



Inviting Culture to the M&A Table

April 5, 2016

About Insperity®

YEAR ESTABLISHED

1986

IPO

1997

2015 REVENUES

\$2.6 BILLION

60 OFFICES

Integrity • Trust • Assurance

ESAC

Employer Services
Assurance Corporation



Introducing ACG members to Insperity

The Association for Corporate Growth has formed a strategic alliance with Insperity to help ACG members achieve a level of predictability in their human resources function so they can concentrate on business and portfolio growth.

insperity.com/acg



Inviting Culture to the M&A Table

TODAY'S PRESENTER



Chelsea Wood
Organizational Consultant
Insperity®

What will you learn today?

During this webinar, we will answer the following questions:

- What is happening in Middle Market M&A?
- What role does culture play in the value of an organization?
- Why is culture important for mergers and acquisitions?
- How do I address culture in my future transactions?

Poll #1

How many deals have you been involved in closing in the past 12 months?

- 0
- 1-2
- 3-5
- More than 5

Poll #2

How many deals do you have in the pipeline for the next 12 months?

- 0
- 1-2
- 3-5
- More than 5

Current State: What We Know About Middle Market M&A

U.S. Ten Year Private Transfer Cycle

It's a great time to be a seller!



Source: Robert Slee, Private Capital Markets

Current State:

What We Know About Middle Market M&A

Buyer Activity

- Over 50% midsize U.S. companies are looking for transformative deals

Seller Activity

- Approximately 33% of midsize U.S. companies are open to or currently involved in being acquired or merging with another firm

Overall Financial Expectations

- More than 40% of middle market organizations expect another financial crisis within the next 3 years
- With premiums at a high, an organization can earn 1x turn more by retaining management and maintaining solid growth/margins

Source: Middle Market M&A Outlook 2016, Citizens Commercial Banking & Alliance of Merger & Acquisition Advisors

Inside the Mind of a Seller:

Typically sellers assign substantially higher value to their organization than buyers

Motives

- Create a family legacy
- Diversify estate
- See their “baby” thrive
- Major life event
- Empower employees
- Benefit their community
- Maximize value

Barriers

- Risk averse
- Comfortable with lifestyle business
- Net worth is tied up in business
- Investment returns won't replace business earnings
- Unwilling to relinquish control

Inside the Mind of a Buyer:

Each exit strategy channel has a unique set of drivers influencing valuation

Strategic Buyers	Financial Buyers	Related Buyers
<ul style="list-style-type: none">• Competitors• Up-stream Complements• Consolidators	<ul style="list-style-type: none">• Private Equity Platform• Bolt-ons• Private Equity Sponsored Management Buy-Out• Replacement Owner	<ul style="list-style-type: none">• Management• Partner buy-in• Family

One of Private Equity Group's main priorities in the middle market is "fit"

Simple Example

What is this car worth?

\$40,000 - \$75,000



Illustrative Purposes Only

How much are these companies worth?

Company A	Company for Sale	Company B
5-7X		5-7X
15 Years Old		15 Years Old
Injection Molding	Injection Molding	Injection Molding
\$40M	\$40M Sales	\$40M
\$4M	\$4M EBITDA	\$4M
Moderate	Market Growth	Moderate
Undeveloped	Management Team	Extensive and Developed
None	Human Capital Plan	Thorough Cascaded Plan
Outdated	Policies and Procedures	Finely tuned
Exists by default	Culture	Cultivated and owned by all
Punishment for errors	Safety	Engrained in operations
High turnover	Turnover	Minimal voluntary turnover
None	Leadership Development	Structured program
Reactive, event-triggered	Training	Structured annual training plan

Company Specific Risk Factors:

Culture directly impacts all of these!

Current State:

What We Know About Middle Market M&A

- The critical role culture plays in M&A long-term success has consistently been identified
- Cultural alignment has been highlighted as a transaction prerequisite
- In a recent article published by Axial Forum, culture clash was outlined as one of three overlooked issues in M&A. Losing talent was one of the other three items which has been linked to how the transaction has been managed.

“The way we do things around here in order to succeed.”

– William Schneider, The Reengineering Alternative



"Here at Company XYZ, we..."

V
i
s
i
b
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e



Culture will exist regardless of whether you acknowledge it or not.

I
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v
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b
l
e

"I know they said that but here we..."

Our role is to **help our clients** make the most informed business decision possible and **maximize the value of their investment.**

Poll #3

What are your primary concerns when you're pursuing M&A activity?

