

The Impact of Culture on M&A

the view of India's leading investors

A study conducted by:
Venture Intelligence & Culturelytics
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Executive summary

A new study conducted by data analytics company, Culturelytics and India's leading investor research firm, Venture Intelligence sheds new light on the impact of culture on the outcome of mergers and acquisitions and reveals significant demand by investors for effective tools to measure and manage culture. This trend will only accelerate as business leaders prepare for a post-pandemic world.

For the study, a survey and in-depth interviews were conducted with India's leading venture capitalists, private equity investors and investment bankers, along with heads of corporate M&A departments. Their responses and insights have given a new window into the effects of culture on M&A.

Impact of COVID-19 on M&A

Nothing in recent history has changed the business landscape as drastically or as quickly as the COVID-19 pandemic. This poses a real challenge for M&A, where measures of past performance may no longer be a reliable indicator of the future.

Like all other activities in our lives, transactions have slowed dramatically, with trillions of committed capital on hold while management is consumed with weathering the immediate crisis. **But deals will resume.** In fact, the pandemic will likely trigger a wave of new deals. Troubled companies will look for exit strategies. And for investors, declining valuations will present opportunities to execute strategic acquisition agendas and position themselves to exceed industry-average growth when the economy recovers.

In the new environment, acquirers will be undertaking significant additional due diligence to assess the effects of the crisis on the seller's business. There will be a premium on forward-looking information as well as qualitative factors around changes in business practices. Culture – people's beliefs and behaviours – will be fundamental in successfully navigating these changes, including:

- people's attitudes towards the new WFH environment
- shifts in values, often towards more people-centric approaches
- building agile and purpose-led cultures that can respond effectively to change
- leveraging the power of data analytics to understand, engage and manage people

Additionally, these deals are likely to be more cross-border, control-stake transactions. For example, we already see China making big investments in Italy and Japanese companies turning their attention away from China towards India.

As a result, culture has never been more important than now for successful deal-making.

Culture: the new due diligence

While the M&A outlook is optimistic, there is a data point that should not be glossed over: studies show that approximately 75% of M&A globally fail to achieve expected the growth goals of the deal. That is a significant failure rate. Failures can often be tied to unfavourable economic or market forces or a change in the regulatory landscape, which can curtail initial plans for expansion or integration.

However, one aspect for failure or success is often downplayed – culture. In 30% of failed deals, cultural misalignment is cited as the top reason for failure. One of the most difficult challenges is integration of leaders and top performers in the merged entity.

Yet, despite this evidence, 'cultural due diligence' is virtually unknown, and many investors overlook the impact of culture on their acquisition strategies because they lack a clear way to measure it. Despite its 'hard' impact on results, culture has always been seen as something 'soft' and unmanageable. Corporate culture is hard enough to evaluate in our own organization, let alone trying to assess the culture of an entirely different company.

It is culture that determines how an organisation will function. No matter how many financial exercises you engage in during a merger or acquisition, ultimately if the people are not aligned, the new entity will not be able to function smoothly.

Mohandas Pai
Chairman, Manipal Global Education

But M&A due diligence continues to mature. With increasing recognition by investors of the importance of culture, and a new, sharper focus on people accelerated by COVID-19, it is expected that culture will soon be routinely integrated into the due diligence process, with practices evolving to accurately assess a target company's corporate culture today and, more importantly, tomorrow.

Key findings of the study

The study clearly showed investors' view of the importance of people and culture in ensuring successful outcomes for M&A.

- Nearly 67% of investors, when looking at proposed mergers or acquisitions, would prioritise investing in an organisation with an excellent team, as they believe that the right team of people can always make the best of an available strategy and is the key to successful integration of two organisations.
- 95% of investors said they would find it very helpful to conduct 'cultural due diligence' prior to a deal, adding a culture assessment to financial, legal and commercial due diligence. Specifically, they would like to see a tool that measures the likely impact of culture on the financial targets for the merger.
- 72% said that culture plays a significant role in successful integration in all or almost all deals.
- 44% said that culture plays its most significant role in successful integration within the first 100 days following the completion of a merger or acquisition. In other words, culture should be an integral part of the strategy for a merger or acquisition from the outset, not just an afterthought.

