Consequences of National and Corporate Culture in Mergers and Acquisitions

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1. Introduction

Mergers and acquisitions, hereafter referred to as M&A, are inter-firm transactions in which one company combines with and controls the purchased company in an acquisition, or two companies combine into one singular company in a merger. M&A transactions are landmark events in companies' lives and can enable firms to reach new customers and markets, rapidly expand product offerings, and reduce competition (Renneboog and Vansteenkiste, 2019, p. 650). M&A deals are also quite common; in the US, 91.4% of publicly listed firms engaged in at least one M&A deal in the 1990s and 2000s (Renneboog and Vansteenkiste, 2019, p. 650). According to Figure 1[1], the US industries with the most M&A deals between November 2019 and April 2020 were commercial services, technology services, and finance (Factset 2020). Figure 2 exhibits an upward trend in the number of M&A deals in the US between 2017 and 2019 (WilmerHale 2020), although 2020 may not follow this trend due to the effects of COVID-19 on the US economy.

While managerial ability helps facilitate profitable M&A outcomes, many other factors can affect all aspects of the M&A process, including the selection of the target firm in acquisitions, the integration of the acquired or merged firm, the frequency of acquisitions, and M&A-related compensation. Two factors of interest studied in this paper are national culture and corporate culture. National culture refers to the broader beliefs, behaviors, and values of a country's people in addition to the predominant religious, linguistic, and racial features of the country (Berrell 2012). Corporate culture, meanwhile, encompasses firms' attitudes towards the future, values such as integrity, honesty, and teamwork, business practices, and firms' physical and mental sense of 'place' (Coleman 2013). Through extensive literature on both national culture and corporate culture's effects on M&A outcomes, this paper seeks to explain the ways that M&A are shaped by the cultural environments around them. Although we assume that employees at all levels of a firm contribute to corporate culture through their previous and current workplace experiences and through their cultural heritage, the first part of our paper will focus predominantly on management and CEOs, who we hypothesize have a much greater influence on corporate culture and thus the viability of M&A deals than lower-level employees. The second part of our paper will focus on broader cultural differences between nations and their influence on M&A. We will then employ both analyses to examine historical M&A case studies' successes and failures.

2. Management's Cultural Contributions to M&A Outcomes

Managers are often incited to pursue acquisitions because of inexperience, increased compensation, and arrogance despite the value-destroying consequences of these deals. According to Khorana and Zenner (1998), CEO compensation rises with value-enhancing acquisitions and is unchanged with value-destroying acquisitions, suggesting that CEOs

[1] Figures 1 and 2 are located at the end of the paper.

prioritizing compensation will pursue acquisitions regardless of long-term value loss (Mishra et al., 2020, p. 661). Mishra et al. (2020) find that manager-level compensation also increases with the number of acquisitions (p. 662). Acquiring firms that are inexperienced in M&A and with a corporate culture dominated by unchecked ambition, greed, and empire-building may be much more likely to seek acquisitions without regard for the long-term value-destroying effects of the deal on firm value (Mishra et al., 2020, p. 662). Since successfully completing an additional acquisition deal in a given year boosts managers' total compensation by 10.4% (Mishra et al., 2020, p. 687), the allure of increased compensation may be a critical factor in M&A decision-making. Firms that are experienced in acquisitions, however, are more likely to reject value-destroying opportunities and prioritize firm value over short-term boosts in compensation from acquisitions (Hu et al., 2019, p. 120). Hu et al. (2019) discover that acquiring firms with experience in acquisitions are 3.57% more likely to achieve successful "mega-deals" (p. 120). Acquisition experience and carefulness pay off; the average deal value for experienced acquirers is $1.5 billion larger than that of inexperienced firms (Hu et al., 2019, p. 125). When acquisition deals do end in failure for experienced and inexperienced firms, Hu et al. (2019) find that experienced acquirers recover within three years of the acquisition announcement while inexperienced firms continuously decline in value (p. 139), and these inexperienced acquirers often continue making value-destroying deals rather than recognizing the negative effects of the acquisitions (Renneboog and Vansteenkiste, 2019, p. 659). If firms do not check the ambition of managers and CEOs, management may likely pursue increased compensation and disregard the firm's long-term financial performance.

