Soft due diligence in mergers and acquisitions

Thesis

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Preface

This thesis was written for Dr. Maaike P. Lycklama à Nijeholt and the R&D Centre for Entrepreneurship & Business Innovation acts as the sponsor. The Thesis concludes my masters of Finance and Accounting at the Rotterdam Business School. During my studies in the Netherlands I have meet many wonderful people and I would like to extend my thanks to Dr. Maaike P. Lycklama à Nijeholt and Mr Jordi Den Ouden, MBA who have been invaluable to creation of this masters. I would like to thank my parents and family for all their support.
Executive Summary
Soft due diligence should play a significant role in mergers and acquisition due diligence since it provides qualitative information which is not present implicitly in the company records. An effective due diligence in merger and acquisition can help acquiring companies in avoiding overpayment, also insuring synergies are identified and exploited. An ineffective due diligence process can lead not just to overpayment but to the failure to achieve synergies or a break-up of the joint company. Many companies fail to achieve the projected synergies or overpay when conducting mergers and acquisitions because they conduct inadequate due diligence. Due to these consistent failures of mergers and acquisitions the creation of better and more useful due diligence processes are required to maintain effective financial system.

The objective of this research thesis is to recommend a number of soft due diligence questions that could be included in due diligence process to provide more information on the soft aspects of companies so to improve the overall depth and quality of due diligence. To achieve this, three case studies will be conducted by interviewing three main groups that are within the due diligence process the companies that acquire and merger with other companies, the legal firms which create and conduct due diligence and the consultancy agencies that conduct the corporate due diligence which includes soft aspects. Primary data will be collected from these case studies, in-depth interviews will use used to gather the opinions on soft due diligence and due diligence process and the collection of due diligence check lists when possible. Secondary data is collected from the academic papers, company papers, textbooks, academic journals and other sources.

Based on the theoretical and empirical research which has been conducted, the researcher was able to find that the field of soft due diligence is already in use in corporate due diligence and also in the minds of some management who deal with due diligence as a regular position in large multinationals. They have been subdivided into certain fields and have people that specialise in the due diligence under the main title of corporate due diligence. You can have topics such as human resource due diligence and ICT due diligence which are soft due diligences. Although there are certain soft due diligences done at different stages of due diligence and the reality of due diligence can effect the ability to conduct soft due diligence, such as time frame and access. Three key stages of mergers and acquisitions shape the type of due diligence topics inquired about. Initial merger talks allow for soft due diligence of the management and the overall fit of the deals appropriateness for both parties. The second stage were the formal due diligence process is being conducted include limited on site investigation, documentation collections and checks conducted on culture, ICT, environment, and human resources. The final and due diligence stage is done in the post-merger integration stage, Deloitte and KLM both indicate that this stage is vital in making sure culture clash does not happen and that the projected synergies are created.

Based on the research conclusions a number of recommendations were written up answering the main research question, these recommendation are as following:
Pre M&A soft due diligence questions, soft due diligence can collect information on management behaviour and attitudes towards the merger and communication strategy.
M&A soft due diligence questions, soft due diligence can collect information on culture and communication, environment, organisation, human resources, ICT depending on the access given.
Post M&A soft due diligence questions, soft due diligence questions areas at the post merger stage are the same as the merger stage but can be done in a in-depth manor due to access and its goal is for maintain of key assets and creating synergies rather than the negotiations that the two previous stages dealt with.

The literature review and the empirical research found that the ineffective soft due diligence resided within a number of other factors such as merger waves, managerial hubris and empire building which became apparent as the source of the ineffectiveness of due diligence and bad post-merger integration was discussed. The recommendation that at 3 stages of merger that there are a number of soft check question areas that can be inquired about, they are: management attitude, cultural aspects and communication, human resources, information communication
technology, environmental and health and safety. As a final recommendation further study into the interplay of these factors is a possible way to better understand why mergers do not reach expected financial results of the pre merger stage.

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Chapter 1: Introduction

1.1 Introduction

The business world has many narratives, which have changed and evolved over time as technology coupled with globalisation changes the dynamics of how business is done and at what pace it is done. One such narrative concerns mergers and acquisitions (M&A's). Mergers and acquisitions have gone through a number of challenges as new frameworks of how businesses should develop and manage assets have changed over time. Two such examples of this are, trends for specialist companies that only focus on their core competences or large mega corporations offering a diversified offering of services and products. These trends are perceived by the growing data and analysis of mergers and acquisitions, with many ideas on what causes mergers and acquisitions and also what can cause the failure of mergers and acquisitions. With this in consideration, despite extensive due diligence tests on companies which are being acquired or merged about 70% of mergers still fail (Bain & Co, 2004). Other studies back up these figures, the estimated failure rates for M&As are typically between 60 and 80 percent for acquisitions (Marks and Mirvis, 2001). These figures have been repeated by many studies over the years as illustrated by “Research into the success of thousands of mergers and acquisitions, large and small over the last twenty years shows that between 55 percent and 77 percent fail to deliver on their intended financial results. Most acquiring firms actually lose money on the acquisition.” (Carleton and Lineberry, 2004), “lion’s share of acquisitions depending on the industry, roughly between 65% and 85% repeatedly fail to create shareholder value.” (Wankel, C. 2008). In this study the research will focus on soft due diligence tests, which are complementary to the financial, legal and limited organizational tests which are done in present “hard” due diligence tests, soft due diligence tests are seen as complementary as they are supposed to find aspects of companies that have been identified as the causes of culture clash and result in the high failure rate.

The purpose of this thesis is to identify a number of soft due diligence checks that can be included into due diligence tests and explaining the rational for including them in the due diligence tests. The analysis is performed using meta-analysis of the literature and interviews with companies conducting due diligence tests for mergers and acquisitions. A meta-analysis is the statistical analysis of a compilation of literature. The meta analysis coupled with the interviews should give a basis of what due diligence test questions are best suited for inclusion in future due diligence tests.

1.2 Problem statement

As discussed above the majority of acquisitions, roughly 65 to 85 per cent fail to create shareholder value (Wankel, C. 2008). These failures can have a permanent impact on the companies, consumers, suppliers and the overall markets. Understanding why these failures happen even with a extensive due diligence check is one of the challenges facing business and academia. A number of theories have been identified as explaining why mergers and acquisitions fail, managerial hubris has been identified as a possible factor, but also communication difficulties, lack of apparent synergies, incorrect judgement of price, company structure, cultural differences, and culture clash are mentioned as possible failure factors. These theories of the causes of the failures of mergers and acquisitions have been written about at length in academia. For this Thesis the researcher will be focusing on the cultural and soft aspects of companies due diligence.

Soft checks differ from hard checks, which focus on legality, taxation and corporate issues. Soft checks refer to checks on cultural, behavioural, organizational differences. These soft factors that have traditionally not been included in due diligence tests, will be identified and presented in the
recommendation with further explanation.

1.3 Research Objective

By researching into what causes the failures of mergers and acquisitions in the context of due diligence tests conducted. To create better techniques for due diligence tests, combining the common financial, legal and organisational checks (hard due diligence tests) with checks on cultural differences and on difference in behaviour (soft due diligence).

1.4 Research Questions

1.4.1 Central question:
What sort of soft due diligence tests would be beneficial to be included in due diligence tests for mergers and acquisitions to give a more detailed information on the soft aspects of companies?

1.4.2 Sub questions
Theoretical questions:
- What is the relationship between the failures of mergers and acquisitions and due diligence tests?
- What are the risks when conducting mergers and acquisitions?
- What are the factors that affect company's ability to successfully merge create synergies when conducting a merger or acquiring a company that is not tested by due diligence tests?
- What are the factors that are checked in due diligence tests and how do they compare with the factors which have caused failures of mergers and acquisitions?

Empirical questions:
- For my sponsor what are most important untested factors in mergers and acquisitions?
- For my case study it will be found, what areas of soft due diligence are conducted by firms in the Netherlands?
- For my case study and sponsor, what aspects of soft due diligence do management require more information on?
- For my sponsor, how can soft due diligence information be collected?

1.5 Summary

Chapter one elaborates on the main focus of the research the thesis. It starts with an introduction to the large number of failures of in the global mergers and acquisitions over previous years and the empirical and quantitative evidence of “What sort of soft due diligence tests would be beneficial to include in due diligence tests for mergers and acquisitions to give a more detailed information on the soft aspects of companies.” It also introduces to internal and external factors that influence mergers and acquisition success. With managerial hubris, the success of mergers and acquisitions is warped by the perceptions of management. Other factors such as merger waves, rational herding, agency and empire building have a impact on the success rate of mergers. After the introduction of these concepts a problem statement focuses from the macro-picture of
Merger and Acquisition failures of managerial hubris, merger waves, empire building onto the subject of soft due diligence and what soft due diligence is, outlining that the thesis is going to research possible soft due diligence checks.

The research objective goes into that the thesis will be doing research into what causes the failures of mergers and acquisitions and the due diligence tests conducted in mergers and acquisitions in order to create better techniques for due diligence tests, to achieve the goal of a better due diligence test.

By setting out this objective while keeping the object in context of the wider M&A failure subject the main research question is presented, “What sort of soft due diligence tests would be beneficial to include in due diligence tests for mergers and acquisitions to give a more detailed information on the soft aspects of companies.” This research question is the question proposed by the thesis sponsor to be answered, so provides the cornerstone for the whole thesis and the sub-questions that are based on what needs to be answered to answer the main question.

In order to understand the research problem, the investigation of what soft due diligence tests for M&As would give more information on the soft aspects is broken down into a number of sub questions to better focus the study. The end of research questions break them down into theoretical questions and empirical questions. Then the overall research structure of the research is presented in a diagram to visualise the research process. The next chapter develops and elaborates the theoretical framework, the literature review which includes economic theories and definition of failure for M&As and relates to soft due diligence topic.
Chapter 2: Literature review

2.1 Introduction

Substantial research has been conducted into mergers and acquisitions in finance and economics literature. This literature review considers and addresses this literature. The first section of the literature review outlines the basic economic theory and what is documented about mergers and acquisitions. The second section of the literature review outlines the possible reasons for mergers and acquisitions and the related economic literature. The third and fourth sections deal with how the literature discusses the definition of failure and the reasons for failure in mergers and acquisitions. The fifth section deals with how soft due diligence is presented in present literature. The sixth section looks at how the literature explains how due diligence tests are conducted. The seventh section consists of concluding remarks on what the literature results are.

