

## CULTURAL COMPATIBILITY IN THE IMPLEMENTATION OF MERGERS AND ACQUISITIONS: THE BANKING SECTOR

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### Abstract

For the last two decades mergers and acquisitions (M&As) have played a leading role in the global economy. The level of M&A activity has steadily increased in recent years. However, the failure rate of such ventures is still very high. The literature indicates that cultural differences between the acquiring and the acquired companies are a major factor influencing the failure or underperformance of a number of M&As. Cultural distance, it is argued, hinders cross-border M&As by increasing the tensions of the implementation process. The values and behavioural differences between distant cultures influence reactions to M&A issues, causing difficulties in combining the organisations. Therefore, cultural compatibility of the merging organizations supports the achievement of a successful implementation. The objective of this study is to examine the cultural compatibility of merging companies, in view of a number of M&As implemented by HSBC, currently one of the largest banking and financial service organisations in the world. The contribution of this study concerns the understanding of the cultural (in) compatibility of the parties during the process of implementation of cross-border M&As, and its implications for practice and scholarship.

Keywords: Cross-border mergers and acquisitions, cultural compatibility, banking sector.

### Introduction

Cross-border acquisitions have become the dominant means of internationalisation, accounting for approximately 60% of all FDI inflows (Schoenberg, 2004). More specifically, cross-border M&As have become a popular strategic tool for multinational firms looking to extend their market reach, develop new manufacturing facilities, develop new sources of raw materials and tap into capital markets (Morosini *et al.*, 1998; Weston, Chung & Hoag, 1990). Through a cross-border merger or acquisition firms can create value superior to what could be obtained through organic growth or other forms of internationalisation. The ultimate goal of most M&As is that the combined strengths of the organisations will surpass the sum of their individual strengths. Indeed, this rationale is particularly evident in organisations that have global ambitions and strive to exploit opportunities across their national borders that will provide them with a competitive advantage in their industry. This study aims to determine how firms in the banking sector approach the implementation process in a cross-border M&A. When different cultures are brought together, conflict, distrust or resistance may arise as a result of the different perceptions and values held by managers and employees from across national and organisational boundaries. Finally, the literature on management practices across national cultures showed that harmonisation between combined banks on the basis of risk orientation, decision making and organisational routines are important to the implementation efforts.

For the last two decades mergers and acquisitions (M&As) have played a leading role in the global economy. The level of M&A activity has steadily increased in recent years. However, the failure rate of such ventures is still very high. The literature indicates that cultural differences between the acquiring and the acquired companies are a major factor influencing the failure or underperformance of a number of M&As.

The cultural fit that exists between combining organisations is directly related to the success of the combination. Most theoretical research to date has argued that such cultural distance hinders cross-border M&As by increasing the tensions of integration. The values and behavioural differences between distant cultures influence reactions to M&A issues, causing difficulties in combining the organisations. It is argued that to succeed in the M&A implementation process requires the merging organisations to be culturally compatible.

The establishment of a deeper understanding of the significance of cultural compatibility in the integration<sup>1</sup> of cross-border M&As in the banking sector may add to the efforts to ameliorate the failure rate of these ventures. This study aims to examine cultural compatibility of the merging parties during the process of cross-border M&As. The relevant literature has critically analysed and the case of HSBC, currently one of the largest banking and financial service organisations in the world, is examined based on archival documentation. The contribution of this study concerns the understanding of the cultural (in) compatibility of the parties during the process of implementation of cross-border M&As, and its implications for practice and scholarship.

This paper is structured as follows. The literature regarding the key issues of the implementation process of cross-border M&As is examined. The case study methodology is discussed. Selected cross-border M&As that HSBC has undertaken are identified, and are subsequently analysed. Then, the findings are presented. Conclusions and practical implications are offered. It is expected that this study will provide a more thorough understanding of the cultural compatibility during the implementation of cross-border M&As, considering the banking sector in a global context.

## **Background and research question**

Cultural compatibility between merging organisations has commonly been a major factor underlying the synergy potential of a bidder and target firm in cross-border M&As. Historically, the poor performance of M&As has frequently been blamed on the failure to integrate the cultures of the combining organisations (Carroll & Harrison, 2002; Huang & Kleiner 2004; Ghauri & Buckley, 2003; Bradley, 2003; Chen & Findlay, 2003). In the context of international bank M&As, Sherman & Rupert (2006) recognized that poor reconciliation of different bank cultures may cause the post acquisition organisation to perform below par.