A corporate culture of pride and 'high risk, high reward' encourages value-destroying M&A deals, especially in firms in which there is a stricter hierarchy and a lack of controls on CEOs' hubris and overconfidence. In their work, Mishra et al. (2020) find that risk propensity is positively correlated with management compensation, thus encouraging increased risk-seeking behavior (p. 685). In addition, CEOs and management may undertake value-destroying M&As to increase their future "professional standing [and] employment prospects" (Malmendier and Tate, 2016, p. 5) despite extraordinarily high risk and low reward for the firm as a whole. While overconfidence and narcissism can be measured in many ways[2], M&A announcement returns for deals involving CEOs exemplifying these personality traits are negatively correlated with their degree of overconfidence and narcissism (Renneboog and Vansteenkiste, 2019, p. 658; Malmendier and Tate, 2016, p. 28). Overconfident CEOs overestimate both the advantages of M&A deals and the value of their pre-M&A firm (Malmendier and Tate, 2016, p. 2), suggesting that managers grounded in reality are able to more accurately judge the payoff of M&A

[2] Narcissism can be measured by counting CEOs' use of first-person singular pronouns relative to first-person plural pronouns in meetings with the press (Renneboog and Vansteenkiste 658).
Overconfidence can be measured by the number of M&A deals a CEO undertakes in a short time span. Overconfidence could also be measured by CEOs' "timing of exercising vested stock options" (Renneboog and Vansteenkiste 658).

opportunities. While strict hierarchicalism and the failure of internal controls to check CEOs' power make value-destroying deals more likely, adept managers who are cognizant of their limitations and who prioritize the firms' interests can make a substantial difference in selecting the optimal M&A deals and creating value-generating growth.

Management-specific abilities to maintain financial performance and synthesize teams are perhaps the most important factors in determining the success of M&A outcomes. Cui and Leung (2020) study management's capacity to generate revenue pre- and post-M&A and find that firms with managers who maintain higher return on assets and operating cash flows prior to M&A are much more likely to maintain this performance in subsequent years following M&A deals than comparable firms (p. 2, 16). In addition, managers' ability to synthesize merging firms' corporate cultures and employee bases can be equally important to the success of M&A (Cui and Leung, 2020, p. 16). Managers who excel in "cultural alignment and goal-setting" (Hu et al., 2019, p. 120) facilitate better returns for M&A deals (Hu et al., 2019, p. 120), a process that might entail the creation of a "new identity and common goals" (Renneboog and Vansteenkiste, 2019, p. 667) for merged firms. Managers who recognize the importance of corporate culture in the long-term financial performance of the firm strive to mitigate feelings of "loss of autonomy" (Renneboog and Vansteenkiste, 2019, p. 667), a rift in the organization of the merged firm, and misgivings about a sense of 'belonging' concerning the newly-combined team, all of which can reduce the merger's value following the merger announcement (Renneboog and Vansteenkiste, 2019, p. 667). Managers may perceive investing significant time and resources into firm synergy as unnecessary, but the benefits of these synergies may outweigh the costs in the long-term.

Trust and integrity are also integral to M&A success. In his work, Datta (1991) suggests that a lack of trust between firms engaged in M&A can be detrimental to firm value and affirms that "low post-acquisition integration does not necessarily mean true autonomy" (p. 291). Acquiring firms' managers often 'pester' acquired employees with increased report requirements and visitations and may attempt to impose their governance style on the acquired team (Datta, 1991, p. 291). Acquiring firms' failure to trust acquired employees may also lead to resignations of valuable executives and employees, which would have a substantial negative effect on firm growth (Datta, 1991, p. 292). Perceptions of firm values from outside and inside the firm are also important; Guiso et al. (2015) posit that integrity contributes significantly to financial success, although their study is not specific to M&A outcomes (p. 61). Using Great Place to Work Institute (GPWI) data, the authors find that increases in perceived integrity within a firm have a significant effect on firm profitability (Guiso et al., 2015, p. 61). While management may overlook the importance of integrity in day-to-day operations, increases in integrity are positively correlated with profit, the number of job applications received, and employee retention (Guiso et al., 2015, p. 65). Thus, managers who advocate for workplace integrity and respect towards colleagues pre- and post-merger may be more likely to maintain financial performance and retain the merged firm's employees in the years following the merger. Values such as integrity and trust may not have intrinsic monetary value, but they may affect the success of M&A deals nevertheless.