- Turnover and Loss of Institutional Knowledge
- Productivity Loss
- Client/Revenue Retention
- Areas/Concerns not identified through Due Diligence
- Inaccurate Financial Projections

Growth Through Acquisition Doesn't Come Without Risk

Concern

- Turnover & loss of institutional knowledge
- Productivity loss
- Client/revenue retention
- Areas/concerns not identified through due diligence
- Inaccurate financial projections

Potential Drivers

CULTURE

What is the first thing that comes to mind when you see these transactions?

DAIMLER



What stands out in your mind about each of the following transactions?

Disney · PIXAR

WIN WIN

IPAQ

Anthem

 WELLPOINT
HEALTH NETWORKS®

Poll #4

On average, how would you rate the success of your previous transactions?

- Successful. We were able to achieve the financial goals as forecasted.
- Successful. We were able to exceed the financial goals as forecasted.
- Successful by financial standards but problematic culturally.
- Unsuccessful, we failed to meet financial goals.

Poll #5

Do you develop a cultural alignment plan prior to closing the transaction?

- Absolutely
- Yes but I think we could do it better
- No plan but we do discuss culture prior to close
- No, we focus mainly on transaction details and save integration/culture work until after close

Culture Change

Top down approach

Overbearing

Winners and losers

Replaces existing values with “new” or “right” values

Research suggests
MOST
cultural change
initiatives fail

Cultural Alignment

Bottom up approach

Collaborative

Win-win

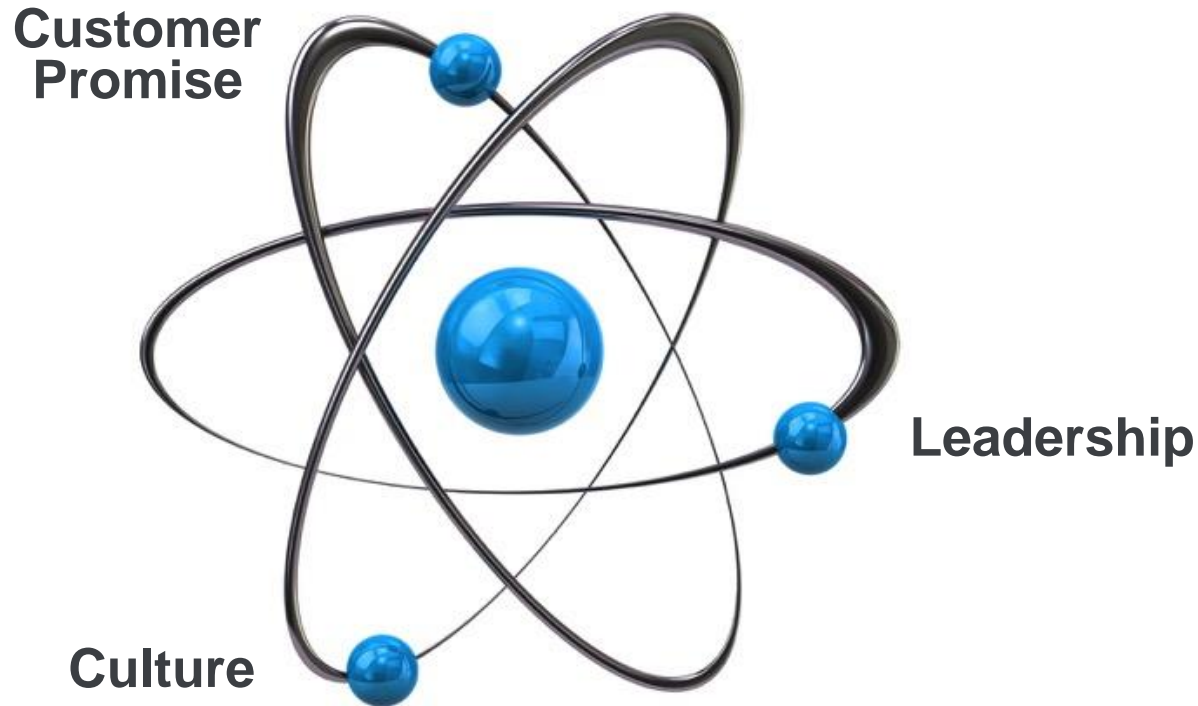
Leverages values that drive existing individual employee behaviors

We believe culture should be defined by what you're promising your customers.

Everything else should be done in service to delivering on that promise.