Merging organisations must leverage their commonalities, for instance, a shared commonality may be in the form of a common language (Hisey & Caves, 1985; Anderson & Gatignon, 1986 Buch & DeLong, 2004). The cultural fit between the merging organisations is also critical to a successful implementation process. The cultures of the combining firms must be similar in order to integrate successfully (Stahl & Voigt, 2005 p.54). However, given that organisations have a tendency to try and keep their own culture, mergers between culturally distant firms are likely to face major implementation problems (Stahl & Voigt, 2005). There have been relatively few studies researching organisational fit across borders. Cross-border acquisitions not only bring together two separate organisational cultures, they also entail the blending of the two national cultures of the firms involved (Schoenberg, 2004). The current literature points out that cultural differences can be found at both the national and corporate level and both can influence the success or failure of cross-border post-acquisition performance (Quah & Young, 2005; Morosini *et al.*, 1998). It is important to clarify definitions for both levels of culture prior to exploring their impact on the implementation process of cross-border M&As between banks.

National culture refers to deeply set values that are common to the members of a nation (Hofstede, 1991; Simon & Lane, 2004). National culture is learned early in life, and provides meaning to 'how things ought to be' and 'how things ought to be done' for individuals in a country (Berger & Luckmann, 1967; Terpsta & David, 1991 cited in Simon & Lane, 2004, 309). This suggests that the various elements that form ones national culture develop overtime and are deeply embedded into the way of life for citizens of a particular country. In this context, integrating different bank cultures would be problematic as each culture is built on a national heritage, which is specific to one nation. In other words, the successful integration of merging banks is constrained by their respective national culture, as the very routines and repertoires used by each bank would be manifestations of this culture. This observation implies that the decision to merge with or acquire a particular target bank across national boundaries potentially rests upon the significance of the national culture differences between the merging organisations.

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<sup>1</sup> Integration of M&As is used here as a synonym for implementation process of M&As.

By including the issue of distance into the equation, national cultural distance is regarded as “the degree to which the cultural norms in one country are different from those in another country” (Kogut & Singh, 1988). In the context of a cross-border acquisition, national cultural distance represents distance in the norms, routines and repertoires for organisational design, new product development and other aspects of management that are found in the acquirer’s and the target’s countries of origin (Morosini *et al.*, 1998). Cross-border acquisitions provide a means in which to access such diverse routines and repertoires in other national cultures without having to follow the development path that leads to them (Jemison & Sitkin, 1986). As a result, the newly combined organisation may have a lesser need to invest in organic growth as access to a large and diverse pool of routines and repertoires will be valuable commodities in a highly uncertain industry such as financial services. Ghosal (1987) states that access to routines and repertoires via acquisition of a firm in another national culture may enhance the performance of the combined organisation through ‘learning’ and ‘specialisation’. Learning between the buyer and acquired organisation is essential to high post-acquisition performance. Following a cross-border acquisition, the two firms interact and learn from each other at numerous levels, pooling their organisational routines (Haspeslagh & Jemison, 1991 cited in Morosini *et al.*, 1998). This implies that the learning effects from an acquisition may help firms in some national cultures develop routines that create a sustainable competitive advantage. Specialisation in an international bank M&A would provide access to routines specific to the acquired bank’s environment. This implies the acquiring bank will gain access to company-specific assets that ease the process of serving the acquired bank’s local markets. In addition, the acquirer may also try to leverage the acquired bank’s unique routine set(s) throughout the newly combined organisation to maximise value. However, if the merging cultures all have different interpretations of the implementation process this will have an impact on the synergy outcomes.

The culture of an organisation determines what behaviours and ideas are acceptable (Nahavandi & Malekzadeh, 1993). Organizational culture differences are cited by many researchers as a key contributor to M&A failure. However, recent research (Larsson & Finkelstein, 1999; Morosini *et al.*, 1998; Very *et al.*, 1997) into cross-border activity suggests otherwise. This research concluded that poor performance between merging organisations is not necessarily a result of the cultural distance between them, but to do with the level of autonomy given to the acquired firm (Schweiger & Very, 2003). Differences in organisational cultures suggest different organisational routines, managerial practices and communication systems (Shimizu *et al.*, 2004), which create challenges for the integration process of merging organisations. Angwin (2000) suggests that managers in different countries have differing perceptions of the external environment because they possess different cultural values. It is also important to note that integration in cross-border M&As is also subject to specific factors that may moderate the significance of cultural differences on the post-merger integration between banks. These factors include: *the degree of relatedness and the integration level chosen, differences in power and size, the degree of retain autonomy on the part of the acquired firm, the mode of takeover, prior acquisition experience of the acquirer and the measures chosen to manage cultural differences* (Stahl & Voigt, 2005).