3. National Culture's Contributions to M&A Outcomes

While firms' corporate cultures have significant effects on M&A profitability and feasibility, the effects of national culture are perhaps equally important. Management affects corporate culture, but it also affects M&A through national culture, especially through CEOs' cultural heritage. Pan et al. (2020) use United States CEOs' last names as a proxy for their cultural heritage and employ the UAI (uncertainty avoidance index)[3] to measure risk-seeking tendencies in CEOs' countries of origin (p. 2978). The authors also infer that origin nations' culture can affect CEOs both directly and indirectly through family traditions, language, and peers (Pan et al., 2020, p. 2978). Pan et al. (2020) discover that increases in UAI of CEOs' origin countries decrease the probability that the CEOs will undertake the M&A opportunity (p. 2979): A one standard deviation increase in UAI of the origin country decreases the probability a CEO will engage in the M&A deal by 16% (Pan et al., 2020, p. 2979). In addition, increases in UAI of a CEO's origin country increase the likelihood that he or she will choose a familiar target company with low restructuring costs (Pan et al., 2020, p. 2979). Thus, even marginal differences between attitudes towards risk in varying nations' cultures can substantially impact the M&A landscape.

Broader differences in national cultures, too, have statistically significant effects on the volume and value of cross-border mergers. Ahern et al. (2015) find that greater disparities between two nations' populations in the trust and individualism indices[4] decrease the dollar volume of mergers between those two countries, and this result is statistically significant (p. 179). The authors create dependent variable ln(1 + Dollar Volume of Mergers), which measures the total dollar volume of mergers between two countries in the dataset, and regress this on multiple culture-related independent variables (Ahern et al., 2015, p. 179). According to their study, a 1% increase in $\ln(1 + |\Delta\text{Trust}|)$ or a 1% increase in $\ln(1 + |\Delta\text{Individualism}|)$ decrease ln(1 + Dollar Volume of Mergers) by 2.68% and 3.09% respectively (Ahern et al., 2015, p. 179). Therefore, differences in work-related attitudes on a national level have significant effects on M&A activity (Ahern et al., 2015, p. 179). In addition, a 1% increase in ln(Geographic Distance) between two countries decreases ln(1 + Dollar Volume of Mergers) by -1.62%, substantial evidence that nations that are similar geographically and culturally engage in more mergers (Ahern et al., 2015, p. 179). Meanwhile, increases in cultural similarities between two countries

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[3] The Uncertainty Avoidance Index (UAI), created by Geert Hofstede and Hofstede Insights, seeks to quantify how comfortable a population is with uncertainty and ambiguity. Uncertainty avoidance is a component of national culture. https://hi.hofstede-insights.com/national-culture

[4] Trust measures the degree to which people believe other people can be trusted. Individualism measures the degree to which people believe income should be a reward for exemplary work, or rather equal for everyone.

increase ln(1 + Dollar Volume of Mergers), and this effect is statistically significant (Ahern et al., 2015, p. 179). Ahern et al. (2015) discover that a .1 percentage point increase in the same dominant religion between two countries, the same dominant language, and a common border increase ln(1 + Dollar Volume of Mergers) between those two countries by 8.1%, 10.25%, and 7.27% respectively (p. 179). Therefore, greater cultural differences may impede initial M&A negotiations and therefore limit the quantity of M&A deals attempted (Ahern et al., 2015, p. 185; Fong et al., 2019, p. 660).