2.2 Economic theory

This section of the literature review will provide an overview of the literature and the effects that mergers and acquisitions have, so as to give some background on the subject that is being researched. Economic theory indicates that if two companies do merge the resulting merged company would have a lower level of profit and supply than the two companies aggregated. It is also noted that the competition would increase their share of the demand and profits. (Pepall et al, 2005) This Economic theory would then indicate that it is a disadvantage for the companies merging, whereas in the real economy mergers and acquisitions are part of the economic reality which is called the merger paradox, which results in the majority of acquisitions roughly 65 to 85 per cent failing to create shareholder value, which creates the paradox between the actions of companies pursuing mergers and the intended results, validating the theory. (Wankel, C. 2008)

2.3 Acquisition reasons

2.3.1 Synergies

Explaining the reasoning behind mergers and acquisitions the ability to create synergies in the new entity has been cited as a major reason. Due to many forms of companies and mergers and acquisitions there are a number of potential sources for synergies, from cost reductions by being able to centralise R&D functions or clear responsibilities in the management functions, joint activities in foreign markets and increasing returns by scale in production and purchasing. These synergies are broken down into 3 main types, financial, operational and tax synergies. (Kürsten, W. 2008) States that these synergies are used as the rational as to why the payments of the premiums are needed, but that much of these synergies are possibilities. The reality of the situation can mean they are never realised which creates an inherent risk of lack of credible data to base mergers on synergies as they are possibilities.

2.3.2 Agency theory & Empire building

The problems of agency were identified because firms having a difference between the management and the ownership can also create differences in objectives so the managers or agents of the will of the owners acted in ways not in the interest of the owners, identified in 1932 (Berle and Means, 1932) observed that in joint stock companies the ownership has separated from the control and that this process could lead to a conflict of interest. So the ownership interest of
generating maximum profit could come into conflict with the managers as the managers could try and maximise utility. The aspect of agency is also identified in M&As in the 1980s. It was proposed by (Jensen, 1986) that M&As are driven by the managerial incentive to grow the company beyond what is its optimal size. Due to the management deciding whether or not to do the M&A and the price for the purchase but not the stockholders of the firm can lead to circumstances were agency theory appears. Due to the power situation, the management's motivation for the acquisition could be against the stockholder wealth maximisation motive and more the management's self-interest. This self-interest can be Empire building. In (Shleifer and Vishny, 1989) it is explained that takeovers can be a managerial strategy to make the management indispensable to the company but at the expense shareholders and their goal of the maximisation of profitability. So if there is the possibility that the management get things which are in their self-interest from the competition of the transaction there is a possibility that they cannot see the costs created, that will affect the shareholders' interests.

Agency theory and empire building is linked to the relationship between management and owners unequal information, management being more informed about the situation leads to information asymmetry.

2.3.3 Hubris
To explain the high percentage of mergers and acquisitions that fail to create shareholder value hubris has been identified as a possible cause. Overconfidence can be the result of past results leading to people taking risks, which might lead to the overpayment for companies which can lead to worse results if they had invested the capital in other ventures. This is supported by that the highest of bidding premiums happens to depend on whether or not the bidder have a track record of pre-merger in terms of the market to book and price to earnings ratios (Raj & Forsyth, 2003) These prior success can lead to overpayment thus lower bidder returns and higher seller profits leads to higher chance of failure in creating shareholder value. It is indicated that premiums paid by hubris firms are 1.5 higher on average. Which indicates Hubris contributes to overpayment which has impact on the financial results of mergers and acquisitions.

2.3.4 Rational herding
Also other theories have been proposed which deepen the understanding of why merger and acquisition happen, Hans Schenk in (Wankel, C. 2008) proposed that rational herding which is dependent on reputations and its impact on managerial expectations could attribute to an explanation of mergers and acquisitions. Scharfstein and Stein's model of agency is that the agents try to fool their shareholders and if they succeed get rewarded, rational herding adds how informational problems cause imitation. In this theory managers look at the decisions made by previous managers and seek to imitate those previous decisions and actions due to reasoning that the decision was based on a good rational. Herd behaviour in which everyone acts based on what everyone else is doing is a observed phenomenon in other areas of human behaviour. The Herding model is able to model and explain why some managers choose paths that their previous managers made rather than using their own information.

2.4 Definitions of failure
There are multiple definitions in which the relative success or failure for mergers could be defined. As described in (Roberts et al, 2010) it depends on how you define failure and success. An extreme definition changes dramatically the number of failures and successes. If the definition of
failure is taken to the extreme of the failure spectrum that of the direct results of the mergers is the company post-merger goes into liquidation, the success rate would be high. On the opposite side of the spectrum if the merger is analysed from a short-term financial perspective, such as a significant increase in the net income or other measures the success rate would be low. If the measure is long term value added from the creation of synergies the success rate is mixed. Due to this it is better to select a definition so there is no mistake about the meaning and criteria.

2.4.1 Short-term failure

(Roberts et al, 2010) Detailed a few documented short term effects of mergers and acquisitions being announced. One such effect is when the announcement is made the value of the target company shares will increase but the shares of the acquiring company value will remain static or decrease in value. This inclination for the target share prices to increase has impacts on the short-term financial success of the merger or acquisition, due to the observed behaviour of the targets share price can result in the company acquiring it paying a inflated price for it. The value difference between the pre bid value and merger bid value represents the inflationary premium and as a result of this inflationary premium the price of the acquired companies are overvalued by the time of the acquisition. This effect is increased with the existence of more than one bidder. Shareholders could have two different views of success in this context of an acquisition. The Target shareholders who sell shares to the buyer at a premium rate will make more money than they would have otherwise. For this group of shareholders in the target who sell the short-term view of the success of the acquisition maybe positive. The shareholders who remain invested in the target and hold shares of the newly merged company will have a longer-term perceptive and view of success.

2.4.2 Long-term failure

(Roberts et al, 2010) Also document the long term view, while explaining that it is more complex and less clearly defined. Identifying that the literature suggests that longer-term performance is dependent on a wide range of factors and variables. If success in the longer-term is analysed in financial terms the long term success of mergers is dependent on two main areas: Payment method and implementation. Mergers are financed by either a cash deal or a share deal or combination of the two types. In a cash deal the existing shareholders sell their shares for a cash sum. In a share deal the existing shareholders receive new shares for their existing shares. They report that in a buoyant economy more deals are done through shares because the value of the shares are likely to increase over time. Although companies that are paying out in share will be more likely to have an overvalued share price, particularly around the period before the deal. The overvalued share price is linked to deal speculation driving a increase in the acquired companies share price. With the completion of the deal the value of the stock generally falls as the true value can be analysed. It was shown in that companies that paid in cash had higher debt levels but undervalued stock. They state that this evidence suggests that in the longer-term mergers that are paid for in shares perform less well from a shareholders point of view if the economy is depressed, if the economy is growing companies who paid for the deal in shares are better off. The final long term problem indicated by the analysis of literature is badly implementation, mergers which implementation last longer than originally intended or badly planned so badly implemented are a measure of if long term measure of success.
2.4.3 Legal definition of failure

There are four main legal definition of business failure as outlined in (Kahya, E. 1997) a firm is considered to be failed 1) if it filed for chapter 7 or Chapter 11 of the US Bankruptcy Code, 2) if the firm is unable to redeem its preferred stock or pay preferred stock dividends; 3) the company was unable to pay the principal or interest on debt, 4) it restructured or attempted to restructure its debt to avoid going into bankruptcy.

2.5 Why do mergers and acquisitions fail

Looking at the mergers and acquisition literature a number of theories on reasons for the failures are presented, a number of areas are highlighted as key areas of the problems and why some mergers and acquisitions fail to achieve the projected results which will be analysed below. The factors that cause failures can be attributed to different stages of the merger and acquisition, pre-merger and acquisition agency failures can contribute to the failures, post-merger and acquisition the soft factors of culture and communications can contribute to the failures.

2.5.1 Agency failures

Wrong reasons which encompasses the problems that arise from agency theory such as empire building indicate that if a merger is done for reasons other than what is best for the stockholders it is a failure. As (Jensen, 1986) indicates M&As can be driven by the managements incentive to grow the company beyond an optimal size which would mean lower returns for the stockholders but would mean the management who are the agents of the stockholders would fail as the agents in their jobs of maximisation of profit but succeed in their own goals, so a M&A which looks like a failure from the stockholders point of view could be a success by the agents view of satisfaction of their desires. So agency theory highlights the difference meaning of reasons and view point on results which have the effect on what a failure is. Agency failures of management is linked to hubris, they are linked by management behaviour.

2.5.2 Communication

Communication and organizational culture in the work of (Communication) are described as linked concepts, as communication practices influence the organizational culture and vice versa. (Fitzgibbon and Seeger, 2002) found that cultural differences were a key factor in the failure of the Chrysler and Daimler-Benz failed merger, citing pre-merger communication creating unrealistic expectations for the deal that could not be meet in reality. The communication style and communication systems are effected by cultural differences. (Hall, 1976) Argues that individuals which are from different culture and societies communicate differently. The sharing of information and communicating to employees have a huge influence on the integration process and the creation of the new culture and expectation of the employees (Appelbaum, Gandell, Yortis, Proper, & Jobin, 2000). In Papadakis (2005) it is further confirmed that using an appropriate communication strategy in sharing information and communicating with employees can significantly improve the odds of success in the post-merger integration phase. The identification that communication and culture as both a key cause of merger failures and as solvable situations with appropriate appreciation and dealing with the issue is key to establishing and development of tools to identifying the problem.

Others have linked communication and culture, “The work of Geert Hofstede (1980, 2001) has been widely quoted as foundational for understanding cultural and business communication.
(Hofstede, 1980) defines culture as the collective programming of the mind, which distinguishes members of one human group from another. 

(Cheng, S. and Seeger, M., 2011) This collective programming links culture and communication, which was repeated in Fitzgibbon and Seeger, Cheng, S. and Seeger, M. which indicates that there is a link.

2.5.3 Cultural aspects

Culture has been identified as a contributing factor to the failure of mergers and acquisitions, due to the ability of culture to create cultural clashes. Cultural clashes have been identified as the contributing factor to failures such as the failure analysed in (Fitzgibbon and Seeger, 2002) which found that cultural differences were a key factor in the failure of the Chrysler and Daimler-Benz failed merger. (Carleton, 2009) Evaluating the ways in which culture clashes happen and identified key areas to evaluate company culture, these twelve identified key area are identified as not being presently included in due diligence tests.

