

# **THE NEW FACE OF GLOBAL M&A. INTERCULTURAL ISSUES IN BANKING INDUSTRY**

**Iulian Warter**

iulian@warter.ro

**Liviu Warter**

liviu@warter.ro

“Alexandru Ioan Cuza” University, Iași, Romania

## **Abstract**

In today's multi-polar world, the complexity of mergers and acquisitions (M&As) in the banking sector has increased dramatically. The likelihood of cultural clashes, which may cause a planned merger to fail, is higher for M&As in the banking industry operating in different countries. Bank of America's acquisition of Merrill Lynch stands out as a testament to a critical issue in many failed mergers: the company cultures of the two financial institutions simply aren't compatible.

Our paper aims to focus on the intercultural issues, which have been investigated by only limited number of studies in the banking industry. The understanding of intercultural issues in the pre-merger stage will make future M&As in the banking industry less problematic. It is of vital importance for the banks to learn from their mistakes, which include not avoiding intercultural conflicts, underestimating management, employees and cultural issues and hence the integration process in the post-merger stage will be more efficient and smooth.

**Key words:** mergers and acquisitions (M&As), intercultural, cultural differences, banking industry

## **Introduction**

M&A deals in the banking sector have usually been justified to increase the bank efficiency and, finally, to create shareholder value, but few studies have analyzed the overall result of M&A transactions to support these motivations that can be accomplished in different ways.

The three most significant problems that have to be faced during a merger process are communication within the organization, oncoming change, and change of culture. For example; if a bank from a country wants to expand to another country through a merger or an acquisition they will have to follow the laws of how to conduct an M&A in that foreign country. However, they will also have to take into consideration the national and organizational culture for the merged/acquired foreign bank and will have to adopt their operations in a proper way.

In order to ease the transition of the merger between the two corporate cultures a common culture is needed and, usually, the one of the acquiring bank will be the one implemented. The bigger the acquired bank is, the more difficulties will be, as the corporate culture of that bank will be stronger and it is likely to be more resistant to change. Taking into account also the different national cultures, M&As between big banks are less likely to be profitable.

Although cultural differences have caused some problems in the integration phase, they have not been unexpected due to cultural due diligence conducted in the pre-merger stage of M&As. These intercultural issues can lead to difficulties of communication and misunderstandings. However, the cultural differences will put higher requirements on the top managers that will have to face these issues. It is also important to look at the positive synergies from the cultural differences, such as those of diversification, knowledge transfer and improved managerial quality, advantages in finding a path to a successful M&A.

Most of the problems can arise in the integration phase of the M&A process due to the fact the merging banks need to join together two, perhaps, completely different cultures. This very sensitive task impose a very sophisticated management in charge in order to adjust the two banks so as to function together. Merging two different banks means merging two different ways of conducting business and the M&A success or failure depends a lot on the understanding of each other's culture, values, beliefs etc. and being able of working together as a team.

## 1. Are “cultural clashes” unavoidable in M&A?

Since the end of the Cold War, the study of intercultural relations has become a popular topic in the field of global politics and economics. But support has been found for views emphasizing both intercultural conflict and cooperation. With all the positive ways of gaining from intercultural cooperation, it seems logical to inquire why economic cooperation has failed. Regions are a basis for cooperation among states only to the extent

that geography coincides with culture. Divorced from culture, propinquity does not yield commonality and may foster just the reverse. The overall effectiveness of multicultural organizations generally varies inversely with the cultural diversity among their members. As a result single cultural organizations are more stable and successful than multicultural organizations. This is true for both political and economic organizations (Rongxing 2012).

Other scholars (Hofstede et al. 2010) emphasise that mergers, acquisitions, joint ventures, and alliances across national borders have become frequent, but they remain a regular source of cross-cultural clashes. Cross-national ventures have often turned out to be dramatic failures. Leyland-Innocenti, Vereinigte Flugzeugwerke–Fokker and later DASA-Fokker, Hoogovens-Hoesch and later Hoogovens–British Steel, Citroen-Fiat, Renault-Volvo, Daimler-Chrysler, and Alitalia-KLM are just a few of the more notorious ones. There is little doubt that the list will continue growing as long as management decisions about international ventures are based solely on financial considerations. Even within countries, such ventures have a dubious success record, but across borders they are all the less likely to succeed. If cultural conditions do look favorable, the cultural integration of the new cooperative structure should still be managed; it does not happen by itself. Cultural integration takes lots of time, energy, and money unforeseen by the financial experts who designed the venture.