Yet, other studies such as that of Chakrabarti et al. (2009) have found that greater differences between nations' cultures increase the long-term profitability of cross-border M&A deals (Fong et al., 2019, p. 633-634). Fong et al. (2019) find that while differences in culture decrease the number of initial cross-border M&A negotiations, once the negotiations proceed successfully, increases in cultural differences have a slight positive effect on the completion rate of M&A deals and a "small positive impact on the long-run abnormal return of the acquirer" due to self-selection and high barriers to entry (p. 660); since cultural differences can impact firm and M&A deal value significantly, both parties must be convinced that the deal is worth completing (Fong et al., 2019, p. 660). While cultural differences have potential repercussions, increases in cultural differences can facilitate a greater "transfer of knowledge" between the firms engaged in M&A (Renneboog and Vansteenkiste, 2019, p. 673). In addition, the effects of cultural differences are likely industry-specific; tech firms and firms relying primarily on intangible assets are more likely to benefit from cultural differences than suffer from synergy losses or lose value (Renneboog and Vansteenkiste, 2019, p. 673). As Teerikangas and Very (2006) state succinctly in their work, domestic M&A are not always "easier" (p. S45) than cross-border ones, and in many cases differences in firm operation and leadership are more influential in determining the success of M&A than cultural differences (p. S45). Scholars' differing conclusions regarding the feasibility of international M&A deals--specifically those between countries with greater cultural disparities--indicate that there is no foolproof method to gauge the true value of these deals; in some instances, greater cultural differences that appear disadvantageous to firm value may ultimately benefit both parties, while in other instances, these cultural disparities may upend M&A transactions or debar M&A negotiations from commencing in the first place. In the M&A process, while increases in the diversity of opinions and perspectives between teams may create a less comfortable environment, the benefits of this diversity can potentially increase M&A deal value substantially. For firm management, then, these cross-border M&A deals would be optimal value-generating decisions despite perceived short-run hurdles, and these particular opportunities should not be overlooked.

4. M&A Case Study Analysis

Case study analysis can illuminate the consequences of national and corporate culture on M&A transactions. In their evaluation of the 2005 Sprint-Nextel merger, Celiktas et al. (2016) find that corporate culture differences were key to the failure of the firm post-merger (p. 6). The

$35 billion deal transformed Sprint into the third largest telecommunications provider behind AT&T and Verizon (Celiktas et al., 2016, p. 1). Sprint and Nextel executives pursued the merger to gain access to each other's customer base and network, reduce expenses for customer support, billing, marketing, and SG&A, and create a combined product offering of complementary products and services (Celiktas et al., 2016, p. 2, 7). While the merger seemed to make sense on paper, corporate culture differences resulted in operational inefficiencies and lackluster employee integration (Celiktas et al., 2016, p. 6).

As previously discussed by Cui and Leung (2020), managers' ability to synthesize corporate cultures and employee bases is crucial to the success of M&A (p. 16). In the Sprint-Nextel merger, management's decision to have two separate headquarters was only one of many decision-making errors in facilitating employee integration (Celiktas et al, 2016, p. 6). The dual headquarters in Washington D.C. and Kansas City increased the cultural divide and prolonged the integration process while also creating difficulties for executives, who had to travel between the company's offices (Celiktas et al, 2016, p. 13). Additionally, the aftermath of the merger led to duplicate jobs at all levels of the firm (Celiktas et al, 2016, p. 6). Management instructed employees to interview for the positions they already held, resulting in suspicion and competition between employees that ultimately degraded morale and contributed to a toxic work environment (Celiktas et al, 2016, p. 6). Many employees and executives left as a result, leading to weakened internal cohesion and the loss of crucial Nextel employees (Celiktas et al, 2016, p. 10-11). The departure of these employees impaired the development and expansion of the Nextel network, which left the merged firm with losses in potential synergies initially pursued in the merger (Celiktas et al, 2016, p. 6).