Understanding the organizational culture from the perspective of non-managerial employees has been developed. The culture can be analysed as a survey based quantitative design, once such tool developed by Cameron and (Quinn, 2011), was the Organizational Culture Assessment Instrument (OCAI), it gathers data from employees completing a survey gaining insight into the cultural dimensions of the included cultural aspects of the organization. Senior management can use such tools to become aware of the culture in the post-merger process and create the pressures that will positively impact the merger success.

Looking at data from 2006 organizational mergers were averaging an approximate rate of 60% failure if the failure was calculated as failing of meeting the anticipated financial expectations (Mitleton-Kelly, 2006).

The relationship that organizational sustainability has with organizational culture and sustainability has been ignored in the merger process. (Creasy, Stull, & Peck, 2009; Knilans, 2009; Nemanich & Keller, 2007). It is expanded on by (Horwitz et al. 2002) that the lack of attention to what the newly formed culture is generates uncontrollable operational costs which could lead to organizational failures. This can cause a misdiagnosis of the problem putting the blame on processes or procedures rather than dealing with the underlying origin of the cultural clash that results from the integration of two entities, (Bruhn, 2004) contributed to this analysis confirming the problems faced by companies merging when organizational culture has been overlooked.

The Organizational Culture Assessment Instrument (OCAI) evaluates six organizational Dimensions of company culture:

<table>
<thead>
<tr>
<th>Six organizational dimensions of company culture</th>
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<tbody>
<tr>
<td>1) dominant characteristics of the culture</td>
</tr>
<tr>
<td>2) organizational leadership within the culture</td>
</tr>
<tr>
<td>3) management of employees</td>
</tr>
<tr>
<td>4) components of organizational culture that keep an organization sustainable</td>
</tr>
<tr>
<td>5) organizational strategy</td>
</tr>
<tr>
<td>6) success criterion</td>
</tr>
</tbody>
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Table 1: Source (Cameron & Quinn, 2006)
Due diligence checks have been changing over time and some include areas which are described as soft due diligence. In (McIntyre, 2004), it is outlined that the primary goal for due diligence is to validate the deal, validating the price, identifying the leadership, discovering significant liabilities and analysing people issues that could compromise the deal, it identified that the human resource section supports the goal of identifying cultural attributes of the target company such as speed to market, total rewards systems, management style and leadership style. Explaining that the primary focus of due diligence related to HR practices has been on employment policies and staffing procedures but explains that HR must also evaluate the inconsistencies within the merging organization, communicate and comprehend the cultural barriers in transactions.

2.5.4 What do current due diligence checks look like

A sample due diligence check list from S&S shows how a legal check list is written up:

Table 2 source: (Legal due diligence questionnaire S&S, 2013)

Due diligence checks lists have clear questions and requests to be completed by the company being acquired, they are presented in a form with chapters and separated into sub-questions.

What does current soft due diligence checks look like?

The present soft due diligence checks can be spilt into soft due diligence conducted in field and soft due diligence checks which exist in literature, in present soft due diligence human resources is a key soft factor included in due diligence. Soft factors which have been included in soft due diligence checks fall into a much wider spectrum than human resources.

In (J. Robert Carleton, 2009) 12 due diligence checks are proposed, they are:
| 1) The intended direction of the company and the intended results. | What is the companies business plan, what is the companies purpose and intent for the organization, what does the business activity within the company intent to result in? How are these intentions explained, described and communicated to the members of the organisation. |
| 2) Key Measures | What does the company measure, why do they measure this, what are happens as a result of these measurements? These measures give a insight into the manner in which everyone from the executives to the lowest rank employee is driven. |
| 3) Key Business Drivers | In the business strategy what are the primary issues? So what is the focus for the company business strategy and how do they define it, is it price differentiation, market share, service quality, innovation, reliability? This is highlighted as a indicator of how the company places itself with the market and what will the managements effort will be within that industry and market. |
| 4) Infrastructure | Dealing with how is the company organized, it can mean how is the reporting relationships organised, to how the staff interface with management. Building up a clear understanding of the way the relationships between groups and units in the organization functions. |
| 5) The Organizational Practices | What are the informal and formal systems within the organisation and how they impact in the the way of doing work? Examples such as how much flexibility is allowed at each level in the system. What does the relationship between the political reality and business reality. |
| 6) Leadership and Managerial practices | Looking at aspects such as how leadership and management approaches are spread within the staff? What value systems about the employees exist in the organisation? How are employees treated and for what reasons? How does the business plan get implemented though the managerial set-up? How are decisions made? Who is involved in each process? These are covered in this section. |
| 7) The supervisory practices | What dynamics are involved in the oversight of the performance of work? This is proposed as the supervisory practices can have a impact on the employees' feelings towards the management and the company and how the approach their work. The nature of this interaction been employees and the supervisory aspect of management is highlighted as the primary tone-setters for the culture of the company. |
These areas of inquiry for soft due diligence checks provide a theoretical background for asking companies that conduct due diligence about soft due diligence to see if they are already done and if they would be of interest of the parties involved in mergers.

### 2.6 Summary

The results that are found on the theory behind the reason and failure of mergers and acquisitions indicate a number of interconnected reasons for the underlying high failure rates. Research shows that the reasons for mergers appear to be reliant of management’s perception of the deals worth and it can be driven by external forces. The literature shows that the reasons that motivate the management to do mergers and acquisitions can influence the effectiveness of the mergers and acquisitions. These motivating factors effects explain some of the financial results problems with mergers and acquisitions.

Having researched and explored the available literature from the period of 1990 to 2013, the merger and acquisition economic theory can be broken down into two key schools of thought. Firstly, connecting that the managerial personnel have on mergers and acquisitions choices, managerial hubris, rational herding, agency, empire building, merger waves, these theories all highlight how human managerial choice and fallibility impact how and why mergers happen and why they fail. Secondly, the effect of due diligence process with communication and due diligence checks the process such as soft due diligence being seen as a possible reason for failures.
These two schools of thought encapsulate the present merger and acquisition literature on what causes mergers and acquisitions to fail, but the few studies that focus on these aspects are reliant on single aspects and do not consider interacting of these factors, a few of these studies mention soft due diligence and fewer mention soft due diligence being conducted and what is needed for improvement. It is also a problem that the research that has been conducted soft due diligence is highlighted as a important factor but it is not demonstrated that soft due diligence can be done in a limited time frame or limited informational environment. A second problem is limited involvement of companies that do due diligence, most research has been conducted by academics and lack information and involvement of the firms that in the real world conduct the due diligence with a few limited cases of firms involvements. Considering the above mention situations and state of the research, it is worthwhile to conduct soft due diligence research in the Dutch market.

Other aspects discussed in this chapter is definition of failure, this chapter elaborates on these definitions of failure which are critical in understanding both how academic and professionals understand mergers and acquisitions failures and its relationship to due diligence, these will be integrated into the methodology questions. This thesis aims to provide a soft due diligence check list for post-merger integration by collecting due diligence checks lists already in use to understand the structure of the due diligence checks, to collect soft due diligence questions that can be asked in the post-merger stage of acquisition to expand understanding of what has to be in a soft due diligence check list and finally to research the present soft due diligence check list systems in place at the consultancy agencies which handle soft due diligence for mergers and acquisitions. Chapter 3 focuses on elaborating the research methodology. It goes into the research strategies used in the empirical research, also going into the data collection details.
Chapter 3: Methodology

3.1 Introduction

This chapter explores and outlines the methodology, research design, and data collection method for conducting the research study. In this study, the qualitative research methodology has been adopted for the process of conducting research. These results which are in-depth answers might be hard to generalize to the whole. (Verschuren, 2010) Case studies have been used to research different areas of the mergers and acquisitions (M&A) due diligence check process, companies requesting due diligence for M&A’s, legal firms which deal with due diligence and consultants which conduct the different aspects of due diligence. These case studies have been created as information is collected so that the best questions are asked, these changes will be authorised by the supervisor. In the following chapter, the methodology for qualitative research will be outlined and discussed, the relevant frameworks and definitions that are important to make the research clear will be explained, the research tools derived from past literature and theory that have been adapted for this thesis has been defined and discussed.

3.2 Theories used in research methodology

Different approaches have been taken into account when creating the methodology for the thesis, this is brief outline of these theories used.

Desk Research: Desk research involves the collection of data from already existing sources (Crouch, 2003). Desk Research can be sub-divided into two areas, Internal Desk Research which is the using of internal documentation from the organisation to conduct desk research. External desk research is done by looking at sources from outside the organisation such as articles, peer-reviewed papers, governmental research data and papers and universities data.

Semi-structured interviews: A semi-structured interview is based around having open questions allowing for the organic growth of the conversation which allows new ideas and tangents to be brought up during the process of the interview, allowing for a more qualitative interview. The interviewer uses framework of themes and questions to explore in the course of semi-structured interview so that the key data can be obtained to answer the proposals questions.

Primary data, this raw data from first hand data collection, carried out by the person/persons doing the specific study or experiment. This data can be both quantitative and qualitative in nature and is related to what the experimenters are looking to collect.

Secondary data is that already exists that was created by others and it can be accessed by using articles, books, papers, journals both online and hard copy materials.

Research Onion

Based on Saunders research onion the overall philosophy is Pragmatism, because the most important determinant on the research is the research question and it is recognised that no single point of view can give the entire picture and that there may be multiple methods (Saunders, 2011). The research approach is inductive as the research is collecting data that is used to explore a phenomenon, identify themes and patterns and create a conceptual framework (Saunders, 2011) in Saunders if the research starts by collecting data to explore a phenomenon that can be used to generate or build theory then you are said to be using inductive approach.

