Due diligence

Part II

Philip Atkinson and Dara Clarke conclude their analysis of due diligence and how strategies of soft due diligence can leverage the rewards of mergers and acquisitions and business expansion.

Companies with strong cultures are attractive

If a culture is dependent on certain personality types, there is little to leave in terms of a powerful legacy. The trend now and in the future is that few acquisitions will be made of businesses whose leaders are the sole or

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even the major influence on the firm. For a company to achieve consistent high performance levels requires a strong positive customer focused culture which will survive most catastrophes associated with people moving on up or being moved on out!

It would appear that if a company does want to create a larger strategic presence, then they might be courting several partners at the same time. The company with the strong performance driven culture will increasingly become the option that poses least risk. We know that companies purchase other businesses purely for their 'order book' but, increasingly, more than the strict value of harvesting key assets are driving acquisitions. Mergers are being driven by synergies and options to create significant impact in world markets.

The world is getting smaller and the competition for the best businesses is underway. The market is full of investors looking for a good deal. Companies are awash with cash and want to invest it wisely. To do so in the absence of 'soft due diligence' is a crime.

You are quick or you are dead

It is true that you are either quick or you are dead in many markets. While it is easy to make the wrong decision, the more that companies commit to understanding their adversaries and their partners, the more accurate intelligence will be on the relative performance of potential deals. We cannot afford to take risks in acquisition, and conversely, we have to take risks because some opportunities will never rise again.

Key issues that relate to soft due diligence

Balance sheets are a fine historical measure of value – but true value lies in what the culture can become if it's built and shaped into a new entity.

- Do we really appreciate the value of the business beyond the tangible bricks, mortar, investments, assets etc?

- What opportunities are there to install best practice in technology, CRM marketing, product portfolio, distribution, routes to market, logistics, HRD?
- What opportunities, currently not pursued, could reap returns for the new business entity?
- What opportunities could never materialise without some form of joint venture?
- How would you value the talents and the value of the managerial group?
- How sure are you that the right chemistry will exist in the management group driving the new entity?
- What value do you put on the company's core competence, and the competencies of the best management team?
- Can you value 'talent' and grow the business?
- How do you measure 'human capital' in the current business – the potential acquiree, and the new entity, which will evolve from coming together?
- Can you ensure that the output from your investigations into due diligence are the key drivers for post acquisition integration?

Developing a cultural audit for mergers and acquisitions, JV's and business expansion

Soft due diligence is about finding out what makes the engine of the business tick, and how we can best leverage our skills to make the two or more businesses who are close to forming a partnership, acquisition or joint venture get the most from the alliance.

Forget any ideas of merging cultures. Merging or integrating cultures ends up in confusion and ambiguity. The resulting averaging process would create a cocktail of cultures, which would confuse all parties.

As it is required to consider strongly the dominant aspects of each corporate culture, it is worthy to note that most cultures have evolved more by accident than design. We do find that many organisations have been shaped by times of intense control in creating a specific culture to deal with a crisis or an opportunity, and periods of more or less slack or non-existent influence when the organisation has drifted.

Every CEO and senior person influences the culture, and not always in a good way. What you can be sure of when you look at a culture and assess its relative strengths and limitations, is that you need a rigorous and robust approach.

Robust and rigorous model

A variety of tools including interviewing, focus groups, and questionnaires to assess the relative health of merging the businesses are applied. These should be designed around a unique approach and a robust model for change.

The design of the initial diagnosis is important. Consider working in a cross border deal. As well as studying ownership, control and organisational culture, the context of the cross-border partnership and the transactions and markets, that will be focused upon are critical in supporting a correct diagnosis.

Cross border deals

Consider an example of working in Europe with a German and a Swedish business. The National cultures have

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similarities and major differences – of which these consequences have to be analysed, especially when the key markets for growth because of the acquisition (for illustration) will be in Southern and Eastern Europe. You will note, there is no more complexity here than in most businesses. Is this an impossible merger? No, it will just require analysis that is more detailed and rigorous integration plans.

Another comparison is a British IT solutions provider with strong ambitions

It is important to work extensively to understand the political and economic context in which the deal has to be finalised

to form joint ventures in Germany and Austria to fill a strong market demand will have to assess their relative chances of success. Because they undertook soft due diligence of several businesses they now understand that they have to create a strong permanent presence in Germany before they can form any alliances. Being aware of the Germanic culture, that company will site an office in the heart of the major city that services their key market – in this case Stuttgart.

