workspace, "M&A in the Insurance Industry in the United States of America, from 2013–Present," May 9, 2024.

Despite the slight decrease in 2023, buyers remain interested in acquiring better firms. For example, Foundation Risk Partners, one of the top 20 largest independent agency brokers in the United States, acquired many organizations in 2023 and plans to continue to do so. In addition, Inszone Insurance plans to complete 60 to 70 acquisitions by the end of 2024, surpassing its 2023 rate.[2]

Deloitte also projected an upswing in future M&A activity, asserting this in its 2024 insurance outlook report:

> Many private equity investors will be undeterred by higher premiums and will continue to pursue a strategy of aggregating smaller brokerages. Additionally, although pricing pressures may continue, expect the market to stay competitive as private equity goes head-to-head with corporate buyers looking to grow through M&A in the middle market.[3]

Cultural Differences: An Unwelcome Plot Twist

The purpose of an M&A deal is to grow an existing business by acquiring markets, customers, specific product knowledge and

In a recent survey of Fortune 500 chief financial officers, nearly 50 percent attributed the failure of M&A deals to "post-deal people problems,"[4] specifically noting cultural differences as a significant challenge. Without a firm grasp of both organizations' cultures, organizational leaders are unable to create effective integration programs.

For example, consider the $36 billion Daimler–Chrysler merger in May 1998.

As the saying goes, the organizations were from two different worlds. One was a German-based operation with a very strong hierarchical chain of command, while the other was based in the American Midwest and used an informal entrepreneurial management style.

The result: an internal cultural war that resulted in deadlocked operations and integration as well as the inability to retain top talent. So, in 2007, Daimler paid Cerberus Capital Management to take Chrysler.

A similar tale can be told about the Time Warner–AOL merger in 2000. But that time, the costs were even bigger. The reason behind the failure? Again, cultural incompatibility.

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Cultural Assessments

How could such large, successful companies overlook cultural integration? Because most M&A deals do not involve quantitative cultural assessment studies.

Such studies evaluate an organization's culture—its heartbeat. They analyze the organization's beliefs and attitudes and, ultimately, should reveal the organization's expectations, philosophies, mission, and values.

Quantitative cultural assessment studies can help management determine ways to minimize the aspects of an organization that are not optimal and maximize those that are.

Over 80 percent of Fortune 500 companies use preemployment assessment tests as part of their hiring process.[5] Of these, 51 percent use the test to evaluate cultural fit.

However, the use of such tests has not yet caught on for M&A transactions. Says David Working, director of investments and partnerships for Zachary Scott: "Culture is rarely assessed or measured in the due diligence process in the same manner as financial or other critical and more easily quantifiable characteristics."[6]

Yet, assessing organizational culture prior to an M&A deal can help leadership teams effectively manage integrations. In fact, in "The Importance of Cultural Integration in M&A: The Path to Success," Ignacio Fantaguzzi and Christopher Handscomb note that "companies that manage culture effectively in their integration planning are around 50 percent more likely to meet or exceed their synergy targets—across both cost and revenue synergies."[7]

However, while cultural assessments can help improve cultural integration in M&A transactions, they aren't perfect. Most corporate cultural assessment tests consist of qualitative information. Few include quantitative data—and even fewer use a mixed method.

Many cultural assessments are similar to preemployment assessment tests. However, to be as meaningful as them, cultural assessments need to become more quantifiable and insightful, as well as able to integrate detailed action steps.

Cultural Attributes

Organizations often identify or define culture differently than employees. To address this, researchers from the Massachusetts Institute of Technology conducted a study in which they identified and defined the cultural attributes that matter most to organizations.[8]

These values are known as the Big Nine Cultural Values, or the Big Nine:

1. Performance—The company rewards high performers and effectively manages underperforming employees.
2. Execution—Employees can act independently, have access to necessary resources, adhere to protocol, and are held accountable for results.
3. Respect—All employees treat others with consideration, courtesy, and dignity.
4. Integrity—All employees act in an honest and ethical manner.
5. Innovation—The organization prioritizes continual development of products, services, technologies, and the workplace.
6. Customer—The organization listens to customers and prioritizes their needs, treating them as the center of all activities.
7. Agility—The organization responds quickly and effectively to changes in the marketplace and can seize new opportunities.
8. Collaboration—The established teams and all parts of the organization work well together. There is not a silo mentality.
9. Diversity—No one in the workplace is disadvantaged for any reason. The most qualified people are recognized by skill levels.

These cultural attributes make up an organization's common language for its culture.

Now let's discuss the three necessary parts of a cultural assessment.

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Part I: Quantified Measurements

Information without analytics is just information, and data without analytics is just data. Therefore, organizations must establish a baseline for quantifying the Big Nine in their cultural assessments for these assessments to be truly helpful.