The “Holy Trinity” of Every Enterprise:

A business is a living, changing organism



When you invite a foreign object into organism, the “body” rejects it.

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Most decisions that are made in the early stages of a transaction will directly impact the culture of the future organization.





Cultural Alignment

“If you could get all the people in an organization rowing in the same direction, you could dominate any industry, in any market, against any competition, at any time.”

– Five Dysfunctions of a Team

**Integration has to do with
alignment and fit.**

**“Successful organizations are
internally coherent and congruent.”**

– William E. Schneider, *The Reengineering Alternative*

DAIMLER



\$650M loss

Hierarchical vs. Loose

“How do you pronounce DaimlerChrysler?... ‘Daimler’ – the ‘Chrysler’ is silent.”
– Common joke circulating during the transition



86% loss of worth

Entrepreneurial vs. Proven Success

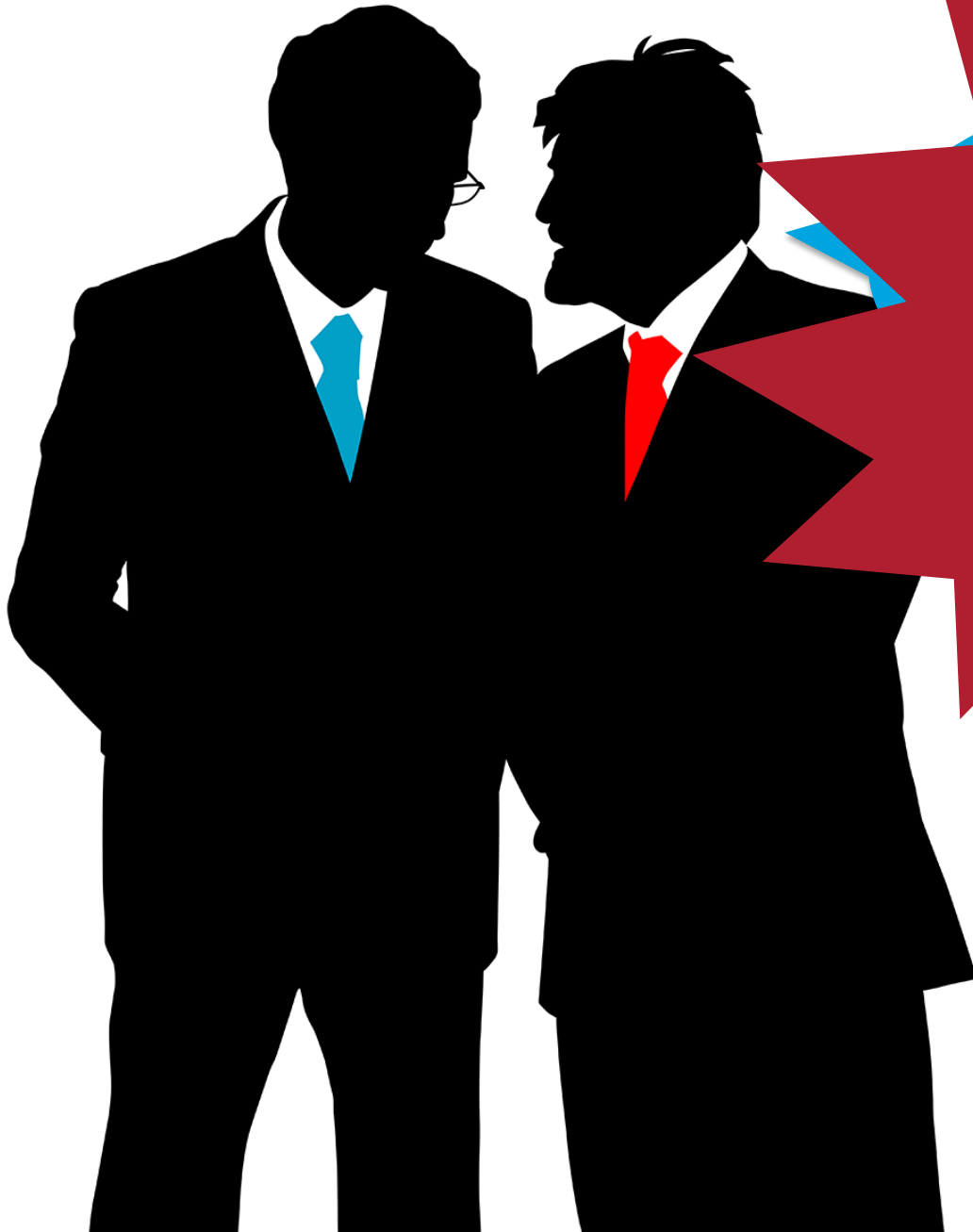
“I remember saying...that life was going to be different going forward because they’re very different cultures, but I have to tell you, I **underestimated how different...** It was beyond certainly my abilities to figure out how to blend...They were like different species, and in fact, **they were species that were inherently at war.**”
– Richard Parsons, President of Time Warner