The methodology choice is Mono-method qualitative descriptive because the data collected in the interviews is non-numerical data (Saunders, 2011), due to the data being held by professionals in the field of Mergers and acquisitions the researcher will use what is called a naturalistic research as the researcher needs to operate within a natural setting, to research in context and establish trust and gather an in-depth understanding. (Saunders, 2011) Because it will be using one method
The strategy choice is going to be based on descriptive study as the research is trying to gain an accurate profile of situation. (Saunders, 2011) and an explanatory study because we are gaining insights about the topic of interest. (Saunders, 2011) A case study will be used to explore the topic within its context, while also highlighting the importance of context. (Saunders, 2011) The use of triangulation will be used in order to ensure that the data collected using semi-structured interviews is telling the researcher the valid information. (Saunders, 2011)

The time horizon for this study is cross-sectional, as the study is time limited so is studying a particular phenomenon at a particular time. (Saunders, 2011)

The research onion visualisation:

![Research Onion Diagram]

Figure 1: Source: (Saunders, 2011)

### 3.3 Research Strategy

#### 3.3.1 Case Study Approach

A number of case studies were done, each case study was focused on a specific sub group in due diligence tests, the companies commissioning them (KLM), the legal firms (Simmons&Simmons, CMS, NautaDutilh) creating the due diligence tests and the external contractors (Deloitte) which conduct the corporate section of the due diligence tests. One of the companies will be KLM for this case study the interview has been conducted with the head of KLM mergers and acquisitions department and a case study approach has been applied. There are three types of case studies, exploratory, explanatory and descriptive. Exploratory and Descriptive are “what” type, explanatory is the “how” type. The KLM study on how the KLM manages its due diligence checks on its mergers and acquisitions. Looking at how due diligence is
organised, how they are developed, how risks are managed. For the reasons of understanding the process the “How” type, an explanatory case study has been chosen for the research. Following on from the KLM case study a number of case studies into legal firms, consultation firms and large international companies has been conducted to better understand how they manage due diligence checks in their mergers and acquisitions.

Quinn, qualitative research would classify the thesis as applied research, under Quinns definition "The purpose of applied research is to contribute knowledge that will help people understand the nature of a problem in order to intervene, thereby allowing human beings to more effectively control their environment." (Quinn, 2002) As the thesis is researching soft due diligence to provide the provider better understanding to understand the nature of the problem to solve it, Quinns definition would be apt. With Quinns explanation of qualitative case studies being analysed and structured around in-depth case interviews "A set of guiding questions is prepared for analysing and weaving reach source, were the information is integrated into a product that provides a highly readable narrative." (Quinn, 2002) The case study, applied research fits a soft due diligence research that explores questions of structure of the due diligence rather than financial information which require a qualitative approach.

3.3.2 Desk Research
Desk research has been used in the research along with case studies. The purpose is to get external and internal information to support the creation of cultural due diligence test for mergers and acquisitions.

3.4 Research Material

3.4.1 Primary data
The primary data has been acquired in the form of interviews. The interviews purpose is to understand the whole procedure of due diligence in mergers and acquisitions, to get the merger and acquisitions manager’s opinion about the potential of cultural due diligence in due diligence checks. The example interviewee is Mr van Wieringen, the Controller Holdings of KLM side of Air France KLM. Because the Controller Holdings is in charge of the whole process of due diligence for mergers and acquisitions, he has given in-depth information on how they conduct due diligence both pre and post-merger or acquisitions from his 30 years of experience at KLM. The interview type was semi-structured interview. The researcher prepared an overarching topics and grouping of topics in advance, and tailor the questions to the progress and development of the interview, and to the person who was interviewed. The interview method was face to face, since it was easy to record, have better personnel connection, even as it requires time and cost to travel. The interview period was roughly one and a half hours, and the language focus is English as it is our common language. The above information is outlined in the following table:
### 3.4.2 Secondary data

Beyond primary data, secondary data collected from internal and external sources has been useful placing the case study in context of current research. From internal desk research, the researcher has sought for data about the type of questions asked in due diligence, including the infrastructure, work practices, legal financial checks etc. this would be available in previously conducted mergers and acquisitions documentation.

For the external desk research, the researcher has searched current literature on the creation of cultural due diligence checks and checks of other soft factors, literature on the failures of mergers and acquisitions and due diligence tests development over the period of 1990s to 2013. The data has been derived from: published reports concerning developments in mergers and acquisitions in managerial literature and research departments of business universities: reputable academic
journals and university journals available in academic databases such as JSTOR and ABT/Inform Compete were the academic journal, papers and industry report are stored. Credible website sources of academics and universities which study and publish their own papers has been used as a secondary source of papers. Business newspapers like Financial Times, and Economists. The aim of external research is to understand the implementation of cultural due diligence, the cause of failures in mergers and acquisitions.

3.5 Quality measures

In order to ensure that the quality of the research is up to a standard that it can be found credible by university some measures have been set up, some of these measures are illustrated below.

3.5.1 Reliability

The research results should be conducted in such a way that it is independent of bias or as independent as it can be made, it should be objective and reflect reality. To measure the reliability of results, the researcher needs to compare different observations using same research method and see if they yield the same outcome. For this thesis multiple samples have been collected and compared. The research is reliable when the results are substantively similar that they can be independently tested and have similar results.

3.5.2 Recency

To ensure the validity and accuracy of the results, the data collected in secondary research should have been conducted recently, no more than ten years.

3.5.3 Relevance

The evidence as stated should be sufficiently related to the claim as made. The researcher has had a close examination of the evidence collected, making sure it doesn't go beyond the main claims, this shall be supported by providing digital copies of the data so they can be independently verified if required.

3.5.4 Expertise

The research data should come from a persons or organizations that have professional background of knowledge and information that is relevant to the subject matter being investigated.

3.5.5 Trained researcher/interviewer

The researcher was familiar with the interview topics and questions and has prepared a well-thought out interview guideline documentation before the interview so that they can be ready for the interview and any changes that might happen. It is necessary for the researcher to talk with the thesis supervisor as to how to design the interview questions so that they properly answer the research topic. In addition, the researcher should be aware of the skills of conducting an interview and how to compose an interview transcript and other skills such as digital recording and backing up data.

3.6 Interview analysis

Interviews were recorded and listened to with key themes written down and compared with
literature to find common themes and answer research questions.

3.7 Samples
The research collected 6 samples interviews of 1 to 2 hours long, although a more interviews requests were sent multiple times companies which meet the requirements were unresponsive.

3.8 Implementation

3.8.1 The criteria of being chosen
Interviewees had to have a reliant background in due diligence, companies were contacted and websites consulted to find employees that fit the background in due diligence required.

3.8.2 Data collection period
The period in which research is conducted has to be considered as it is a snap shot at a particular time and place. The development of research and opinions of the people interviewed is a constant factor in this area as developments are happening constantly. Experiences and company initiatives can change the overall outlook and understanding of due diligence. So the interviews were conducted in July-August 2013 period.

3.9 Summary
This chapter elaborated upon the research methodology from the qualitative angle. The research strategies provide a framework for how to answer the main research questions “What sort of soft due diligence tests would be beneficial to include in due diligence tests for mergers and acquisitions to give a more detailed information on the soft aspects of companies.” and the related sub questions. How the primary and secondary data is collected and analysed in order to complete the research objective. The interviews and open questions that will be asked to experts of the field to gather data from their knowledge, understanding, experience and perspective. These face-to-face interviews will sought to create data to form a consensus of sources to reduce bias and increase reliability of the study and data.

Chapter 4 deals with the empirical findings of the study, describing the findings and were they appeared in the interviews. These findings are elaborated in relation to the sub questions and main question. Other narratives related to literature and the topic will be described. The data collected in the interviews are used to give in-depth insight for the analytical process.
Chapter 4: Research & Findings

4.1 Introduction

Chapter 4 focuses on the Empirical findings of the interviews in the case studies, during the analysing process each interview will be broken down and the relevant answers for the research questions will be answered. The intention of the analysis is to be descriptive of the samples. The logic is that while the samples might not be a complete sample of companies that do soft due diligence in the EU that the sample of legal firms, consultancy agencies and companies being international firms they will have a representative sample of the Netherlands.

As presented in table 5, the six interviews are listed by what company the work for in alphabetical order. Although there were 29 interview questions the open ended nature of interviews lead to follow up questions.

<table>
<thead>
<tr>
<th>Company</th>
<th>Interviewee</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMS</td>
<td>Christian Delgado</td>
</tr>
<tr>
<td>Deloitte Consulting</td>
<td>Vincent Oomes</td>
</tr>
<tr>
<td>KLM Royal Dutch Airlines</td>
<td>Nico-van Wieringen</td>
</tr>
<tr>
<td>NautaDutilh</td>
<td>Wendy Guepin &amp; Joost den Engelsman</td>
</tr>
<tr>
<td>Rotterdam School of Management (Erasmus)</td>
<td>Buhui Qiu</td>
</tr>
<tr>
<td>Simmons &amp; Simmons</td>
<td>Albert Wiggers</td>
</tr>
</tbody>
</table>

Table 5: Source: Timothy Dixon

4.2 Empirical research and the finding

The following chapter presents the results of the case studies of companies involved in due diligence for mergers and acquisitions. This chapter discusses the results of case studies and the answers to the research questions.

This study examined the merger and acquisitions (M&A) due diligence procedures and how soft due diligence is integrated and not integrated into them by interviewing participants in the M&A process. This chapter presents the results of the research methodology in the previous chapter. Firstly the data collection method, geographical data and response rate is outlined. Next, the findings and results of interviews that are tied to the eight research questions.

4.3 Geographical data

Data was collected exclusively in the Netherlands in Rotterdam and Amsterdam. Due to the Dutch commercial lawyers, consultancy firms and large corporations being based in these two cities, making geographic sample focused.

4.4 Response rate

One out of ten large multinationals corporations responded positively to requests for interviews,
four out of ten legal multinational firms dealing with due diligence responded positively to interview requests positively and one out of three large multinationals consultancy firms responded positively to interview requests. Out of ten academics contacted 1 out of 10 replied.

4.5 Research questions

After conducting the interviews and analysing them the answers will be presented that correspond to the research questions.

4.5.1 Question 1:

What is the relationship between the failures of mergers and acquisitions and due diligence tests?

Interviews at KLM and Deloitte identify a few relationships between the failure of mergers and acquisitions if described as the inability to achieve projected synergies and overpayment, these relationships are as described.

-Rushing due diligence leading to information being incomplete which lead to the company not achieving the synergies they projected, KLM pointed out that a company purchased a distribution system in Spain without looking at the rental contracts leading the company to be unable to achieve cost efficiency synergy.

-Not asking the correct questions due to rushed due diligence, KLM described a case were a company rushed a purchase asking only about cash flows but not costs, only latter to find out cost-effectiveness was very low causing them to sue KLM.

-Deloitte described companies that had done due diligence without consideration of the soft aspects in post-merger integration leading them to face huge financial, Deloitte stated that post-merger integration is reliant on due diligences to create the first day of operation plans and without understanding the soft aspects of a company it is very easy to lose synergies and be unable to recover them as the soft aspects are retained in the employees and the network around them.