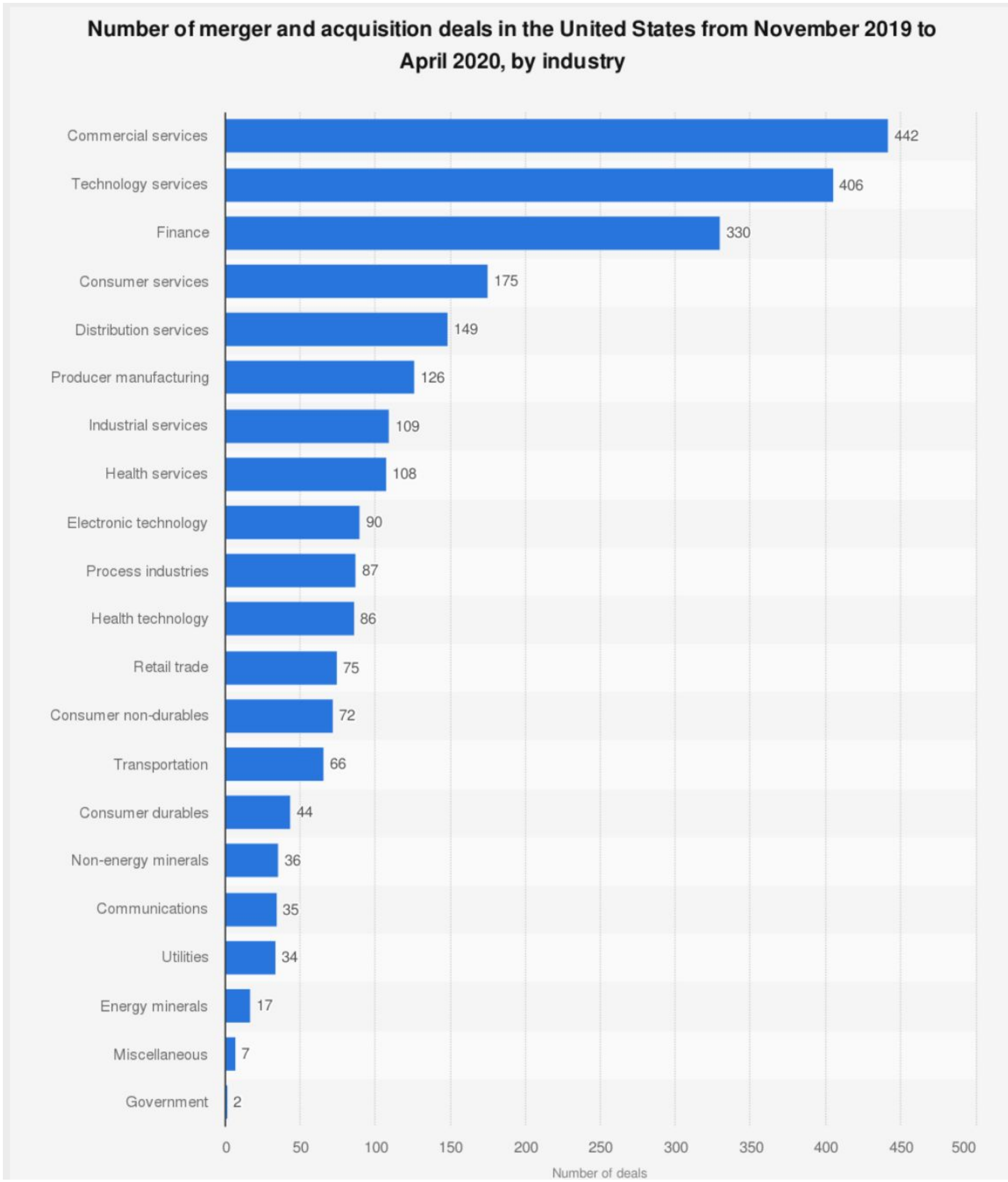
Renneboog and Vansteenkiste (2019) posit that cultural alignment and unity in goals and identity are important for a newly merged firm to operate efficiently (p. 18), and in their merger, Sprint and Nextel were not able to successfully integrate corporate cultures (Celiktas et al., 2016, p. 9). Management's ability to facilitate synergy between the merged firm's two employee bases was tested by the stark differences between Sprint and Nextel's corporate cultures prior to the merger (Celiktas et al., 2016, p. 9). Sprint was a "century-old telecommunications titan" that held a more bureaucratic, top-down approach to planning and decision making (Celiktas et al., 2016, p. 9). Nextel, on the other hand, was a newer, smaller firm that embodied a more entrepreneurial spirit and had a more delegated decision-making process (Celiktas et al., 2016, p. 9). Management's attempts to facilitate employee integration through resources such as communication teams and chat rooms ultimately failed because mid-level managers did not implement them (Celiktas et al., 2016, p. 12, 13). Nextel employees also believed that their brand was diminished by decisions that favored Sprint, such as Sprint-centric branding (Celiktas et al., 2016, p. 14). Although Sprint adopted Nextel's color scheme for the new logo, Nextel felt slighted by the new logo's text: The word 'Sprint' had a larger font, while the phrase "Together with Nextel" was below 'Sprint' in a smaller font (Celiktas et al., 2016, p. 14). Before the merger, management believed Sprint-Nextel was an opportunity to combine synergies and boost operating efficiency, but management's improperly-executed integration plans and the unequal dominance of the 'Sprint way' solidified the merger's failure (Celiktas et al., 2016, p. 13). By 2008, Sprint-Nextel had lost millions of customers and posted an almost $30 billion write-down to goodwill as a result of the merger (Holston 2008; Celiktas et al., 2016, p. 8).