Generalising the literature review it can be stated that the current literature on cross-cultural management examines extensively the implications of cultural differences in cross-border activity. Many researchers have proposed different theories to address the cultural complexities associated with doing international business. But despite the depth of research available on cross-cultural issues, there is no single theory that is widely recognised as a flawless approach to tackling cultural differences in a cross-border situation. More specifically, the literature shows a severe lack of research on the implications of cross-cultural compatibility on the integration of banks following a cross-border merger or acquisition. The vast majority of research that is available is very broad and primarily focuses on the impact that national and/or organisational cultures differences have on a combined organisation, with little attention specifically given to integration. It is this gap in the research that makes up the core of this study. The HSBC Group has been chosen to be the case subject.

HSBC has undertaken a number of well-publicised cross-border acquisitions in recent years. The Bank has two main reasons for undertaking these acquisitions: (i) to strengthen its position in those foreign locations and (ii) to consolidate their position within the banking industry as a whole. However, in the selected cases, the eventual synergy realisations (and the integration problems) have received very little attention in either academic circles or the media. Thus, the research question investigated in this study is: “*What is the role of cultural compatibility in the successful integration of HSBC’s cross-border M&As?*” The empirical focus of this study is to answer this question demonstrating how significant cultural

compatibility is to the implementation of cross-border M&As through analysing the role of national and organisational cultures of the acquired banks in HSBC's ability to integrate these cultures in this bank.

### **Research method**

A qualitative research method was adopted to provide rich and thick descriptions about the phenomenon, using six specific HSBC cross-border M&As, involving acquired banks from different countries in the study. Qualitative research is a technique used to establish an understanding about a particular event. Its nature lies with the idea that meaning is socially constructed by individuals in interaction with their world. Thus, the world is seen as not fixed, single or agreed upon, but actually represents constructions and interpretations of reality that are in flux and that change over time (Merriam, 2002). The advantages of using qualitative research is that it is flexible and adaptable to change (Saunders *et al.*, 2000) and it helps in establishing causal relationships between variables. Specifically in this study the ultimate goal is to establish a relationship between culture compatibility and the level of integration achievable.

In this study, the researchers collected information from multiple sources, namely observations, published documents and internet sites because the findings and conclusions in the case were likely to be more credible if they were based on different sources of information. The use of archival records was also an important source of data collection in the HSBC case, as described in the literature (Yin, 2003; Creswell, 2003; Merriam, 2002). When using archival records the study made attempts to ascertain their accuracy as well as the conditions under which they were produced. The accuracy of the archival records was confirmed by analysing independent sources (e.g. F.T, *The Economist*) that also discussed the subjects found in the archives. Furthermore, the flexibility of multiple methods allowed to pursue various paths to extract the information, whereas a single method is one dimensional and restrictive. In sum, the multiple sources of evidence helps to address the issue of construct validity as each source provides measurements of the same phenomenon (Yin, 2003; Merriam, 2002).

### **Main results and discussion**

This study has analysed six acquisitions associated by HSBC of the following banks: Bank of Communications Limited (China), GFBital (Mexico), CCF (France), UTI (India), Midland Bank (UK), Bank of Bermuda<sup>2</sup>. The main focus of the analysis is on cultural differences between the acquirer and acquired firms and how these affect post integration outcomes. Results of this study show the following main points:

(i) On the one hand, high cultural distance between banks can impede the integration process of international bank M&As, although cultural clashes are not to be expected every time banks with different cultures combine. This result confirms previous studies in the literature (Tihayi *et al.*, 2005; Shenkar, 2001; Barkema & Vermeulen, 1997). On the other hand, cultural compatibility coupled with commitment of both management and employees in cross-border M&As will smooth the implementation process. The main relationship that we found was that cultural distance is linked to integration outcomes. That is, the closer different cultures are to one another, the greater the shared understandings, which results in the banks sharing a similar view on how integration should be managed. This connection reduces the possibilities of conflict when engaged in cross-border M&As, whilst simultaneously easing the integration process.