Consider these results from a quantitative sample survey of two insurance brokers using the Big Nine:

M&A Cultural Comparison

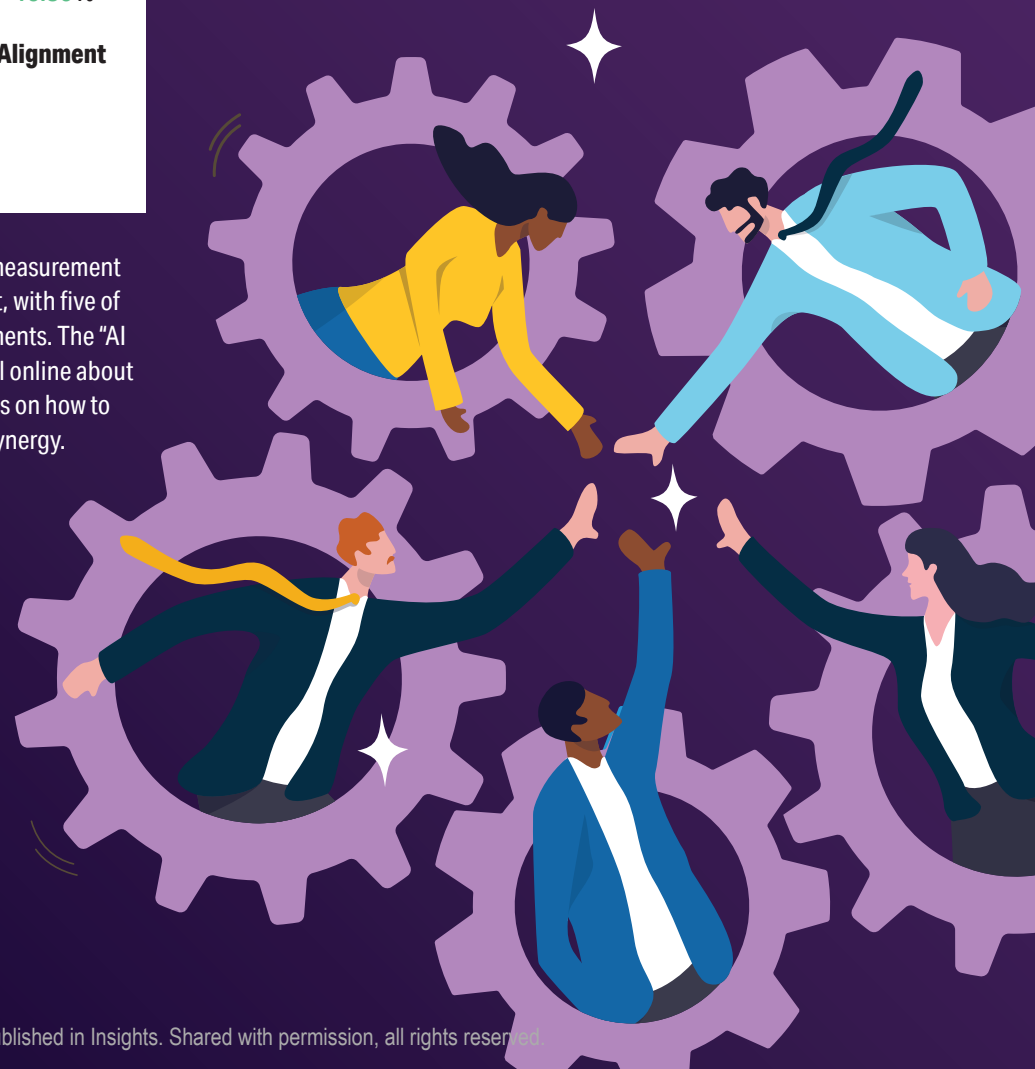
		Company A	Company B
1.	**Performance**	18.933%	19.13%
2.	Execution	15.751%	14.87%
3.	Respect	13.54%	9.76%
4.	Intergrity	10.582%	11.24%
5.	Innovation	9.801%	10.26%
6.	Customer	9.481%	4.21%
7.	Agility	9.13%	5.67%
8.	Collaboration	8.303%	9.0%
9.	Diversity	4.479%	15.86%

Cultural Fit Match Score 86.608% Alignment

AI Insights

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The cultural alignment ("match score") measurement for the two organizations is 86.6 percent, with five of the nine values having similar measurements. The "AI Insights" function provides further detail online about each of the values, as well as suggestions on how to integrate them to achieve the greatest synergy.