Consider several businesses in an African state of such as Nigeria. One would have to take account of the National culture, its religious and political heritage. It would also be wise to consider political conflicts that have arisen between the three key tribal groups and contemplate also how

this will affect your business if you are going to trade in specific geographies. For instance, in some regions the dominant tribal grouping may exert more influence in some territories than others, and this could impact on human resource, supply and logistics issues.

We can see how one model may be suited for Sweden but would clearly be inappropriate for work in Africa. It is important to work extensively to understand the political and economic context in which the deal has to be finalised in order to avoid the potential of business failure.

Partnering with dealmakers

It is clear that one approach does not fit all, and the approach to cross border work is unique and tailored with precision. This is because those undertaking the research have to work very closely with the partners of the businesses and confront potential problems early on. Only by doing this, can we develop strategies to resolve key issues for immediate action.

What is important is that there should be no surprises along the tortuous route of business expansion due to merger or just organic growth.

Corporate culture

In some cases, nationality can have a profound effect on post acquisition integration because it may favour one particular style of management akin to the relative culture of a country or a region, but it is also important to consider corporate culture in different functions, territories and specific facilities.

Nobody has time to run around businesses handing out questionnaires, then assessing, and ranking these by site and function. Soft due diligence is not a corporate climate survey to assess the relative state of teamwork, communication and the role of training – rather it is strategic, not tactical, and focuses on how to resolve issues that will arise when the businesses come together to form the new larger business entity.

Speed and confidence in the approach

Speed is of the essence, and rapid improvement and implementation has to be the key strength. When one understands the process of change in this context, one can anticipate problems and address them before they become a major barrier to integration.

Of course, one has to realise the considerations of the strong Investor groups and institutions as well as the behaviour, both actual and predicted, of the existing and the new management team.

'Sensitive' and 'incisive' are two words, which come to mind in this study. The study is a quick and reliable series of storyboards and scenarios that capture the spirit, the opportunities, and the scope for growth are identified and presented..

Ultimately, the data generated from Soft Due diligence, and the decisions that flow from these studies are the direct input for post acquisition strategies for speedy integration.

The role of leadership and culture in post acquisition integration

The phrase 'without Leadership there is no change' is a dominant theme in any post acquisition strategy. Fundamentally, you need a plan to deliver results. The simplest way to do this is to agree specific deliverables within the period of 5, 10, 20, 40, 60-250 days after formation of the new business or formal takeover or merger. Simply charting the whole process helps people to understand that there is a plan for the way the management team want the business to evolve. A stronger, firmer view and plan is going to be very powerful in shaping the new entity. In reality, there is often no formal plan and

It is important to design the culture the way you want it to evolve

many joint ventures, acquisitions etc, limp along rudderless. It is obvious these will never achieve the synergies for which the acquisition or new business deal was envisioned.

The big danger is believing that two or more cultures can be simply integrated. Doing so creates a cocktail of cultures where confusion and ambiguity reign. What is important is designing the culture and the post acquisition or expansion plan for the new business entity specifically to meet its strategic imperatives. Relying on a 'jigsaw' approach, with bits and pieces from here and there, is not coherent and does not work. Then, neither does flying by the 'seat of the pants' while hoping things will gel naturally.

Dangers – over promising and under delivering

Any business expansion – either joint venture or merger, is going to create winners and losers. There is a good bet that not everyone will be happy with the new relationships and direction. Some who are disgruntled will not air their dissent but still can be creating mischief and mayhem around the business. This has to be acted upon immediately. It cannot be allowed to gain ground. New standards and behaviours are critical and require to be reinforced and modelled with managers behaving as leaders.

This requires some forceful direction and leadership. Here, leaders have to be careful not to 'over' promise or give guarantees. There are no guarantees in this M&A business. Although some may think this approach inhumane, the manager cannot just deliver platitudes to staff to make them feel comfortable. No one can guarantee that things will not change. Leaders cannot guarantee job security. Neither can they state with no confidence that there will be no change.

To be realistic, managers may not have control of all variables and would be foolish to pretend otherwise. They may have signed a 'confidentiality agreement' or simply not been included in the decision making process and do not have a response. In the inability to answer to a question, it's better be honest. The truth is, "We don't know as yet but we are working on it." It is much better being truthful than fabricating an answer making guestimates or constructing untested scenarios!

Too many managers 'make promises as they go along,' because they feel it is better to give some direction than appear not to be in charge. We need to forget our own managerial vanity and adhere to a discipline.