(ii) A bank needs to adapt its management practices to the culture of the acquired bank to increase the chances of successful integration. Banks should expect to face different cultures when doing business abroad and therefore, should be willing and/or able to adapt their practices accordingly. Perhaps the most important factor to consider when reconfiguring business practices to a different culture is the "speed" in which the adjustments are made. The general consensus is that a quick implementation of changes is beneficial because it minimises the amount of uncertainty among the members of the combining firms (Homburg & Bucerius, 2006). However, in opposition, Bragado (1992) emphasises that a slow approach to post merger integration may have to be adopted because a period of studying and understanding between the employees of the merging organisations is often needed. He also argues that the speed of integration also depends on the fit between the organisations, especially cultural fit. It was also observed that in cross-border M&As the merging organisations need to have a congruent approach to integration, otherwise, the differing perceptions, values and behaviours held by the parties will hinder integration. If merging banks fail to establish common

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<sup>2</sup> Bank of Bermuda was associated with US culture in this study.

understandings and expectations for the integration process then lost synergies is the inevitable result. To avoid such an outcome, the cultural differences between the banks should be identified at the target selection stage, where the best approach to achieving integration can be agreed upon and carried forward into the actual integration process.

(iii) National and organisational culture differences have a negative impact on the integration outcomes of international bank M&As. We found that differences along Hofstede's uncertainty avoidance, long term orientation and individualism dimensions carried the highest threat to achieving positive integration outcomes in a cross-border M&A. Differences in uncertainty avoidance between HSBC and the acquired bank could obstruct integration because a risk adverse bank wants to keep control of its decision making process once integrated into the Group. The inability to impose rules that allow them to manage all integration situations or outcomes would contravene their cultural practices. It should be noted however, that in acquisitions an acquired firm is rarely given a high degree of autonomy because the motivation to acquire usually stems from the acquirer's belief that it can use the acquired firm's resource more efficiently (Larsson & Lubatkin, 2001). For that reason, the more that autonomy is restricted, the more likely the acquired management will feel dominated by, and inferior to, the acquiring management, and therefore the more likely that integration problems will be incurred (Cartwright & Cooper, 1992).

In the cases we observed that combining cultures that are direct opposites may cause the integration process to become disjointed. This is because the organisations involved in the integration process would not be working towards shared goals. Specifically, a bank with high individualism will be more interested in its own achievements, whereas the bank with a collective culture wants to work closely with its partner and is willing to commit all necessary resources and time to achieve synergies with longevity. This observation confirms Jemison & Sitkins (1989) opinion that the extent of the participant's commitment can escalate the momentum of integration, leading to premature solutions and shortcomings in integration. The study found that differences in masculinity and power distance across national borders had little influence on integration outcomes.

The findings stress that "culture clashes" can cause integration problems, especially when high and low context or universalist vs. particularist cultures meet. The high and low context (Hall) and universalist vs. particularist (Trompenaars) dimensions overlap given the similarities in their representations. As it was stated, both the low context and universalist cultures represent rule based behaviours which are universally agreed to by the culture one lives in. In contrast, high context and particularist cultures are concerned about building and sustaining close relationships with people, and protecting those relationships irrespective of what the rules might dictate. In the context of integration in international bank M&As, the combination of these distinctive cultures would make synergy realization a complex task for the management of HSBC and the acquired bank(s) to achieve. However, the research also indicated that merging firms are not destined to collide just because their cultures are different or because they come from different nations. In fact, the combination of banks from different cultures or nations can provide access to new resources and capabilities that help customise products and/or services that are firm-specific, thus making it extremely difficult for competitors to imitate service offerings.

(iv) HSBC's absorptive capacity enables the Bank to easily adapt to other cultures; the learning benefits accrued from adaptation helps the Bank overcome the cultural barriers faced in cross-border M&As. Each of these findings will be discussed in greater detail below. The case analysis implies that the cultural differences HSBC faces when acquiring a foreign bank may not prevent full integration to occur. The basis of this finding rests upon HSBC's corporate image of being "*the world's local bank*". Given that the bank drives to be locally responsive within all the countries it operates, it is well positioned to cater for the specific needs of the organisations, government and individuals in those countries. When HSBC enters into cross-border M&As they blend the local expertise and knowledge of the acquired firm with their own capabilities to provide a customised service. Their ability to adjust business practices to the culture of an acquired bank means that cultural barriers in their cross-border M&As are significantly lessened, if not completely eliminated.