The right organizational culture and team morale are essential for any company's success. Quite often these softer issues are overlooked especially in merger situations, leading to failed outcomes.

Amit Dixit
Senior Managing Director, Blackstone

New tool to measure and manage culture

To address this growing need, Culturelytics has created the world's first AI platform designed to define and measure organizational culture and its financial impact.

Combining the power of advanced AI algorithms with the latest behavioural science, Culturelytics allows business leaders, for the first time, to go beyond anecdotes about culture and get the data-driven cultural insights they need to make informed investment decisions and build cultures that drive business success.

In M&A deals, cultural fit is as important as financial calculations. People associated with M&A deals in both organizations should be in a give-and-take mode to make culture work for the merged organization.

Amitabh Chaturvedi
Group CEO, Karvy

Two of Culturelytics' products – **MnAGenome™** and **InGenome™** – are designed specifically to ensure that organizational culture support the realisation of the business and financial goals of a merger or acquisition, both prior to and following a transaction:

- Prior to a merger or acquisition, **MnAGenome** allows the buyer to conduct accurate, data-driven 'cultural due diligence'. It measures how well the target company's culture is aligned to the goals of the combined organization. It also provides investors with a '**Value Adjustment Factor**' which predicts the impact of cultural alignment, or misalignment, on the financial targets for the deal. This allows buyers to sharpen their deal strategy, possibly adjusting price or planning pre-deal interventions to enhance cultural alignment.
- Following a merger or acquisition, **InGenome** provides leaders with the insights they need to ensure that culture supports the goals of the merger. It assesses the progress of integration and uncovers cultural factors affecting post-transaction performance. It also provides leaders with a '**Performance Variance Factor**' measuring the unforeseen impact of cultural misalignment on outcomes. All of this helps companies adjust integration strategies to more effectively reach targets.

These innovative products provide detailed insights into aspects of organizational culture critical for resilience and success in the VUCA environment:

- **Adaptability**: ability of employees and the overall organisation to adapt to change.
- **Values**: whether employees share management's vision for the business, and how to build a purpose-led workforce.
- **Networks**: the real patterns of influence, collaboration and information exchange within the organization, and the champions for change.

Innovating new practices in M&A: the global role of India

From the perspective of Indian investors, India is poised to become a leading investment destination globally in the new environment. It is the world's fifth largest economy by nominal GDP, the third largest by purchasing power parity (PPP), and the sixth largest consumer market with nearly 60% of the GDP driven by domestic private consumption. It is also expected to grow seven percent (2019-2022) outstripping a global rate of 2.8%. It also has a young population, a stable democratic political system, and ranks among the world's leading importing/exporting countries and long-standing members of international trade and investment regimes, including the World Trade Organization.

In addition, Indian business leaders are particularly open to international M&A now, as a way of gaining access to new markets in a time of mounting trade wars and tariff barriers.

As a result, there is an important opportunity for industry leaders in India to pioneer the introduction of innovative practices around people and strategy – including cultural due

diligence – that will increase the success rate of mergers and acquisitions, both in India and globally.

In the wake of the global COVID-19 pandemic, this study provides timely evidence for the vital role of culture in the success or failure of M&A, and the opportunity for Indian investors to lead the way in incorporating culture into due diligence practices and contribute to the global M&A success rate.

For any questions about the study, or to find out more about their work, please contact the research partners via the links below.

The research partners:

- **Culturelytics:** Where culture meets AI. A data analytics company that has created the world's first analytics platform to help leaders measure and manage organizational culture for success.
 - www.culturelytics.ai
 - For product info: www.mnagenome.com

Culture – aligning people with purpose – is the key to resilience, the compass that will allow companies to navigate the crises and opportunities of the post-Covid VUCA world.

Yeshasvini Ramaswamy
Founder, Culturelytics

- **Venture Intelligence:** India's leading provider of information and analysis on private company financials, investment transactions (including private equity, venture capital and M&A) and their valuations.
(www.ventureintelligence.com)

The deal 'ecosystem' has matured significantly in recent years to acknowledge the pivotal role of culture in M&A, from the origin of the deal to successful integration of the parties. But predicting cultural match is still in the realm of art; any tool that brings more science to the process will have a positive impact on all transactions.

Arun Natarajan
Founder, Venture Intelligence