-KLM, Deloitte and the 3 law firms identified due diligence tests and rushed due diligence tests can lead to unforeseen problems, which leads to overpayment. Overpayment is considered a failure for mergers and acquisitions as it is a waste of capital, for the consultancy firms which are both law firms and consultancy companies like Deloitte they identified their job was to make sure the merger was a success for the company, the success being the completion of the merger, to do this their jobs were to identify problems so that they can be considered in the deal, be that as a deal breaking issue or a reduction of payment issue. KLM identified that a merger success was more than its completion but if the deal was beneficial, citing the Air France merger compared to the British Airways proposed deal as a example of how management decides if a deal if worthwhile and what is successful, citing that the Air France deal was a more equal partnership than the British Airways for the management, not that it presented better synergies but was better for management.

-KLM and Deloitte identified in their interviews that due diligence is based on both experience of the personnel conducting the due diligence and documentation from legal firms and consultancy firms, this relationship between experience and due diligence is not conducive to transparency of due diligence processes, this effects the ability of due diligences to avoid failure.

The interviews indicate that relationship between failure of mergers and acquisitions is a complex interaction in between managerial factors such as hubris/empire building and ineffective due diligence, management create situations were due diligence is not conducted properly and/or the post-merger integration is incorrectly done leading to the failure of the mergers from a synergies and overpayment standpoint. Because due diligence is a mix between hard and soft factors and the experience and quality of measures are not standardised or regulated which perpetuates the high failure rates.
4.5.2 Question 2:
What are the risks when conducting mergers and acquisitions?

Deloitte, KLM and the Law firms identified a number of risks when conducting mergers and acquisitions. Deloitte identified the risk of losing possible synergies if post-merger integration is not performed and prepared for, KLM and Deloitte identified overpayment for companies as a risk as in correct due diligences can lead to factors that would reduce bidding prices being missed leading to overpayment. KLM, Deloitte and the Law firms identified unknown legal risks can cost both the buyer and seller in the deal if they are left unknown.

4.5.3 Question 3:
What are the factors that affect company's ability to successfully merge and create synergies when conducting a merger or acquiring a company that is not tested by due diligence tests?

Based on the results of the interview at Deloitte a number of factors affect the ability of a company to conduct due diligence, mainly access and time, this means due diligence tests have certain blind spots, areas were you are unable to collect information or limited information. These areas are managerial commitment at pre-merger stage, due diligence stage areas that are not tested in depth are HR, environmental issues, company culture, key staff and communication, as mentioned in the Deloitte interview, these factors all affect the post-merger integration phase.

4.5.4 Question 4:
What are the factors that are checked in due diligence tests and how do they compare with the factors which have caused failures of mergers and acquisitions?

Deloitte indicated a number of factors which are tested in due diligence, they are: “Legal due diligence, Tax due diligence, Commercial due diligence (what is the management plan. Company analysis “where are we now, Market analysis, competitor analysis, Forecast review/business plan review), Financial due diligence (backward looking ), Environmental, HR due diligence (interviews with management about how able they are for-fill the business plan), IT due diligence”

Another factor is the type of buyer KLM, Deloitte and the legal firms mentioned two main types of buyers:
Financial buyer (Private equity, cultural due diligence not done as the financial control changes but not management/shareholders change the company doesn’t)
Strategic buyer (Corporate buyer)

The reasoning why financial buyers requires less due diligence is down to shareholders being changed but the management being left intact, corporate buyers are looking to create synergies and this requires integration, meaning more due diligence work. This is explained by Deloitte. “When you have a corporate transaction were you have the merger of two companies you have cultural issues 'but' pre-deal " but while it might have to be looked into more, it is more important looking at if they are able to make money on the deal, what should they bid do we get management on board that kind of thing, but the wider organisation it is not a thing, unless it is a red flag were there is such a big cultural issue that it is never going to work. Usually it is not a big thing (cultural issues at the pre-deal stage) In the post-merger stage it is a big thing, that process already happens before the transaction is already closed we call it day one readiness and that kind
of work we try make sure that on day one when they walk in they know what they want to do, that process could take a couple of months. It looks at how integration is going to work, what is the structure of the integration program, what are the milestones going forward. After day one you look at culture you do a cultural survey, you could also do cultural prints were you ask people to do a survey. At least it is on the radar screen also the communication part is important, day one readiness is about how you going to communicate and tell, this is done by the cultural integration team they start at day one readiness and then stay for one or two years to complete integration. Communication and culture team, the synergies case team working...”, “Three-four week period for due diligence”- interview with Deloitte partner
This coupled with the three to four weeks' time period for due diligence highlight why post-merger integration failures lead to financial failures as in a short period of time you have to evaluate and get ready a company for day one readiness and any problem with the deal logic coming from managerial hubris will affect the quality of the due diligence.

“It's a moving target no one can pin it down, we think there are two problems, 50% of it is deal logic does not make sense in the first place the other 50% is post-deal errors were they don’t do proper integration, you have to do proper preparations. Some of this is physiological like merger fever, herd instinct people want to join in, group dynamics and CEO psychology which effect pre-deal failures, these are difficult to deal with as they are our clients, post deal because of hubris and herd mentality they did not think about the integration well enough and the post-merger process badly done, it is not difficult just a lot of work. But lots of companies do it too little or too late and that is where things go wrong. Ideally if there is proper deal logic at the binging, as a part of a deal you think of the synergies, the blue print and the stages to introduce integration as that effects the synergies case and valuation so you don’t hand over risk into post deal, that is were problems can arise as you have two groups of people handing information over as both groups are not involved with the other stage. So you need someone who exist in both stages in control. Most large companies hire consultants to help deal with post-merger integration but the hand over is still dangerous. Culture is one of the underlying factor to that.”-Deloitte interview
The interview with Deloitte partner identifies two running trends in the interviews and literature post-deal errors and deal logic being wrong. Due diligence is the process going on being the all this, the larger psychological issues witch create the two major problems of post-deal errors and bad deal logic also create the situations were ineffective due diligences are conducted. These all create a Merger and acquisition market were if the expectation are inflated, due diligence are not correctly done, which leads to failure in the financial terms of not creating the synergies and overpayment. Due diligence is linked with merger waves, managerial hubris and hubris is the cause, ineffective due diligences is the effect.

4.5.5 Question 5:
What are most important untested factors in mergers and acquisitions?
There are a number of quotes which gives a insight into untested factors in mergers and acquisitions.

“their are check lists for commercial due diligence there are standard template for the deliverable but we don’t use a check list, there is a standard form but the analysis is different as the killer slide can be different based on the company. For financial due diligence it is more standardised as revenue is revenue but they also work with a standard report template and remove slides they do not need.” -Deloitte interview
So depending on what is required a number of different aspects can be tested, some standardised others aspects are different as the analysis is were the details are more subjective.

“Yes culture is taken into consideration in the post-merger process, there is a cultural print
assessment, usually you are aware of this aspects about how things run in that company explicitly
the management stage Deloitte works this out by talking to management, working out the
communication with the management, helping them understand what is in the deal for them.
Working out how culture effects communication” - Deloitte interview
“We use the heart of change by John Kotter, we base our whole strategy of change management
on that. We also have our as one methodology for cross cultural analysis” - Deloitte interview

As Deloitte mentioned they do cultural print, which is cultural due diligence which is a subset of soft
due diligence, other areas such as human resources due diligence are also tested, along with the
other soft due diligences. Culture is analysed mainly in the post-merger process, which is important
as companies which seek to mitigate overpayment or false synergies will only find out problems
once payment is conducted. So culture and communication is the most important aspect untested
in hard due diligence for mergers and acquisitions.

Deloitte, KLM and NautaDutilh mention hubris as factor that can cause problems in the mergers
and acquisitions, this factor is not tested and could also play a part in the failures.

4.5.6 Question 6:

What areas of soft due diligence are conducted by firms in the Netherlands?

Deloitte, KLM and the law firms mentioned a few areas of soft due diligence that are being
conducted by firms in the Netherlands, such as human resource due diligence, ICT due diligence,
environmental due diligence, cultural and communications due diligence, also environmental and
health and safety due diligences, managerial due diligence. These soft due diligences are not
standardised but based on the expansion of the standardised legal due diligence due diligence
check lists provided by legal firms and modified by management, the legal firms and consultancy
agencies based on industry, reason for merger, requirements. For this reason they are conducted
but each due diligence is then reliant on everyone in the deal being experienced in soft due
diligence.

4.5.7 Question 7:

What aspects of soft due diligence do management require more
information on?

Deloitte and KLM indicated that the information differs based on the reasons for the company
purchasing the company, an investment fund would have requirements for less information on soft
aspects as they are not replacing management or preparing for integration, a company that seeks
to integrate a company to create synergies in a merger or acquisition requires more information on
how the company creates value so that in the post-merger integration they do not destroy value
and understand how to create synergies, Deloitte outlined that management is interested in
learning in the initial stage of due diligence how committed the other firm is to a merger or
acquisition, once due diligence is being conducted they want information both on possible
synergies but communication and how value is created, in the final post-merger stage they want
information on all these factors. These soft due diligences are conducted under the term
commercial due diligence, which can include information of culture, communication, ICT,
environment, management, Human resources, organisation, these areas are key at understanding
what is behind the value creation, were you are going to find the synergies and were to avoid
problems so that the company can create the financial results.
4.5.8 Question 8:
How can soft due diligence information be collected?
In discussions in the interviews with the legal firms, Deloitte and KLM two systems of collecting information was available, documentation such as financial documents, leases for buildings, human resources contracts can be collected, environmental policies and legal documents to name a few examples, these documents form the basis of due diligence, answering the questions, the next qualitative collection techniques were mentioned by KLM and Deloitte that is in the company experience, KLM and Deloitte both mentioned that by going into a company to collect documents and ask questions and observations you are able to gain some insight into the company. Although Deloitte mentioned that depending on the merger you might be unable to access any documentation or in-depth qualitative information as they might restrict buyers information by using a data room/online data room to get information or limit the information to only publicly available documentation. So soft due diligence information can be collected both by using company documentation and by collecting qualitative information of observations of the company internally.

4.5.9 The Central question
“What sort of soft due diligence tests would be beneficial to include in due diligence tests for mergers and acquisitions to give a more detailed information on the soft aspects of companies”. Based on interviews there are three main stages of mergers and acquisition which require soft due diligence, pre-merger due diligence stage, due diligence stage and post-merger integration due diligence. Each of these stages have different levels of access, requirements and meaning, Table 3 illustrates these.