Posted \$29 billion loss

PowerPoints vs. Pep Rallies

“The two sharply different cultures have resulted in clashes in everything from advertising strategy to cellphone technologies.”
– Kim Hart, Washington Post, November 25, 2007



CULTURAL MISALIGNMENT

Potential costly pitfall
causing **TURNOVER**
and **INSTITUTIONAL**
KNOWLEDGE LOSS

Purchased with a valuation of \$7.8 billion; as of December 2013, earned over \$9 billion worldwide.

All 15 of the films produced by Pixar are among the **top 50 highest-grossing animated films** of all time; 13 of the films have received critical and financial success.

“We drew up an explicit map of what elements of Pixar would not change... an explicit list of guidelines for protecting Pixar’s creative culture.”
– Brookes Barnes, Power of a Prenup, June 2008

Disney applied learnings from Pixar and found success with movies like Tangled, Frozen, and Big Hero 6.

**Value is created through cultural alignment;
similarly, it is devastated by culture clash.**



Cultural alignment eliminates...



“Companies with cultural alignment
are 6 times more profitable.”

– Good to Great



COMPAQ

\$40b PC Division Earnings

The immediate obstacle raised was that the two companies had two vastly different cultures, so they devoted the time and resources to begin a **comprehensive comparative cultural analysis for both organizations.**

To bring the two companies together, they began a process to determine what their employees valued, what moved them and what motivated them.

Win-win for all stakeholders

“HP...made storage a priority during the integration and promoted the technology to channel partners... [We] increased sales...reached annual revenue of more than \$30 million.”

– CEO, Sequel Data Systems (Compaq Partner)

“Addition of Compaq vastly improved HP's presence... my business grew into a nearly \$40 million solution provider.”

– President, Lilien Systems (HP Partner)

CEO proactively addressed uncertainty, aligned leadership and maximized synergies by engaging a consultant who specialized in culture and began by diagnosing the cultures of the merging companies.

“The team spent time connecting, understanding each other’s behavioral styles and working together to define the customer-focused culture and the new strategy.”

– Dr. Larry Senn, Corporate Culture Pioneer

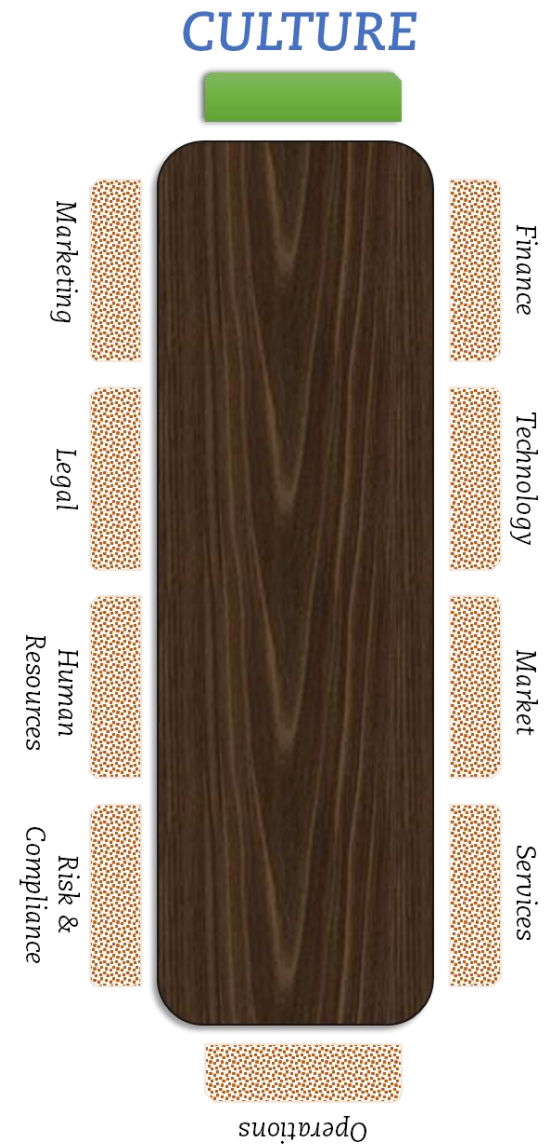
As a continuation of their success, Anthem recently bid to buy Cigna for \$48 billion, projected to close in 2016.