Gesteland (2012) defines business culture as a unique set of expectations and assumptions about how to do business. A major purpose of his book is to help readers understand their own expectations and assumptions as well as those of their international customers, suppliers, colleagues and contacts. When comparing business cultures it is important to avoid stereotypes, which are lazy ways of describing people and behavior. We need to remember that no two people of any culture are exactly alike: there are regional, generational and individual differences, among others. In his book, Gesteland (2012) employs carefully observed cultural tendencies when describing similarities and differences in international business behavior.

It is generally believed that culture plays a determinant role in investments, Warter and Warter (2014: 798-811) remark that in such operations, meeting among businessmen, managers and other professionals in the field is, first of all, meeting in specific circumstances, among more or less different cultures. The likelihood of cultural clashes, which may cause a planned merger to fail, is higher for M&As in the banking industry operating in different countries. They may, however, also appear in domestic M&As. Differences in opinion between key managers of banks with differing strategies may be enough to deteriorate some steps in the integration process.

When the steps are carried out, cultural differences have often delayed or hampered a smooth implementation of the integration process.

A paper by He (2009) remarks that a greater difference in management style may lead to more significant cultural clashes and to difficulties in the integration. It is therefore important for foreign acquiring companies to be more cautious in introducing changes in these two management areas. In turn, Ghauri and Usunier (2003) assert that culture clash in negotiation may be strong at the very start, when negotiators expect behaviour from the other side which normatively corresponds to what they are used to as well as to what they consider as the most appropriate for effective negotiation. Cultural adaptation is not necessarily symmetrical.

The assumption behind post-M&As typologies is that the higher the need for integration, the higher the degree of change required in organizational culture and identity, management systems and HR practices (Gomes et al. 2012: 2874-2900). And in his study on integration in M&As, Whitaker (2012) observes that every integration is unique, but studies have confirmed a few key reasons mergers underdeliver or fail outright. Here they are:

- conflicting goals and strategies. The main problem here seems to be that companies fail to realize they have conflicting strategies until after the integration process has begun;
- poor communication. This unfortunately is a problem in almost every merger, and the primary reason is always that information and decisions can be slow to develop, so people get anxious as a result. It is imperative that integration managers push communication planning, because senior executives tend to undercommunicate;
- conflict, conflict, conflict. When new management teams can't get along, resolve issues, or plan well together, many things will suffer. Conflict is unavoidable, and a little conflict often produces better results. When conflict results in paralysis and execution dysfunction, however, it can significantly retard integration success;
- disparate cultures. Cultural assessment risk and how to manage cultural integration is addressed elsewhere in this book, but sometimes culture clashes can become so distracting that they can grind integrations to a halt. Culture clashes also make most employees anxious and in many cases downright miserable. This is one of the most important areas to stay on top of in your integration planning.

Banks top managers have a positive expectation of their capability to master the human and managerial relations, including cultural clashes. The outcomes of many M&As does not seem to confirm, however, the validity

of these expectations. When two companies with different cultures merge, the newly formed company will often take on a new culture that is quite different from either the acquirer's or the target's culture (DePamphilis 2014). Cultural differences can instill creativity in the new company or create a contentious environment.

In a recent paper, Warter and Warter (2014) consider that cultural diversity in organizations can be both an asset and a liability. Whether the losses associated with cultural diversity can be minimized and the gains be realized will depend likewise on the managers' ability to manage the negotiations and due diligence processes in an effective manner. In turn, Sarala et al. (2014: 1-20) highlight that that organizational cultural differences may contribute to broader employee skills, yet we warn that these kinds of skill sets may be more difficult to coordinate. Owing to negative social identification, organizational cultural differences may also decrease behavioral flexibility of employees and can make it more difficult to align HR practices across the acquiring and the target firms. A cultural audit can help the firms anticipate the effect of organizational cultural differences and adjust the integration process accordingly.

Zander and Zander (2010: 27-37) remark that for all practical purposes, only one cultural difference could exist, but it may be the one that not only sets the boat rocking but actually sinks it. Subsequently, cultural differences in the grey box may vary in nature and quantity, but it is only during the integration process that the full effect of their impact on knowledge transfers becomes salient.

Apart from explicit corporate differences, and staff association with a specific type of national culture, there is likely to be differences in staff rules and rewards, which can lead to friction between the two teams. These intercultural issues impose higher requirements on the management in order to integrate all the different cultures and to communicate without having too many misunderstandings. The overall pattern of connections between employees of the combined firms (interpersonal relationships), the kind of personal relationship people develop with each other (trust) and shared interpretations and systems of meaning among parties (shared identity) are influenced by cultural differences and how they in turn impact M&A outcomes (Hajro 2014).