Table 6: Merger stage, depth and meaning table

<table>
<thead>
<tr>
<th>Merger Stage</th>
<th>Depth of information and level of access</th>
<th>Meaning for companies conduction Merger or acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-merger/initial meeting</td>
<td>Low depth, low access</td>
<td>To see if the management is committed to the deal</td>
</tr>
<tr>
<td>Merger due diligence</td>
<td>Low to high depth, low to high access depending on type of merger</td>
<td>Collecting documentation and meeting management to work out a biding price and any synergies</td>
</tr>
<tr>
<td>Post-merger integration</td>
<td>High depth and high access</td>
<td>Integration of the two firms while minimising value destruction.</td>
</tr>
</tbody>
</table>

Table 6: Stages of merger (Deloitte interview interpretation) Source: Timothy Dixon

At each stage soft due diligence can be conducted, Deloitte and KLM mentioned these 3 stages and that at each stage you have questions to be asked. Pre-merger: Management’s attitude towards the merger and the initial terms can be questioned. As the management and the conductions will affect the post-merger phase and the merger stage this is a important stage even if no hard data is collected. Merger due diligence stage: Deloitte and KLM identified that depending on the company you can get different levels of access which then reflects the amount of data you can collect in both hard
and soft due diligence, if they are closed you might only be able to access their annual reports and other public documentation, if they are open they might allow you a few meeting with management, access to virtual data rooms, visits to the offices to collect information and documentation. In this stage the main hard and soft due diligence is done before the deal is done, here soft due diligence for environment due diligence, cultural due diligence, Human resources due diligence, Health and safety due diligence, communication due diligence, ICT due diligence can be conducted, within the framework of corporate due diligence, documentation on these issues can be collected, interviews with management can be conducted and visits to corporate offices and sites can be conducted if available, these all provide a certain level of quantitative information on the company and can be used in discussions of potential synergies or negotiations on pricing and conditions.

Post-merger integration: These same due diligence checks can be verified and expanded on in the post-merger integration stage, but in more depth and to a greater degree of accuracy, Deloitte identified that this stage is vital in securing the synergies and key employees.

4.6 Summary

The research data was presented quick summary:

4.6.1 Central question:
What sort of soft due diligence tests would be beneficial to include in due diligence tests for mergers and acquisitions to give a more detailed information on the soft aspects of companies?
A: The due diligence tests found that would be beneficial to include were split up into three sub area, pre-merger due diligence which focused on managerial attitudes, merger soft due diligence which focused on Culture and Communication tests, managerial attitudes tests, key staff tests, the last area was post-merger integration were due diligence is still conducted on all of the above areas but with greater access.

4.6.2 Sub questions
Theoretical question:
− What is the relationship between the failures of mergers and acquisitions and due diligence tests?
A: Due diligence failures were tracked to ineffective managerial understanding, planning and rushing the process. These lead to Mergers and acquisitions being wrongly valued and post-merger integration failures, these can be tracked back to managerial hubris.

− What are the risks when conducting mergers and acquisitions?
A: The main risks are the inability to create the synergies projected in the financial deal leading to overpayment.

− What are the factors that affect companies’ ability to successfully create synergies when conducting a merger or acquiring a company that are not tested in due diligence tests?
A: Culture & communication, environment, HR, ICT were highlighted as a number of factors that affect the company’s ability to create synergies that are not tested.

− What are the factors that are checked in due diligence tests and how do they compare with the factors which caused failures of mergers and acquisitions?
A: Financial, legal and corporate issues are checked in due diligence tests, these factors can lead to failures of mergers and acquisitions but they were not the cause of all the failures.

Empirical question:
− For my sponsor what are most important untested factors in mergers and acquisitions?
A: Communication, Culture, managerial attitude, HR, were all identified as untested or under tested factors.
For my case study it will be found, what areas of soft due diligence are conducted by firms in the Netherlands?

A: Cultural & communication, Environmental, organisational, Human resources, ICT and managerial soft due diligence has been found to be conducted by firms in the Netherlands.

For my case study and sponsor, what aspects of soft due diligence do management require more information on?

At the 3 stages of due diligence, different aspects are required, 1st stage managerial soft due diligence, 2nd stage Cultural & communication, Environmental, organisational, Human resources, ICT and managerial soft due diligence can be conducted in a cursory manner if they are open, in the 3rd stage Cultural & communication, Environmental, organisational, Human resources, ICT and managerial soft due diligence can be seen in-depth, due to open access to the people and documents. Key aspects are managerial, Cultural & communication as they impact synergies.

For my sponsor, how can soft due diligence information be collected?

A: Information can be collected at meetings with management, meeting people in the office environment and in the virtual or real data room files.

Chapter 5 deals with the conclusions of the study, leading to Chapter 6 which contains recommendations.
Chapter 5: Conclusion and recommendation

5.1 Introduction

The conclusion and recommendation and outlines how soft due diligence has already been integrated into the wider due diligences offered by consulting firms, leading into how the research has found that managerial behaviour impacts both merger and acquisition reasoning but the ability for due diligence to be conducted. The main conclusion answering the main research question answers "What sort of soft due diligence tests would be beneficial to include in due diligence tests for mergers and acquisitions to give a more detailed information on the soft aspects of companies?". Allowing for the recommendations based on the answered research question.

My research findings and information collected from the literature concerning mergers and acquisitions, merger failures and soft due diligence outline a number of areas were soft due diligence can provide better information as part of the whole due diligence process in mergers and acquisitions. The suggestions in the recommendations answer the research question and should be taken into consideration for further research into mergers and acquisitions.

5.2 The conclusions

Academics and companies have been investigating the reasons for the high failure rates in Mergers and Acquisitions since the 80s, soft due diligences position in the mergers due diligence process has been one such sub area of investigation, soft due diligence has become widely integrated into due diligence with Human Resources, Information and Communication Technology and company culture all being included into the M&A due diligence process with their own consulting firms and departments dealing with these aspects. Which was due to a large number of factors including studies into a number of high value failures of M&As and research indicating a 60%-80% failure rate of M&A's and the increasing research into human aspects of companies into how they can create synergies or cause failure, along with other aspects that are causing failures.

These causes of failure can be attributed to a number of aspects of managerial and human behaviours. Merger and acquisition failures are mainly linked to overpayment or inability to create synergies, these are then sub divided into other theories related to why there is overpayment and lack of synergies such as the reasoning/deal logic and failures of implementation and external pressures such as merger waves, rational herding. Analysing the impacts managerial behaviours in terms of soft due diligence the reasoning failures (Bad deal logic leading to lack of synergies, overpayment, hubris ect ect) and implementation failures are linked because management that are responsible for the setting up of the due diligence process are the same management that are also impacted by hubris, merger waves and rational herding, which means the same managerial problems that create overpayment would impact the due diligence process. The causes of overpayment and lack of synergies have been researched and linked to the managerial behavioural aspects such as hubris due to the history of merger waves and agency theory in finance being established.

The failure in the adequate conducting of due diligence has been identified by Delliot, KLM and NautaDutilh coupled with the failure of including soft aspects of due diligence in M&A due diligence have been identified as reducing the information needed to preform successful integration and negotiations, these soft aspects include Environment,HR, IT and Cultural due diligence which provide information for post-merger integration and negotiations. These failures also appear in the pre-merger stage with the failure of conducting pre-merger soft due diligence with the management such as attitudes and communication.

The researcher while questioning the interviewees about soft due diligence inquired about the causes of failure to provide better soft due diligence questions, these questions based on the literature review addressed managerial hubris, communication failures, culture clash, merger
waves these interviews outlined that these factors are interlaced, as in merger waves create a environment of increased mergers which influences the management creating hubris which can cause communication problems due to rushed due diligence which leads to culture clash. These insights will need research of their own to verify but the causes of merger failure such as over evaluation, lack of synergies, can be linked to the economic theories of hubris, communication, merger waves and culture clash.

The researcher focused on discovering and understanding the main rational behind due diligence and why it is being conducted to identify weaknesses and gaps. Conducting the literature review it was found by the researcher that the were large market failures caused by herd mentality of management and agency theory/hubris are seen as key theories underlying the due diligence and due diligence failures. The theory herd mentality of management and agency theory effects the number and reasoning behind mergers which is major factor in success or failures of mergers.

The 3 stages of merger and acquisition due diligence all have requirements for soft due diligence, these due diligence's are already in use by large corporate consultation agencies like Deloitte in their corporate due diligence department, corporate due diligence is the closest to official soft due diligence. Large companies like KLM have departments dealing with mergers and acquisitions have a understanding of soft due diligence but it is not formal. Different literature placed the blame for the 60% to 80% failure of mergers and acquisitions on different factors but talking to Deloitte, KLM and the 3 legal firms it seems more plausible that the factors are interrelated, bad merger logic is caused by hubris, empire building, merger waves but they also are related problems, if due diligence is not done and the post-merger integration is badly done, while being rushed there will be a cause such as managerial hubris. So the literature in due diligence lacks clarity, while the members of the consultancy agencies have a deeper and more interconnected thinking about were soft due diligence fits into mergers and acquisitions. The 3 stages of mergers and acquisitions give us 3 areas for soft due diligence to provide beneficial information.

1 stage: pre-merger talks: Soft due diligence of management and communication.
2 stage: merger due diligence for price negotiations and finding of synergies: Human resources, communication, environmental, cultural, ICT due diligences.
3 stage: most merger integration and first day plan of action:
These are the areas of questioning for due diligence to provide useful information for the companies conduction merger and acquisition due diligence.

5.3 Recommendations

My research findings and information collected from the literature about mergers and acquisitions, merger failures and soft due diligence outline a number of areas for soft due diligence to be done for better information for the whole due diligence process in mergers and acquisitions, the following suggestions answer the research question and should be taken into consideration for further research into mergers and acquisitions.

5.4.1 Soft due diligence for pre-merger managerial meeting stage

In the initial meetings with management certain issues can be addressed, understanding these issues will provide soft due diligence and help provide useful information for the negotiations and even if negotiations should be sought, as in the case of KLM/British Airways were pre-merger managerial meetings soft due diligence lead to them being aborted.
Table 4: Pre-merger due diligence questions, Source: Timothy Dixon’s interpretation of the results of Deloitte and KLM interviews

Currently this area of due diligence is informal, management teams who conduct mergers do this, the consultancy firm Deloitte mentioned this but unlike due diligence check-lists this area of due diligence is based heavily on opinions and interpretations of the management team. Hence, this area of due diligence could be heavily impacted by external factors such as hubris, empire building and merger waves, as the psychology of the management will affect its outcome.

