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Is this M&A a match made in heaven?

Culture, lifestyle important factors when choosing a partner

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In the old days, mergers and acquisitions were all about the business of making money, says Rich E. Honen, a partner with Phillips Lytle, LLP.

"Now we have to take a more holistic view of the business, and the people they do business with," he says. "Executives and board members need to ask, 'Is this company going to fit in with the way we like to do business?'"

Honen

In other words, do both companies share the same ethics and values?

Business leaders considering a merger or acquisition are increasingly turning to environmental, social and governance (ESG) criteria, which cover a range of issues that did not used to be part of the analysis, such as climate change, work conditions and diversity in hiring and in board composition. It is becoming clear that a strong ESG profile is expected in the 21st century.

"ESG is equivalent to going to live with someone and seeing if you really approve of their lifestyle," says Honen. And with a growing emphasis on ESG, due diligence is becoming more complex. Says Honen: "There's a 30-page checklist for lawyers and every day that list gets longer and longer."

When you're trying to get a handle on a company's culture, asking questions alone won't tell you all you need to know, says Honen. He encourages business leaders to visit the facilities and talk to employees, customers and other stakeholders.

"Find out what a typical day is like," he adds. "You need to find out if everything they are telling you is correct and if anything is going on that could be a problem."

Performing a thorough investigation of the company culture is time-consuming but imperative, agrees Mark Kovaleski, managing partner at Mengel, Metzger Barr & Co.

"One of the main reasons mergers fail is because of the lack of a cultural fit," he says. "So much time and effort is spent on financial due diligence–making sure the numbers make sense– and less time on cultural due diligence."

More mergers fail than succeed, says Kovaleski. "You have to come into it eyes wide open," he says. "Both sides have to give to make it the best culture for combined firm."

Kovaleski

Some boxes to check, according to Kovaleski: What are the company's policies on diversity, equity and inclusion? What are the ground rules for remote work? What type of benefits does the company offer? Does the company exhibit ethics and integrity? What's the tone at the top? How do executives view and treat their people? Does the company play an active role in the community in terms of outreach and volunteerism? Do the employees enjoy working there? Has the company won any awards?

"This is a process you cannot rush," says Kovaleski. "A company might look good on paper, but it requires repeated meetings to understand the people you are going to go into a partnership with."

To illustrate what happens when two wildly different cultures collide, Kovaleski described a meeting scheduled between executives of two merging companies. The meeting was planned for 7:30; one group arrived at 7:30 a.m., but the other group didn't show. They arrived at 7:30 p.m.

"That's when they thought the meeting was — that's what they were used to," Kovaleski says. The merger ended up falling apart. "It was very rushed into, so they didn't have time to dive down deep enough to make sure it was a good cultural fit," he adds.

Ultimately, says Kovaleski, the question to ask before a merger is: "Are these people you are joining forces with individuals you would want to grab a cup of coffee or beer with?"

Traditionally, due diligence in the environmental arena focused on mediation, like cleaning up after an environmental spill. Now, business leaders are also investigating a company's carbon footprint. Over the last several years, Alex McClean, a partner at Harter Secrest & Emery, has had clients disclose emissions, usually with the goal of reaching carbon neutrality.

"It takes detailed work to generate that information," but it's necessary for the merger to go forward smoothly," says McClean. "If the target hasn't done anything [to track] emission that creates problems. It creates misaligned cultures."

Once two companies' fates have

McClean

become intertwined, one can get dragged down by the other's actions or policies. For example, in an international merger there may be practices that are legal in one country, but viewed with disfavor in the United States, such as using animals to test cosmetics.

"You want to avoid gaining a bad reputation with customers because the other company doesn't comport themselves in socially [acceptable] way," says Honen. Even a company's supplier can fall under scrutiny. For example, if a law firm uses a paper manufacturer that treats its employees unfairly, or has bad environmental policies, this will reflect badly on both companies once a merger goes through, he says.

Enter a merger or acquisition as carefully as you would a marriage, Honen advises.

"Make sure you really know one another," he says. There is the temptation to ignore red flags at the promise of a union. Unfortunately, says Honen, overconfidence can obscure reality. "Maybe the new company thought that what they were doing was just fine," he says. "Maybe the problems, instead of going away, got worse."

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> — MARK KOVALESKI