The Daimler-Chrysler merger is another example of the impact of corporate and national cultural differences on the success of a firm post-merger. In 1998, German automaker Daimler-Benz and American automaker Chrysler engaged in a $36 billion merger (Hollmann, 2011, p. 434). Daimler sought a stronger foothold in the American market and combined distribution channels, technologies, and manufacturing processes for economies of scale to maintain a competitive advantage in the global auto industry (Hollmann, 2011, p. 434). The various differences in organizational culture between the firms, however, created difficulties in the integration process (Hollmann, 2011, p. 436). In a situation quite similar to Sprint-Nextel, Daimler and Chrysler had conflicting decision-making practices, creating inefficiencies (Hollmann, 2011, p. 435). Daimler was more bureaucratic, hierarchical, and authoritative, common characteristics of German corporate culture (Hollmann, 2011, p. 435, 437). Chrysler, on the other hand, was less methodical and encouraged creativity in the decision-making process (Hollmann, 2011, p. 435). The German management also favored implementing detailed and precise plans, while the American management preferred to 'work things out' through a trial and error process and general experimentation (Hollmann, 2011, p. 436). Hollmann et al. (2011) argue that these differences can be attributed to cultural differences at a national level as well (p. 436-437). According to Hofstede's cultural dimensions model, Americans are more individualistic, short-term oriented, and risk-seeking than the Germans, who are more team-oriented, risk-averse, and methodical (Hollmann, 2011, p. 437). While the deal was seen as a merger of equals at first, this was ultimately not the case; the Germans ended up taking control of management (Hollmann, 2011, p. 438). This lack of partnership and cooperation in creating new organizational practices led to Chrysler's loss of $512 million in the third quarter of 2000 (Hollmann, 2011, p. 438).