Each question has no numerical value or answer, they are qualitative data points to be considered and analysed.

5.4.2 Soft due diligence for merger due diligence stage

The second stage of soft due diligence is in the negotiation stage, the legal firms and Deloitte indicated that the key rational for their due diligence is to provide information that will make the deal a success, which they indicated meant the completion of the merger. The information that should be collected is to for-fill the statutory requirements and to provide information which could be used to reduce the price, get grantees and finally provide information for first day readiness and post-merger integration. For soft due diligence the same rational is true, to provide negotiations with information and provide the post-merger teams with information. Soft due diligence's sub-topics and example questions in table 5.

Soft-due diligence questions and area of soft due diligence

| Management attitude | - How is does the management see the deal  
|                    | - What are the motivation for the management to be positive about the deal  
|                    | - What are the beliefs of the management  
|                    | - What is the managements attitude  
| Communication      | - How to communicate with the management  
|                    | - What difficulties could their be with communication  
|                    | - noticeable differences in communication style and attitude  
|                    | - What do they value  
| Source             | A interpretation of the literature and the results of the interviews with KLM and Deloitte outlined pre-merger checks on management communication.  

| Culture and Communication (C&C) | -How do management communicate with staff  
-What is the managerial culture  
-What are social norms in the workplace  
-How to the staff dress  
-What is the formal and informal work practices  
-What is the formal and informal staff behaviours  
-How do the staff regard the deal  
-Is the staff misinformed about the merger or acquisition  
-How do people communicate  
-Who holds power in the communication system  
-What are the formal and informal systems of communication |
| Human Resources (HR) | -How is the human resources department organised  
-How are the staff treated by HR  
-How does HR see its function within the company  
-What is the formal structure of HR  
-What documentation and standards are there for HR  
-How do the staff see the HR function. |
| Information Communication Technologies (ICT) | -How is technology utilised  
-How does it differ in each department  
-How much investment in the equipment and training is their. |
| Environmental | -What are the environment standards/safe guards if any.  
-How does the environment standards compare to industry average and best practises.  
-What is the attitude towards these standards |
| Health & Safety (H&S) | -What are the Health & Safety standards within the company.  
-How does the Health & Safety Standards compare to industry average and best practises. |
| Source | The interpretation of the literature and interviews with KLM and Deloitte outlined merger & post merger checks. These answers were subsequently interpreted by the researcher. |

Table 5: Soft-due diligence questions and area of soft due diligence Source: Tim Dixon interpretation of interviews.

Soft due diligence has a dual purpose in main due diligence stage, firstly negotiation stage it can identify problems that can lead to lowering the bidding price, meaning less overpayment or the revision of potential synergies and in the most extreme cases highlight a problem that jeopardises the whole deal logic, leading to its abandonment. Secondly it provides detailed information for first day readiness and post-merger integration.

This currently is done under the title of corporate due diligence by large due diligence providers such as Deloitte consulting, although it does also include all aspects of due diligence such as Financial and legal due diligence. In order provide better soft due diligence, the due diligence must work within the bounded reality of 3-4 week period and limits of what companies give access to and what is reliable, finally it must provide information that for-fills the requirements of the company.
conducting the due diligence, so it should provide details for its negotiations and post-merger integration, anything outside these boundaries it is not possible to get access to or superfluous to managerial requirements.

5.4.3 Soft due diligence for post-merger integration stage

The soft due diligence questions/check list would be the same as the merger stage due diligence as the key subjects are the same, the key differences is the depth of the investigation/access and the rational for the due diligence. Because in post-merger integration the goal is not the negotiation but securing the synergies, key personnel and getting the company ready for merging without the destruction of the value in the company, so “first day readiness” plan which is the plan of action in the first day, week and month of management change over is based on the information collected in the soft due diligence process of the merger is used to help the management conduct the merging. Due diligence is done to make sure the information is true and useful, insuring value is created and not lost.

Both KLM and Deloitte highlighted post-merger integration as a key area were value is destroyed in a merger, that said all areas are important and those who go into a deal with faulty deal logic could likely fail at each stage compounding their eventual failure.

5.4.4 Soft due diligence and merger and acquisition failure

In the theoretical framework a number of overarching economic theories where outlined to what causes the failure of mergers and acquisitions. The failures which can be classified as overpayment and exaggerated or wasted synergies are further expanded and explained in the theories of hubris, merger waves, rational herding and empire building and cultural clash theories, these theories as a whole are attributed as the likely cause of merger and acquisition failure in the literature. In the interviews these types of failure and causes of failure are mentioned and explained. For this reason the soft due diligence should be kept in context of the developing literature on merger and acquisition. There is also the factor that these different topics such as hubris is linked to other factors such as due diligence in ways not yet understood completely so research into better soft due diligence questions must keep track of these external influences.

5.4.5 Thoughts from the researcher

Soft due diligence does need to be formalised, but Deloitte and its fellow consultancy company have the expertise with this subject and what little literature on the questions that should be answered are exploratory at best. To find the real questions and test them will require the help of one or more large consultancy company like Deloitte to conduct joint research as it was mentioned by Deloitte that every major consultancy company had similar ideas and check-lists but it was experience of the personnel that created the results, a check-list is nothing without the mind. So future research needs to seek partnership in my opinion.

The literature on the subject of failure of merger and acquisition jumps between accusing one or a couple of major subjects as the main reason for failure, this simplistic view is detrimental to the field, this problem is a complex system of interrelated causes and effects, Deloitte, KLM and the law firms showed me that due diligence is only as good as the management that organises it, so if the “deal logic” is messed up by managerial physiology problem like hubris having soft due diligence is a moot point, the deal is already beyond saving. For future research it would be beneficial to look at mergers and acquisition failure from a systems point of view, looking at how each problem is related, so that way each can be understood in context of the others.
5.4.6 Critical reflections

While the research does provide an answer backed up by due diligence experts in the field of mergers and acquisition in the Netherlands, into what soft due diligence tests would be beneficial to include into due diligence tests to provide more detailed information on soft factors it is not known if these soft checks are able to be put into practice, the short length of time and limited access to information in the due diligence process, coupled with the aspect that it lacks paper work, making it harder to conduct. So while the questions are based on the views of the interviewees it is not known if they can be conducted purely in the due diligence.

The size of the study was limited to the Netherlands which limited the number of possible companies to contact, so the sample is snap shot of the Dutch soft due diligence process not the whole worlds soft due diligence process, although this is less of a problem as the companies interviewed where international companies which share their knowledge so the information should be in-line with international standards.

It came out in the interviews and research that other factors impact mergers and acquisitions, hubris, merger waves, empire building, agency theory all play a part in the process, ignoring them and not trying to understand soft due diligence within the greater context could be detrimental to understanding due diligence, although due to the limited scope of the study the answer to the central research question should be not be affected to much as it focuses on purely what soft due diligence would be beneficial, not soft factors larger effects which is within area that the other major impacting factors of due diligence would become problematic.

The availability of data and theory on soft factors has impacted the study, the field of soft due diligence has been developing since the 1980s but lacks the development of other areas of due diligence which have existed around the same time, such as IT due diligence, even the large consultancy company Deloitte consulting has limited sources which it developed, so the answer to the central research question is also limited by the underlying lack of development. Although the central research question has been answered and there is information available after in-depth research, so the field soft due diligence is not completely inaccessible.
Appendix 1: Bibliography

Books

Journals
employees”, The Leadership Quarterly, Vol. 18, pp.49-68.


Other


Appendix 2: Interview Summaries

Interview summary

Multinational company

KLM: Controller Holdings at KLM Royal Dutch Airlines: Nico-van Wieringen
Nico-van Wieringen is the controller of holdings due to Air France and KLM both having holding departments, created to make the consolidation of KLM Air France work. Experienced in dealing with due diligence and post-merger integration. Had 37 years of working at KLM and has worked on 20 due diligence processes. Summed up KLMs due diligence process, they have a standard due diligence questionnaire that is 50 pages and lists all due diligence questions, including environment, finance, accounting, governance, Human Resources, which was created by their lawyers. Which they add their own questions but they work with legal and mergers and acquisitions is more of the implementations were they work as a team to see if they should make a deal or not. He is fully convinced that company culture has an impact on companies. Motivations, Business environment, ways people work. Thinks that culture is everywhere in a company as it impacts everything, environmental, HR so culture is in every field of due diligence process. Mentioning the case of KLM & British airways failing to agree with a merger but agreeing to merger with Air France being attributed to its managerial cultural difference.
Nico-van wieringen mentions that while cultural due diligence is in the heads of top managers it is not a formal effort. So there are no separate questions or sections but more the underlying tone of each question. Two stages of interest in culture is mention firstly cultural fit when talking to management and post-merger integration and implementation stage. “In the answers to the due diligence test they are hidden”
He indicated that management look informally at the 12 areas of soft due diligence checks that J. Robert Carleton uses, but that they have become increasingly important for large companies as they become transnational due to the risk of problems arising due to the global influence on rules, regulation, culture and business practices. A very informal and experience based system, which is impacted by feelings but they use these feeling impacted policy of KLM such as knowing India had no Health and Safety tradition they introduced the UK system of Health and safety to create the measures for KLM but this was due to the informal system of soft due diligence. Qualitative aspects of management such as leadership style can be found in documentations but is more qualitative if it is backed up by observations, Nico-van Wieringen stated this. You can get a intimidate feel for a company by visiting it.
Due diligence is a learning process, not a commanding process of what should be. The information to do soft due diligence is within the experience of the auditors, controllers and investment bankers not from literature. Soft Due diligence/due diligence is the entrance qualification, it is fundamental. It’s the “quality entrance exam” But buyer management can rush the exam and fail to see problems due to their attitude influencing the due diligence.

Multinational Consultancy Company

Deloitte Consulting B.V.: Partner | Strategy & Operations: Vincent Oomes

Deloitte Consulting Vincent Oomes

Vincent Oomes is a partner at Deloitte Consulting, working in the commercial due diligence and merger and acquisition strategy work side of Deloitte for 25 years, has worked with 50-100 merger and acquisitions in his job. Describing that in the M&A process there is a well-structured process, first the a investment banker is hired who look for buyers, you have a teaser, then an information memorandum, then there are none-binding offers, the highest bidders are chosen and they can do
extra due diligence. There is buyer and seller side due diligence, on the seller side you have vendor due diligence, for the vendor you prepare documents of the financial, tax, legal and markets, called commercial due diligence. On the acquisition side you have access to the electronic data room due diligence on financial, tax, legal, commercial and environmental. There is also HR due diligence and IT due diligence. So commercial due diligence is one of the seven due diligence streams. Commercial due diligence is mainly done happens for private equity buyers, there are two types of buyers financial buyers, strategic buyers, strategic buyers want to commercial due diligence to see if the business plan is good as they are not from the industry in question. Commercial forward looking, finance is backward looking. Operational side looking at the costs, a 3 or 4 week project as the time line until final offers is 4 weeks. Commercial is company analysis, competitor analysis and business plan review. HR due diligence is done by other companies, similar to head hunting films conducting interviews with the management who give a verdict how well management can fulfill the business plan.

