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Human Due Diligence

By David Harding and Ted Rouse - October 2, 2007

Someone may soon buy the European bank giant ABN AMRO Holdings. The Royal Bank of Scotland and Barclays are each offering more than $80 billion and investors are waiting to see if a sale goes through.

But if the past is a guide, markets will focus on assets, portfolios and business synergies and overlook a key to whether the deal is successful: people.

People issues are often the root of failed deals, our research shows. That is because they are frequently an afterthought in the frenzy of a deal. Dealmakers gather reams of financial, commercial and operational data. But they often pay scant attention to what we call human due diligence -- understanding the culture of an organization, the roles that individuals play, and the capabilities and attitudes of its people.

When the human factor takes a back seat, post-merger problems quickly pile up: Managers are forced to postpone decisions or are blocked from making them. Differing management styles frequently lead to infighting. Talent exits. Integration stalls. Investors grow impatient.

In some of the most successful deals, there's a flip side. Rigorous human due diligence helps acquirers get off to a running start. Having done their homework, the new bosses can uncover capability gaps, as well as defuse points of friction and differences in decision making. Most important, when critical people decisions are made right away -- who stays, who goes, who runs the combined business -- an acquired business is much more likely to succeed.

This benefit is borne out in research we conducted among managers involved in 40 recent merger and acquisition (M&A) deals. In 15 deals classified as "successful," nearly every acquirer identified key employees for retention during due diligence, or within 30 days after the announcement. This task was carried out in only one-third of the unsuccessful deals.

Dealmakers thus need early answers to some key questions: What's the thesis for this deal -- the rationale for doing it in the first place? Which individuals are critical to making it happen? What organizational structure will best support it? And whose culture should predominate? Once answered, human due diligence can then determine how well the target's current structure and culture will mesh, which top executives should be retained, and how to manage the reaction of the rank and file.

For example, when Cargill Crop Nutrition acquired IMC Global in 2004 to form The Mosaic Company, a global leader in the fertilizer business, the Cargill team quickly saw that the two companies' organizations had similar structures that both functioned well. They decided the new company would combine the operations and functional organization of both.

The new CEO, who came from Cargill, then set out to fill the top boxes. He met with the top 20 executives from both companies and questioned the heads of HR and the CEO of IMC Global. These interviews revealed differences between Cargill's consensus-driven decision-making process and IMC's more-streamlined approach, which emphasized speed.

Cargill's culture prevailed. But with knowledge of the individuals and how they worked together, the CEO selected leaders who reinforced this position. Cargill managers also sought to explain the benefits of their decision-making system to their new colleagues, rather than simply imposing it.

In some situations, the target's people are precisely what the deal is all about. The Chinese company Lenovo's acquisition of IBM's PC business, completed in May 2005, is a case in point. In fact, the board of Levono's controlling shareholder allowed the company to pursue the deal if -- and only if -- it could recruit IBM's senior executives to manage the merged enterprise. Levono's interest ran beyond the top people. The company offered a job to every IBM employee, with no obligation to relocate or accept reduced compensation.

Most companies, however, will need to determine as soon as possible who goes and who stays. And that requires the kind of assessment that goes into any high-level hiring effort. Acquirers should gather performance reviews, interview third partie, and assess executive track records. They should probe leadership styles and evaluate how managers dealt with difficult decisions. Most of all, acquirers should get to know potential new colleagues as individuals.

How the organization feels is a primary way public companies attract and retain talent. And how an organization behaves as a unit determines its success.

Up front, human due diligence helps acquirers decide whether to embrace or kill a deal and determine the right price. It also lays the groundwork for a speedy integration. Ultimately, for ABN AMRO and other big deals, the people part of the equation will be key to its success.

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