It must be remembered that these situations can change radically overnight. New information and stakeholders come on the scene – unexpected responses evolve from Government, State Institutions and Regulatory bodies. Competitors complain, or anti 'business expansion' can appear as a major media threat to the deal finally going ahead. One can plan, but the plan must always be flexible, and have the degree of spontaneity to work outside the defined box.

If in doubt, when asked a question, ensure that every person in a leadership position either respond with the agreed message or make no comment at all. It is better to respond with, "We are still working through the key issues and will inform you as soon as we have arrived at a strategy and solutions".

It is better to do this than to invent an uncertain response or story that you will have little chance of defending when things settle down. The danger of not doing this is that it destroys the credibility of the managers who are running the new business and does not get the business off to a new start from the key investor's viewpoint

Communication and the grapevine

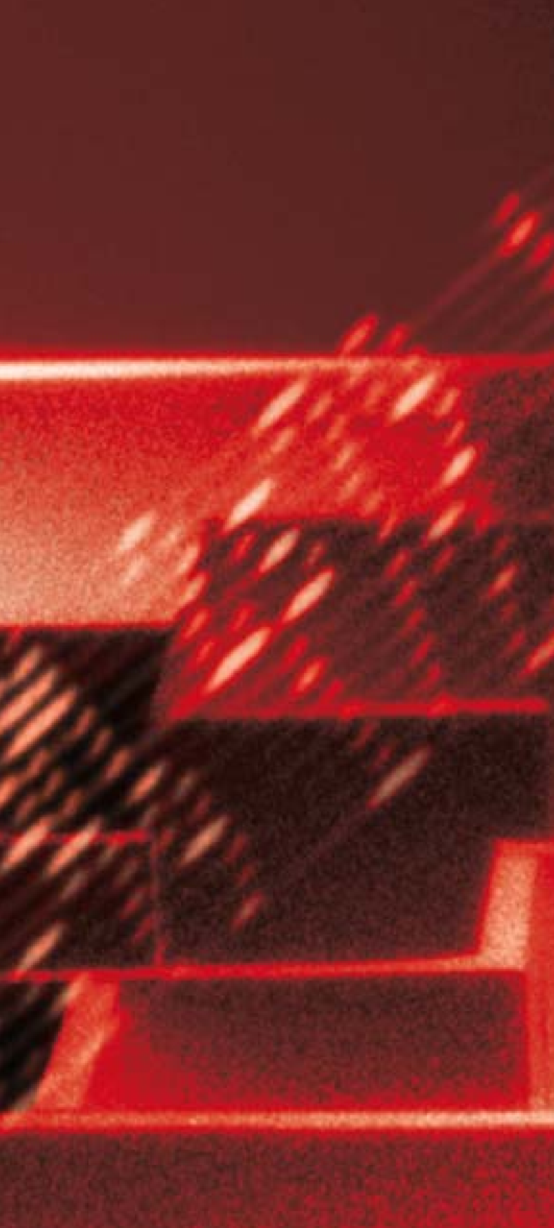
According to Price Pritchett, Guru on M&A integration in the 80s, top executives should take charge of all communication as much as possible. This means controlling both formal and informal communication, and fuelling the unofficial grapevine with positive carefully designed messages.

Know with certainty that the grapevine takes a brand new dimension in terms of shaping dialogue. Pritchett even suggests that unofficial 'grapevine chat and business' can consume as much or 10-20% of the average day for the average employee. Even if this estimate is generous this negative 'grapevine speak' with others, using email and the phone can have tremendous negative impact and consequences on the business especially if the media are tuned into the conflict.

Remember, much of the information conveyed via the 'grapevine' is inaccurate, distorted, destructive or even spiteful, and not usually in the best interests of the new business. We suggest that we create a communications strategy that focuses on the use of a variety of media but concentrating on shaping the direction and content of the 'unofficial grapevine' to deliver new positive messages. The way to achieve this is to control communications, and agree a key and precise role for those in Leadership positions.

Moreover, it should be remembered that anyone with direct reports is a leader. This is the time to apply rigorous and high standards. If people are in leadership positions and not supporting the business in its venture – then replace them with others who will create the optimistic future. Holding on to managers who are not shaping the future for the better is the worst thing any company can do.

Nationality can have a profound effect on post acquisition integration



There will be resistance to change – because people like living within their ‘comfort zones’

Post acquisition is like a fast breaking news story

Whether we like it or not, we will not have all the answers to all the difficult issues. A merger or business expansion reflects the pattern demonstrated in the media when a news story breaks that has special significance. Reporters and experts are commentating on events as they evolve, but often there is ‘no pattern to the story’ and where there are omissions in coverage or ambiguity exists, ‘uninformed opinion, conjecture or pure imagination fills the void’.