“There is an assumption in the corporate world that you need to integrate swiftly, my philosophy is exactly the opposite. **You need to be respectful and patient.”**

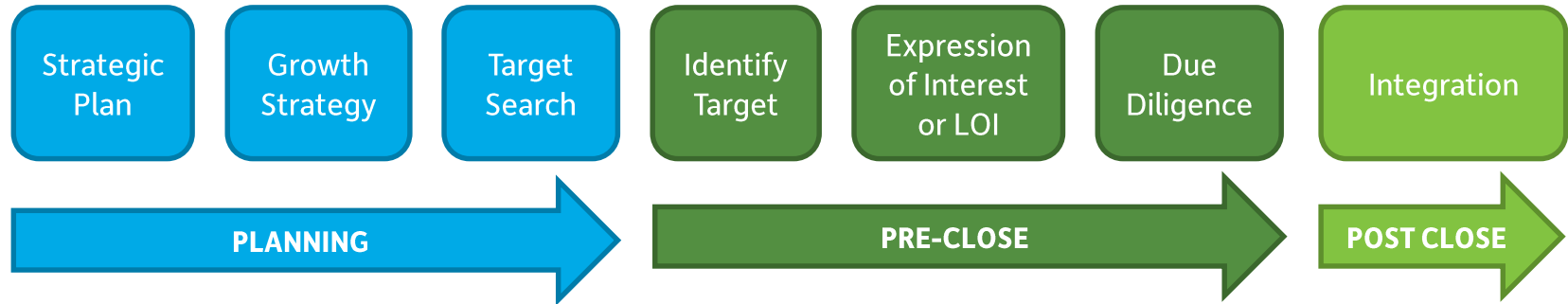
– Robert Iger, CEO of Walt Disney

You want to protect the critical aspects of both organizations to continue historical success and maximize the benefits of the transaction.

- What has traditionally helped make it successful in the past?
- What critical factors cannot change without impacting the bottom line of the organization?



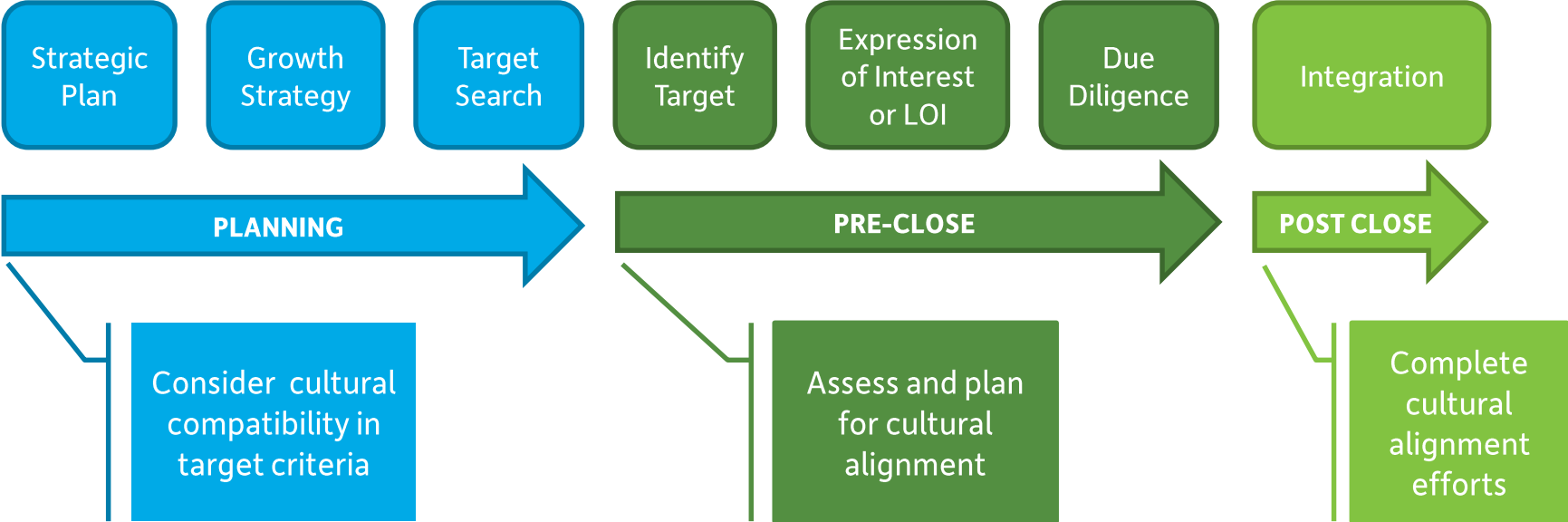
“Traditional” M&A Model



In this traditional M&A model, cultural alignment is often an afterthought raised when investigating unfavorable outcomes associated with the transaction.