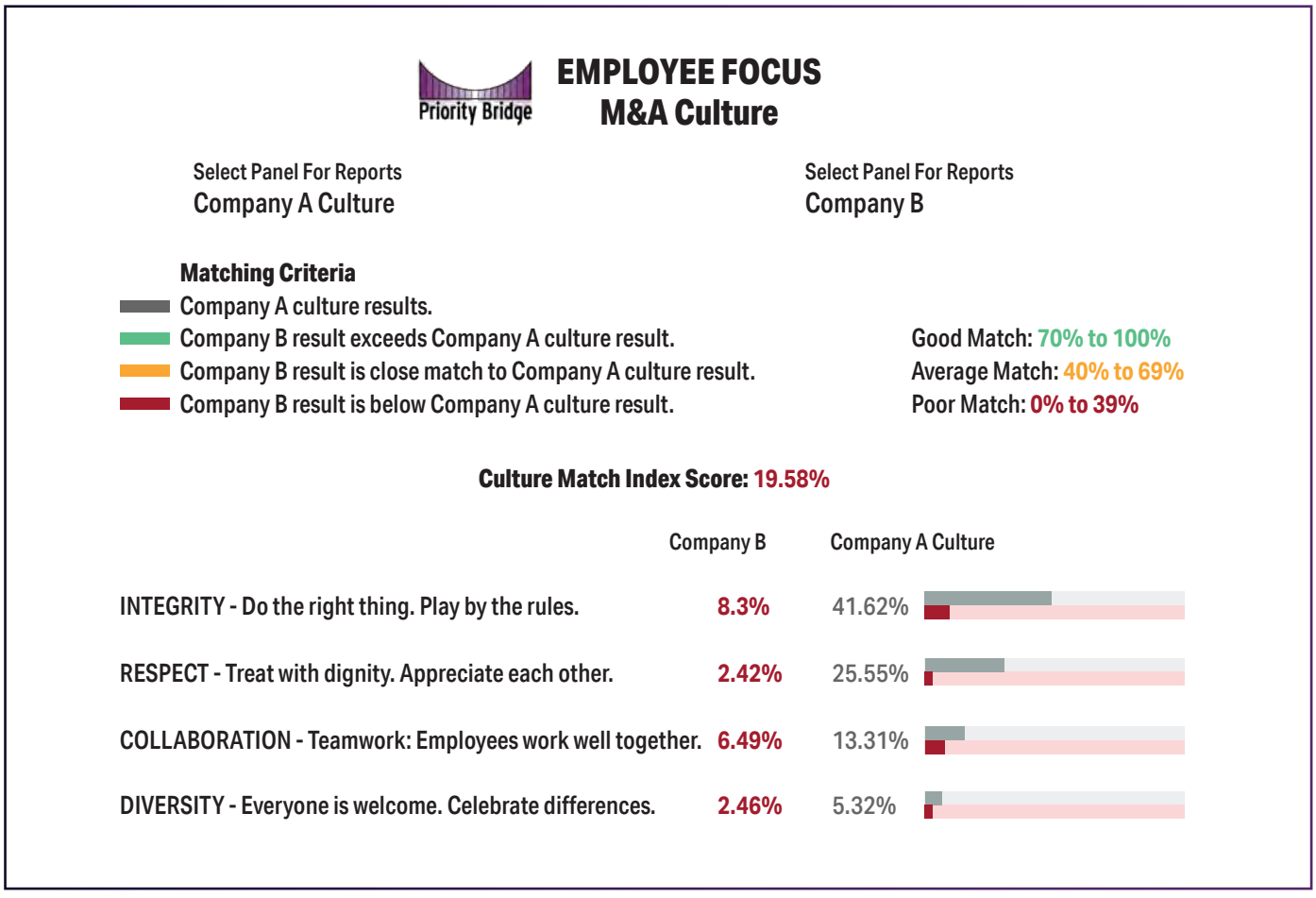
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Part II: Diagnosis

The comparison of Company A and Company B identifies common strengths and possible causes of friction between the two organizations. In recognizing areas of alignment and misalignment, it is important not to classify any data points as positive or negative. Organizations with different cultural values are equally able to succeed—as long as they're amenable to engaging in a cultural integration program.

Data from a cultural assessment can be displayed using various methods. The diagnostic tool below, for example, shows two insurance brokerage organizations with differing cultural values, particularly in relation to integrity, respect, and collaboration.

The overall cultural match is less than 20 percent. While such a result does not necessarily indicate that the M&A is not viable, it does suggest that management will have to expend a great deal of effort to align the two organizations.



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Part III: Actionable Steps

Organizations involved in M&A deals cannot design a new culture until they understand their current one. This involves determining what leaders from both organizations want to achieve and initiatives needed to steer the blended organization toward these goals.

Next, the leaders should ensure that messaging is communicated clearly and disseminated widely. These actionable steps should promote and encourage employees to work to achieve the merger's goals.

Cultural compatibility between organizations involved in M&A deals is critical to the combined organization's success. Organizations that are culturally aligned can experience many benefits, including:

- Higher probability of meeting goals
- Fewer integration issues
- Greater retention of key customers and employees
- Better decision making
- Higher selling price for the organization being acquired
- Assurance that the M&A deal is worthwhile ■



1. Ignacio Fantaguzzi and Christopher Handscomb, "The Importance of Cultural Integration in M&A: The Path to Success," McKinsey & Company, February 1, 2024.
2. Catherine Oak and Bill Schoeffler, "Industry Trends to Exploit for 2024," *Insurance Journal*, December 4, 2023.
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4. Ellen Steinlein, "The Power of Listening Well for Successful Mergers," Fierce, Inc.
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6. David Working, "Assessing Cultural Fit in Acquisitions," *Insight*, 2020.
7. Ignacio Fantaguzzi and Christopher Handscomb, "The Importance of Cultural Integration in M&A: The Path to Success."
8. Donald Sull, Charles Sull, and Andrew Chamberlain, "Measuring Culture in Leading Companies," *MIT Sloan Management Review*, June 24, 2019.

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