An interesting view is revealed by Viegas-Pires (2013: 357-370). The author shows that the relationship between culture and integration is not static and refers to chain reactions. For instance, changes in organizational culture, despite their transitional cost, may change the cultural challenge at the national level. Similarly, integration decisions and actions may affect the nature of the cultural challenge at the global level.

## 2. The cultural barriers/differences impact on M&A performance

Teerikangas and Very (2012: 392-430) highlight several questions that remain unanswered. For one, what is M&A performance against which culture can be measured? Should performance be measured in terms of financial or non-financial metrics; over what time frame following the deal? For another, who are the respondents, and how does the choice of buying or target firm respondents affect results? Are there industry effects, or country effects?

In most studies the main reason given for merger failure is “cultural differences.” These issues must be better addressed so that future mergers will succeed where others have failed. A systematic and triangulated approach to assessing cultural differences needs to be in place and communicated through the management ranks and beyond, as Trompenaars and Asser (2010) point out. There are many tools available to help in this, but importantly, the authors have found that it is not just about measuring cultural differences and/or resolving potential challenges.

Organizations may therefore actively manage the perceptions of cultural differences through the media by providing information about the involved organizations, educating the general public about the intended objectives of a cross-cultural merger or acquisition, and clearly communicating the benefits of such a transaction to local constituencies as Rottig (2013: 439-451) points out. As in personal marriages, which are greatly facilitated if approved and supported by the bride’s and groom’s respective families and friends prior to and during the wedding, the sociocultural integration process in M&As will be facilitated if the involved organizations can gain and maintain cultural legitimacy in their surrounding organizational environment.

Turning a merger or acquisition into a success may be difficult due to the challenges inherent in virtually all stages of banks M&As. Dealing with differences in regulatory and accounting systems and, cultural differences among banks operating in different countries, requires high-level management skills and significant resources.

Warter and Warter (2014) highlight that although most of the researchers point to cultural determinants of M&A, there is not a general common opinion of the main M&A success factors. Marks et al. (2014) remark that, finally, because cultural differences are multilayered, it is often difficult for executives to get their arms around exactly what’s going on, much less what to do about it. So, while they are preoccupied with managing the financial and operational aspects of integration, along with the ongoing demands of running the day-to-day business, it’s easy for executives to shy away from

the rigors of managing culture clash. Instead, they often ignore or deny cultural differences or pretend that the combining cultures are more similar than they really are. The problem with this pattern is that just as an organization cannot effectively operate with incompatible information systems, it cannot succeed with multiple incompatible ways of doing things.

The creating period of sociocultural integration relates to the post-M&A process perspective as Rottig (2013) argues. In this stage of a merger or acquisition, the involved organizations need to be integrated, the combined workforces must work together effectively, and the expected goals and objectives of the transaction (such as, for example, creation of synergies, knowledge transfer, access to complementary resources and capabilities, etc.) are to be achieved. In other words, in this period, the cultures of the involved organizations have to be integrated effectively and tangible results have to be created. The author concludes that this corresponds to personal marriages, in which a mutual life is being established, offspring produced, and a family built that is more effective and valuable as a whole than the sum of its individual parts.

Yet, the negative impact of cultural differences is thus expected to be smaller for M&As within the same group of companies (internal acquisition) than for external acquisitions (Arvanitis and Stucki 2014: 339-360). The cultural barriers may lead to loss of key staff and/or clients with a negative impact on M&A performance. It may be on account of the cultural differences and/or labour market rigidities that friendly M&As are more common than hostile takeovers in the banking sector.

Ahammad et al. (2012: 458-480) reveal that a main reason for the lack of consistent results produced by research on acquisition performance in several disciplines (e.g. strategic management and finance) is that it has failed to account for Human Resource (HR) practices implemented during M&As. Although HR practices have frequently been mentioned as a potential contributor to the effectiveness of M&As, there is a dearth of empirical studies of the relationships between HR practices and top management retention.

Gomes et al. (2012) highlight that prior literature has long recognized the importance of national cultural differences in affecting M&A performance, but there is little, if any, recognition of regional variation. Without explicit planning and activity aimed at managing these differences, these regional variations caused substantial and enduring problems for some of the integrating firms in this study. The importance of regional variation in culture is not fully recognized in the M&A literature and has far-reaching implications for considering how M&A may integrate across regions in other geographic contexts.