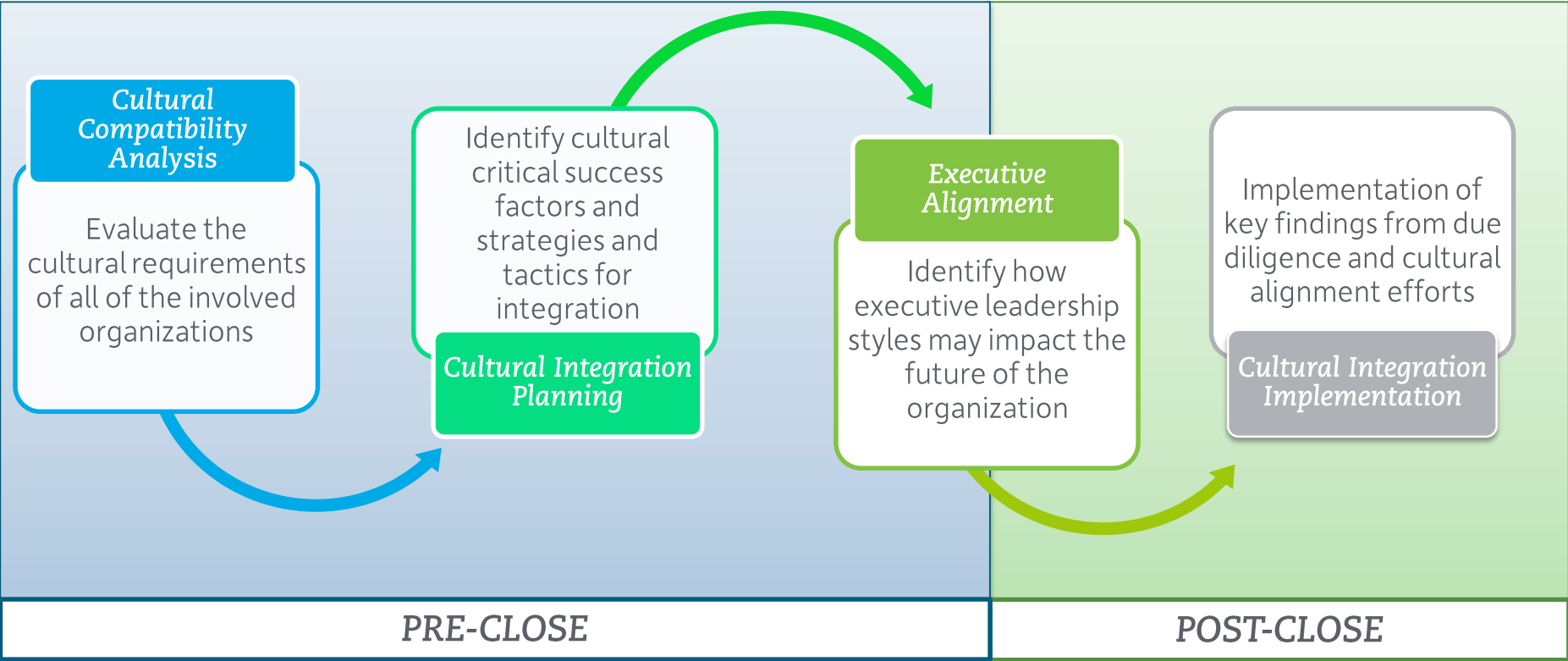
For example, why certain financial measures haven't been achieved or the loss of the acquired employees post-close.

Proposed M&A Approach



We are not recommending a completely different M&A approach or adding overly complicated processes – Rather integrating cultural factors throughout your existing process.

Culture's Role in the M&A Journey





Questions?

Thank you for joining us

For more information, or to speak with an
Insperity® business performance advisor, visit
insperity.com or call us at **866-814-6817**.