We do not want this approach to characterise the rise of any new business. If we do, we waste time and resources replying to ‘conjecture’ and ‘opinion’ rather than striving forward. Too many examples of ill-judged responses are evident in M&A activity. Why do management teams think they need to respond to speculative stories especially of the negative variety? It is best to state confidently, “At the time this is pure speculation and we have no comment.”

Not enough management teams develop a sound public and investor relations theme and see it through. We can see that when one does exist, there is a requirement for the managers to remain disciplined to adhere to the party line.

The key points above are all to do with managing the merger or expansion just after the news has been released – in the short-term.

Short and long term integration

You may be surprised just how badly ‘Post Integration Strategy’ is designed, engineered, implemented and managed in companies. To resolve such issues requires a simple message, control of formal and informal communication when and where appropriate, with a focus and plan on leading us through the early days. In the absence of leadership, there is chaos. We need strong decisive action to demonstrate the ‘business expansion’ has been thought through, and that this is going to be one of the acquisitions or expansions that actually work.

Post acquisition in the long term

Here, long-term can refer literally to just days and weeks. Any business should have considered who is going to be driving the business. Where practical, names need to be in positions in the hierarchy – even if these are only holding positions.

There are key issues

- What strategy do we have for moving forward rapidly with confidence?
- What impact will current expansionary activity have on our product mix, our customers, our markets, the stock market and investors?
- How can we create a structure that clearly articulates and communicates our plans and ambitions in concise and clear fashion?
- What culture will we shape, and what are the core values and behaviours that will take us where we want to go?
- What is the role of leadership in this process?
- How will the post acquisition plan roll out, and how do we communicate this to all our constituencies?
- How can we create a strong performance driven culture that will delight investors, and provide an excellent return on shareholder capital?

Operationalising post acquisition

In reality, things will go wrong. Some key people in the new structure will not live up to expectations and others may be the wrong selection for the demands of the role. Some employees will feel a degree of disappointment. There will be resistance to change – simply because people like living within their ‘comfort zones’. Systems will not always work, technological solutions may create problems in the short-term, there may be a breakdown in the supply chain and some customers and consumers will leave or express disdain for the new operation. This is natural, and not everything can be accounted for in advance.

Investing in prevention

However, it is possible to develop a risk assessment of the most likely scenarios, negative and positive, where problems arise and either put a ‘band aid solution’ in place temporarily, or resolve the issue completely. In reality, the usual remedy is the ‘band aid solution’ because there is so much going on companies will not have the resources to fix every problem. Although people may complain about partial solutions, action has been taken to resolve issues in the short term.

Leadership and post acquisition plan

For any business, you must have plans for 5, 10, 20, 30, 40 days after the business expansion, and these must focus on the bullet points above. People issues will be key. Our people are the most precious resource and will take you nearer to your goals if they are led sensibly with energy and a positive mindset.

The world is getting smaller and the competition for the best businesses is underway

Right from the first step in considering the acquisition or expansion, the businesses must plan for how change is to be implemented. It can only be implemented through people, and their relative degree of motivation towards making the 'business expansion' work is largely governed by the mindset of their managers.

Do the managers inspire their people to work towards building the new business entity? Is the new work culture strongly reinforced and rewarded by the actions of the management group? Can people clearly see the way forward and identify the behaviours that will enable them to achieve the new business? These are all questions that a post acquisition plan will answer.

Cultures' consequences: summary

Methodologies exist and have to be tailored to meet the needs of any business expansion whether it be focused on cross border JV's, mergers and acquisitions, or business expansion into new territories and markets.

In partnership with experts, the companies will have the building blocks and the expertise to build the culture of the new entity. A major error made by designers of such cultures is they think they can integrate two or more cultures into one. If you do this, what you get is a cocktail of cultures, with ambiguity as the main thrust.

It is important to design the culture the way you want it to evolve. Most companies fail to do that – either believing that culture is outside their remit, or that it is a difficult task beyond them and their advisors, when this is not the case.

Corporate culture is a very tangible technology and can be designed and managed with ease. Yes, it may be difficult at first, but you have to confront the issues with a risk assessment and contingency plans. Those who do this can make the synergies happen with ease.

Moreover, rest assured that those who fail to plan for their acquisition or expansion, plan to fail!

80% of mergers, acquisitions and business expansion fails to achieve the synergies for which they were designed, purely because the culture does not exist to create the new future for the partners.

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