Weber, Tarba and RozenBachar (2011: 373-393) posit that the failure to find a consistent relationship between the indicators of synergy based on relatedness and the M&A success may stem from an overemphasis on the pre-merger stage at the expense of the negotiation process (Weber et al., 2011) and post-merger stage, including the integration approach used during the processes of integration. With a few exceptions, the strategic and finance literature has not considered the possibility that in the management of a merger, the problematic interaction between the buying and the target firms (due to cultural differences) or low coordination and cooperation between managers (as a result of the culture clash following the merger) may play a key role in the M&A success.

### 3. The challenge of intercultural issues in banking industry

Gomes et al. (2012) state that although all the mergers are in the same industry(i.e. banking sector) and the same country, there was evidence of significant cultural differences between different geographic regions, particularly but not exclusively between the North and South, which influenced the M&A process. The high percentage of failures in banking M&As, market globalization, and advancement in technology have caused intercultural issues to become critical factors necessary for measuring M&As performance.. Many scholars and practitioners are looking for ways to enable leaders and managers to integrate organizational and national cultures in order to achieve the M&As goals.

Rosenbaum and Pearl (2009) believe that this financing team is tasked with providing an objective assessment of the target's leverage capacity. They conduct due diligence and financial analysis separately from (but often in parallel with) the M&A team and craft a viable financing structure that is presented to the bank's internal credit committee for approval.

An example of a successful M&A operation is the merger of JP Morgan and Chase Manhattan that created the second largest bank holding company in the United States. In 2000, JP Morgan and Chase Manhattan merged in a deal reportedly worth \$ 35 billion, one of the largest mergers in the history of banking industry. The main reason of the success is a good plan for integration and consolidation of human capital. Kim and Finkelstein (2008: 617-646) conclude that finally, when banks with different product offerings merge, the integration process is less likely to give rise to the need for downsizing, which could result in loss of human capital and demoralized employees.

Another scholar (Fiordelisi 2009) claims that on the whole, integration deals often require that the banks involved in the deal change their corporate culture: the workforce may have to change their mindset, cultures and behaviour. In addition, M&A deals involve transformation in the organization structure and, consequently, power redistribution among the managers of the two banks: the conflict of interest and loyalty may deter the success of the M&A deal. An interesting remark is also offered by Walter (2004). He argues that whereas many of the factors determining whether an M&A transaction in the financial services sector is accretive to shareholders have been explored extensively in the literature, little attention has been paid to issues surrounding corporate culture. This is a “soft” factor that arguably explains some of the differences observed between expected and actual shareholder value gains and losses. In some cases, clashes of cultures within the merged entity appear to have been the reason for M&A disasters. The author concludes that corporate culture has certainly become one of the most actively debated issues distinguishing successful from lackluster performers in the financial services sector.

## Conclusions

The increase in market globalization enables a significant growth in cross-border banking M&As that face possible intercultural conflicts. Leaders and managers involved in M&As who ignore the impact of cultural differences on M&As outcome face a potentially chaotic integration. They need to identify specific strategies, in the pre-merger stage, to combine organizational cultures in order to enhance successful mergers. These strategies involve understanding, motivating and directing staff towards the organizational goals.

The reason for focusing on cultural differences and their implications on the M&As processes is because the integration strategy will determine whether the M&A will lead to success or failure. It is important for the bank to turn the cultural differences to an asset rather than consider it as a liability. A cultural diverse management is likely to smooth the M&As processes, and also to lead to increased profitability. Hence, if one bank includes the competence and different culture of the other bank in the management, the cross-border M&A is more likely to be successful due to a more diverse leadership.

Expanding abroad through cross-border M&As will increase the bank’s knowledge of other cultures, which will make the integration process of the next M&A easier and better chances of succeeding. These outcomes are due to improved experience and having learned from previous mistakes and mis-

understandings. The stages of M&As exposes the new organization to multiple cultural challenges. The way the bank deals with these intercultural issues will determine whether the M&A will lead to success or failure. Banks that effectively manage change and culture integration tend to affect positively M&A performance. This means that the bank turns the cultural differences to something positive rather than to consider it as a critical matter.

Cultural differences are what the banks consider to be the most prominent problems when initiating cross-border M&As. In order to have a successful M&A, the top managers involved need to understand the objectives of the M&A, the intercultural issues, and the management of human resources. The banking M&As waves might imply a broader view to accommodate different cultures of merged banks, and a different leadership approach in order to redirect policies, integrate cultures, and motivate employees for successful merger implementation.

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