When asked about cultural due diligence he mentioned that it is a problem for corporate transactions as you are merging two companies, for private equity you just change shareholders, in the pre-merger stage they focus on how much to bid, if they get management on board, for the organisation it is not a big thing unless it is seen as a red flag. In the post-merger integration the organisation is taken into consideration and starts before the deal is closed, it is called “day one readiness” taking a couple of months to work out how they are going to be integrated, at this stage cultural due diligence is looked at, doing cultural prints. The people and communication part is looked at by Deloitte’s team. The team conducting the post-merger integration has a work stream of communication which deal with cultural aspects.

Mr Oomes stated that Deloittes rational behind the reasons for failure are that there are two problems 50% the deal logic does not make sense which are pre-deal errors, 50% post deal problems when people do not do proper integration. Pre-deal errors can be caused by physiological of the CEO and group dynamics problems like deal fever, hubris and herd mentality. Post-merger problems are caused by post-merger integration preparations not happing or being badly done, such as two separate teams conducting the preparation and implementation which Deloitte has looked at. Most large corporations hire consultants for post-merger integration but hand over is still a risk. Culture is one of the underlying factors in post-merger integration, Commercial due diligence structure is based on a standard template which is edited per requirement of client, they have “Killer slides” which are key aspect for that business.

They are aware of cultural issues and do the cultural print, you have to be aware of how things are run, especially the management, it is mainly based around being aware of it, listening as you are meeting the management not the regular employees and so it is related to communication. Explaining things to management like what is it for them.

The culture and communication are highlighted as key to integration

They use theory such as the heart of change by John Kotter at Harvard business school and “as one” methodology created by Deloitte

Described the deliverables of the M&A process at Deloitte, from the due diligence to integration.

All 12 cultural due diligence factors exist in Deloittes due diligence process

Intended direction is done pre-merger in the when looking at the base line strategy (Management strategy)

Key measures KPI (in the management reporting)

Infrastructure relationships are looked at if deemed necessary

Organisation practices, such as formal and informal communication is also looked at, every stage it is looked at.

Leadership and managerial practices is also confirmed as checked in corporate due diligence at the managerial level and based on the type on integration, such as full absorption or at arm’s length. Explained about integration and the issues around it. Retaining talent is included in Human resources due diligence. “Coalition of the willing” A small group of loyal and key personnel on the side of main merger company.

Technology utilisation is done as part of IT due diligence, usually based around risk and integration costs.

Physical environment is checked pre-deal due to location costs, leases and other factors at
different stages of integration. Although it is rarely given priority due the 80 20 rule, 20 the things will create 80 the value.

Cultural artefacts is done, due to viability but the emphasis on knowing for when understand “Company religion” and creation a new “Religion”

They have a cultural test research and tools.

He stated that M&A approach has evolved over the years and standardised, so everyone uses the same kind of things. Consultancy companies are very homogeneous in their approaches.

Very little access to management 1-3 hours pre-merger: very little access to culture

After merger: As much time as needed and lots of access: Culture is looked at in-depth due to integration.

Hubris plays a part in people not thinking about the side effects of M&As and not hiring consultants creating a situation where failure is more likely.

Advocated for a much more thought out M&A process, so thinking about the logic behind the deal before the M&A not just as you starting when negotiating.

Multinational Law Firms

NautaDutilh: Partner Joost den Engelsman & Senior associate Wendy Guepin

Joost den Engelsman is a partner in the corporate side of NautaDutilh, he has been assisting clients on M&A for 15 years involved with over 150 to 300 M&A cases over that time period, Wendy Guepin is a Senior associate in the corporate side of NautaDutilh coordinating M&A investigations he has been assisting clients on M&A for 10 years involved with over 100 to 200 M&A cases over that time period.

M&A due diligence is subject to the clients requirements and is largely dependent on the industry. They deal with legal and taxation aspects of due diligence. They have two main check-lists tax included, tax not included, although they have many other templates, but standard check-lists are the start of the process each is tailored to the situation. They never send out a standard template but they send a tailor made check-list that evolves over time as they get a better understanding of the situation.

They made the distinction between the due diligence check lists and the reports about the investigation, in the check-lists they are not addressed but in the report they are addressed. They attributed the lack of soft factors in the due diligence was because of now knowing the target enough to know if it is a risk, documents are the starting point but the soft factors are collected in question and answered sessions which are integrated with the report. Detailing the situations in which legal due diligence is impacted by soft factors and detail the risk and the recommendations. A number of detailed examples on the work councils, supervisory boards, contracts relationships based on industry, explaining that the days when legal firms only looked at hard legal factors such as fines and prosecutions was over and that soft aspects are now inbuilt in their process.

The soft factors knowledge of the law firm comes from their experience of the lawyers not documentation. The legal check-lists are developed by groups of specialists from around the company. Dutch case law and personal knowledge is the foundation of the process, not outside theory. The due diligence advice is based around what the client requests, practical advice rather than just a detailed list everything.

Outlining that overestimations of the ability to merge, failure of communication, the human factors of mergers and the failure of managements to gain momentum of integration for the first 100 days where stated as probable cause of the high failure rate. Commercial due diligence was highlighted as a place where soft due diligence is done due to the soft due diligence being part of the business plan analysis and the 100 day plans, rather than the legal due diligence which has less scope. 100 plans contain many soft factors like communication.

They did not have any of the 12 aspects cultural due diligence included in their check lists as they were outside the scope of legal and more in financial and commercial due diligence scope.
Simmons & Simmons: Partner: Albert Wiggers

Albert Wiggers is a partner in the corporate M&A department of Simmons & Simmons Amsterdam, done M&A for 18 years now as a partner he is in charge of coordination of the whole process. Depending on the tasks he leads the legal teams or coordinates the whole process on behalf of the client.

He explained a brief overview of how due diligence is conducted, the legal reasons why, the overall aim explained that legal due diligence aim is to ask the relevant questions in such a way to grasp what the company looks like, how it does its business and where are the potential areas of concern such as risk. The check-list is based on the expertise of the legal firm and the company hiring the firm coming up with a joint documents. He explained they are limited in what they can report to what is in their area of law.

Cultural due diligence is based on if they seem relevant, Dutch based companies it is mainly left up to the company as they should not be challenged, non-Dutch companies the issue of culture is included in discussion of the setting up of the due diligence. But no specific question are included in the check list and what cultural due diligence requires in the person investigation, rather than written check-lists.

Mr Wiggers mentions that due diligence is not just about getting information to reduce the price but the two other reasons are getting to know the company which includes company culture and getting ready for the post-merger integration. The questions in the due diligence check-lists are almost entirely based on experience, over the past 30 years of the due diligence check-list hundreds of lawyers experience has gone to develop the check-list to its present form.

When asked about the high failure rate he pointed out that depending on how you measure failure the rates of failure would change on your definition. The other aspect mentioned was merger momentum, once a merger starts many people are invested in it being finished.

Asked about soft due diligence, he says it is taken into consideration and they are planning on adding some questions to the due diligence check-list but it is more part of commercial due diligence. The majority of the M&A due diligence processes end with a meeting with management and here they usually check certain soft aspects.

He recalled that he does not remember any M&A being stopped by culture difference but does remember a client that had years of trouble due to culture clash at the managerial level. Just like KLM Mr Wiggers mentioned that owner management became just management after M&As there has been problems, he said that the researcher thesis must emphasise that companies must look at these factors more and that they should prepare for the post-merger integration.

The 12 cultural due diligence question areas are not included in the legal due diligence.

CMS: Attorney at law: Christian Delgado

Christian Delgado, Attorney at law and senior associate corporate M&A team, worked for 7 years in corporate team. CMS corporate team manages teams of other M&A due diligence and conduct reviews of corporate documentation.

Areas due diligence check: Corporate, employment, IT, IP, real estate, commercial contract, litigation, ect. Depending on the determined areas of interest of the clients and type of takeover, he mentioned that these red flag issues are what they focus their reports on.

He mentioned that he never had considered soft due diligence or culture, although after more questioning and explanation he mentioned that the employment side of legal firm would look at things like work council relationship and communication. He also mentioned other areas have culture as a underlying aspect of everything which give the general feeling of what is being checked. It was debated that due diligence check lists would also vary based on where they were created and for who they were created as culture effects what people look for.

He drew the line that legal aspects where only related to the compliance to the law, culture would be avoided.

The use of a standard form that covers 99% and a catch all “Other” question, this form is then edited down. Which is designed by CMS lawyers. Christain Delgado recommended looking at
corporate experts to find companies that would have more soft due diligence experience. The legal due diligence is a outline of the risks not advice on if they should go ahead with the deal just outlining the risk. Outlining what he thinks could cause the high failure rate he cited inflated expectations, clients thinking they are going to achieve something they cannot. He would not consider soft due diligence as a topic in the legal due diligence in his work group. But he understands how it does effect companies but they are contained by legal terminology and subject, the only impact would be by peoples “gut feeling” about the deal. Legal due diligence is based on experience gained on the job. The 12 cultural due diligence question areas are not included in the legal due diligence.

Academic Interviews

Rotterdam School of Management (Erasmus): assistant professor of finance: Buhui Qiu
Summary:
Buhui Qiu teaches two courses on mergers and acquisitions, understood due diligence as a in-depth audit of the target, understand that part of due diligence is to assess if there is a match of corporate cultures. Thinks soft due diligence and cultural due diligence is relatively new, did not have a understanding beyond a “text book” understanding. He added environmental impact due diligence, corporate responsibility due diligence are also being developed more in recent years and he considered failure as overpayment for the acquired company. He did have a understanding of management impact on mergers and acquisitions and the overpayments because of management irrationality/hubris. So hubris leads to overpayment and that their needs to be a separation of powers from the valuation and negotiation. He thinks that hubris is a major factor in the failure of M&As. Generally the text book answers confirm and duplicate what has been found in literature.