5. Conclusion

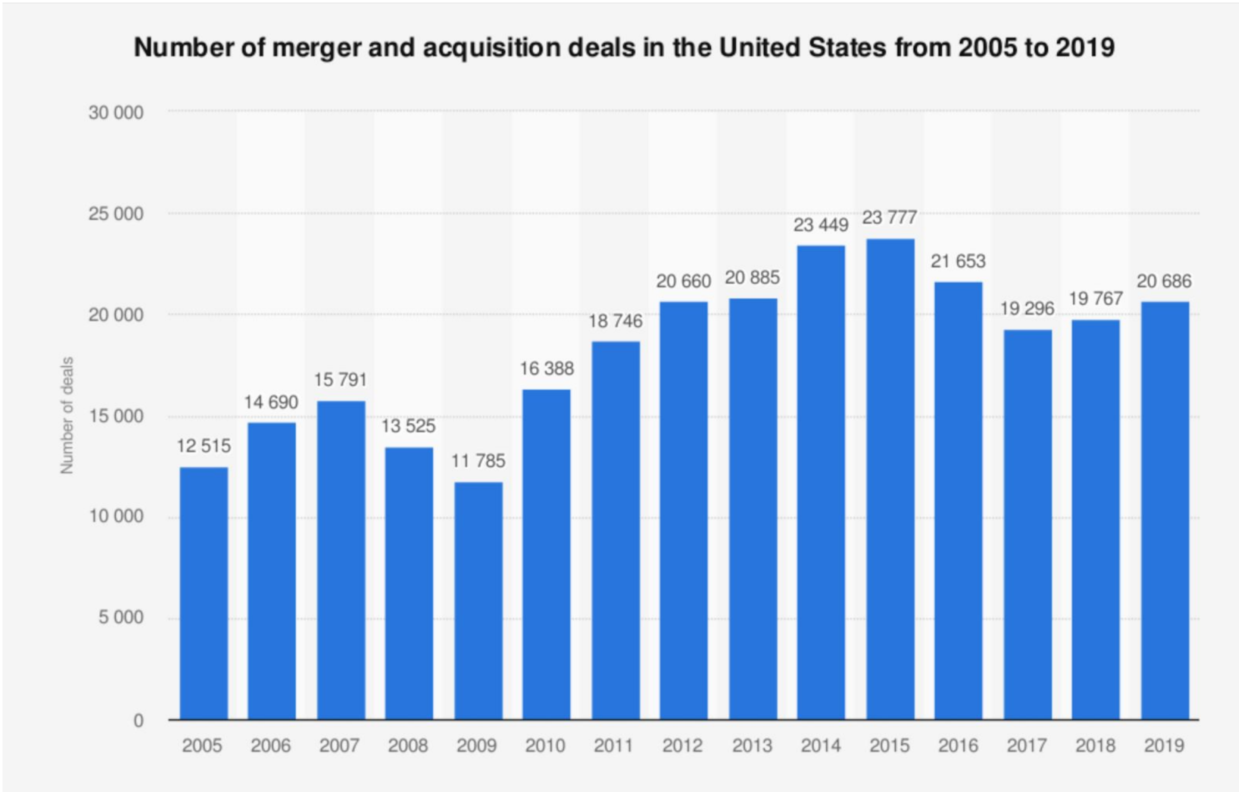
Differences in national and corporate culture can have substantial effects on M&A outcomes and deal profitability. Cultural differences between nations can substantially decrease both the number of cross-border mergers and the value, synergy gains, and long-term profitability of M&A deals. Yet, larger cultural differences can also facilitate the transfer of more knowledge and skills between teams being merged or acquired. Although M&A deals are often value-creating and beneficial to shareholders, CEOs and senior management may pursue M&A opportunities unnecessarily due to overconfidence, the allure of compensation and professional advancement, and general risk-seeking behavior that can arise from cultural heritage and the corporate environment. In addition, managers and CEOs may overlook corporate culture during the M&A process, but literature analyzed in this paper affirms the importance of fully integrating teams, creating a new, united company, and establishing inter-firm trust and respect both pre- and post-M&A. The Sprint-Nextel and Daimler-Chrysler mergers exhibit the breakdowns that can occur when a firm's management is non-attentive to the social intricacies of the workplace. Despite the hurdles associated with merging cross-border firms with significant national and firm-specific cultural differences, the diversity of opinions and perspectives that can be gained from this process can increase M&A deal value and the long-term value of the firm. The benefits of such deals, therefore, should not be overlooked. As the effects of COVID-19 on the global economy become more apparent, further research could analyze the effects of working from home and 'Zoom culture' on M&A activity, including cross-border transactions.

Figure 1: Number of merger and acquisition deals in the United States from November 2019 to April 2020, by industry



Source: Factset. (2020). "Number of Merger and Acquisition Deals in The United States from November 2019 to April 2020, by Industry." *Statista*, Statista Inc., 1 May 2020, https://www-statista-com.ccl.idm.oclc.org/statistics/246750/number-of-munda-deals-in-the-united-states/

Figure 2: Number of merger and acquisition deals in the United States from 2005 to 2019



Source: WilmerHale. (2020). "Number of Merger and Acquisition Deals in The United States from 2005 to 2019." *Statista*, Statista Inc., 4 Jun 2020, https://www-statista-com.ccl.idm.oclc.org/statistics/914665/number-of-ma-deals-usa/

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