With HSBC's ability to absorb local factors into its business practices the most important return that be gained from cross-border M&As is the "learning benefits" that the bank accumulates. Haspeslagh and Jemison (1991) argue that real learning benefits derive from the transformation in the acquirer's own organisational capabilities and competitive strategy. They suggest that such transformation involves the reconfiguring of the acquiring company's strategy and organisation prompted by the acquisition. Their research found that companies that achieved the most learning from incorporating acquisitions in their

organisation were those in which, through a history of prior restructuring and acquisitions, organisational change had become an accustomed part of the organisation's culture (Haspeslagh & Jemison, 1991 p.252).

Related to the issue of learning through localisation, HSBC's ability to adapt to local environment gives rise to the concept of *absorptive capacity*. Absorptive capacity is a firm's ability to "recognise the value of new, external information, assimilate it, and apply it to commercial ends" (Cohen & Levinthal, 1990). The findings show that HSBC's absorptive capacity mirrors the framework discussed by Zahra & George (2002), comprising four complementary dimensions to absorptive capacity: *acquisition, assimilation, transformation and exploitation*. For instance, HSBC collects information via international M&As to understand the characteristics of a nation so that they can serve their specific needs. HSBC is geared towards being locally responsive so one can assume that internal routines and processes are conducive to analysing, interpreting and understanding information about a foreign location, thus their absorptive capacity also includes assimilation. HSBC adapts its services by absorbing the local expertise of an acquired foreign bank and combining it with its own expertise and capabilities, which does constitute transformation. HSBC exploits opportunities in foreign countries through its ability to respond to local needs by adjusting or leveraging its competencies. Most importantly, HSBC's absorptive capacity shows that the Bank has the capacity to leverage and exploit the knowledge that it acquires from doing international M&As.

### Conclusion and implications

This study has analysed the acquisitions by HSBC of the following banks: Bank of Communications Limited (China), GFBital (Mexico), CCF (France), UTI (India), Midland Bank (UK), Bank of Bermuda. Results of this study show the following main points: **(i)** High cultural distance between banks can impede the integration process of international bank M&As, although cultural clashes are not to be expected every time banks with different cultures combine; yet, cultural compatibility will smooth the integration process; **(ii)** a bank needs to adapt its management practices to the culture of the acquired bank to increase the chances of successful integration **(iii)** National and organisational culture differences have a negative impact on the integration outcomes of international bank M&As **(iv)** HSBC's absorptive capacity enables the Bank to easily adapt to other cultures; the learning benefits accrued from adaptation helps the Bank overcome the cultural barriers faced in cross-border M&As.

The in-depth nature of this study has added to the limited literature currently available on the influence of cultural differences on the implementation process of cross-border M&As in the banking sector. The most interesting finding stems from the learning benefits that derive from HSBC's absorptive capacity. It would be very appealing to explore in greater depth whether having an absorptive capacity as described by Cohen & Levinthal, (1990) and Zahra & George (2002) would help banks acclimatise to a foreign country more quickly, thereby reducing the cultural difficulties faced in international M&As. Another attractive area of research that would have expansionary value to this study is an analysis focusing on the management of the acquired banks once they've become a subsidiary of the HSBC Group. Specifically, the research could assess the level of autonomy HSBC gives to its subsidiaries and to what extent does this affect subsidiary performance. For additional validity, it is recommended that some quantitative analysis is included.

In this study, the findings have highlighted a number of management implications. First, banks should undertake cultural assessments, secondly, banks should introduce social controls to smooth the integration process and minimise the influence of cultural differences. In cultural assessments, a fit between the merging organisations is carried out as soon as possible. The knowledge gained in a cultural assessment will assist in designing an integration plan because the examination allows both parties to identify their organisational strengths and weaknesses (Bradley, 2003). Social controls include coordination efforts such as transition teams. The transition team can be set up to provide coordination during the implementation of change in M&As. The team would include members from both banks to ensure the interests of all parties are served. It is important to note that the absence of social controls such as transition teams can result in "post merger drift". Consequently, post integration drift can cause integration efforts to stall out (Mark & Mirvis, 1992). Thus, the establishment of a transition team will increase the chances of successful integration.

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