Screening and evaluating potential merger or acquisition candidates: some suggestions for a critical process

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Corporate growth through merger and acquisition is one of the many growth strategies open to the firm. Such a growth strategy can be divided into three stages: formulating the merger/acquisition strategy; screening and evaluating potential candidates; and implementing and integrating the merger/acquisition. In this article, the second in a series of three, the focus is on the second stage. Research findings into the evaluation practices utilized by twenty acquisition intensive South African companies are reported. Broadly speaking, evaluation in the South African context is seen primarily as a team effort, and the domain of top management, assisted by staff personnel where necessary. Taking between one to three months to complete, the evaluation practices of organizations represented display considerable variance. Some adopt a structured approach, and utilize formally developed evaluation checklists, while others rely on an *ad hoc,* informal approach. While several methods to evaluate managerial competence were suggested, no process to evaluate either managerial compatibility or the culture of potential candidates were discovered. Understanding of the concept of organizational culture was found to be minimal, though the research findings indicate a contingent role for organizational culture in the merger/acquisition process. The article is concluded by making some suggestions which, while not guaranteeing transaction success, should lessen the chance of failure being attributable to inadequate candidate evaluation.

Korporatiewe groei deur middel van samesmeltings en oornames is een van die vele groeistrategieë wat deur die onderneming gevolg kan word. 'n Sodanige groeistrategie kan in drie fases verdeel word: die formulering van die samesmelting/oornamestrategie; die keuring en evaluering van potensiële kandidate; en die implementering en integrasie van die samesmelting/oorname. In hierdie artikel, die tweede in 'n reeks van drie, word die tweede fase aangespreek. Daar word verslag gedoen oor die navorsingsresultate van die evaluasiepraktyke van twintig oorname-intensiewe Suid-Afrikaanse maatskappye. Breedweg gesien, word die evaluasieproses in die Suid-Afrikaanse verband primêr as 'n spanpoging gesien. Dit word ook as die domein van topbestuur, bygestaan deur ondersteuningspersoneel, beskou. Die evaluasiepraktyke, wat tussen een tot drie maande neem om te voltooi, vertoon 'n noemenswaardige neiging tot afwyking. Sekere maatskappye gebruik 'n gestruktureerde benadering en maak van formeel-ontwikkelde evaluasiekontrolelyste gebruik, terwyl ander op 'n *ad hoc,* informele proses staatmaak. Hoewel verskeie metodes wat daarop gerig is om bestuursbekwaamheid te evalueer, voorgestel is, is geen proses wat daaop gerig is om óf bestuursversoenbaarheid óf die kultuur van potensiële kandidate te evalueer, geïdentifiseer nie. Daar is bevind dat die algemene begrip van die konsep organisasiekultuur minimaal is. Ten spyte hiervan dui die navorsingsresultate op die belangrike rol van organisasiekultuur in die samesmelting/oornameproses. Die artikel word afgesluit met sekere voorstelle wat, alhoewel dit nie die sukses van 'n transaksie waarborg nie, die waarskynlikheid van mislukking weens ontoereikende kandidate-evaluering, in 'n mate kan beperk.

Introduction

External merger or aquisition is one of many growth strategies open to the firm (Pearce, 1982). Corporate growth through merger or acquisition can be either a viable strategy, or the road to ruin, depending on many factors, including the approach adopted by the acquiring firm in its merger or acquisition activities (Brews, 1987). Recently, research was conducted into the perceptions and practices of twenty South African companies actively pursuing a growth strategy based upon merger or acquisition. In the research programme the merger/acquisition process was divided into three key stages: determining a merger/acquisition strategy; screening and evaluating potential candidates; and implementing and integrating a merger or acquisition. The findings of the research relating to Stage I (determination of a merger/acquisition strategy) were reported in a previous volume of this journal (Brews, 1987). The purpose of this article, the second in a series of three, is to report the research findings relating to Stage II: the screening and evaluating of potential candidates. Section three of the questionnaire employed in the research dealt with acquisition evaluation, and was designed to discover information about aspects of the evaluation processes employed by the companies represented. Questions were included on who does the acquisition evaluation, whether a specific evaluation checklist is employed, and the length of time taken to evaluate potential candidates. More specifically, questions were included on how management of the candidate is evaluated, and whether or not any need exists to evaluate the culture of the organization concerned. Respondent understanding of organizational culture was also explored, as well as the processes employed by the organizations represented to evaluate the culture of potential merger or acquisition candidates. Finally, evaluation issues regarding the acquisition of owner managed and smaller concerns were investigated. In the interests of time, no questions on screening *per se* were included, though the options available in the screening process are discussed in this article. Full details on the research methodology employed, and respondent characteristics, are contained in the first article, and will not be repeated here.

As noted in the first article, the research does not claim to be representative of all parties involved in the execution of mergers or acquisitions in South Africa. Rather, the series endeavours to provide an overview of some major strategic issues encountered by organizations adopting a growth strategy based upon mergers or acquisitions. By describing the practices of twenty active acquisitors in the South African context, and comparing these practices with the theory, hopefully valuable insights will be provided into the process of creating corporate wealth through merger or acquisition. Also, the research does not claim to cover every aspect of the merger or acquisition process. Clearly, such an endeavour would go beyond the confines of an individual research programme. In this article I do not deal with all aspects of the screening and evaluation process, but rather cover important aspects which have to date received little attention in the literature.

Screening and evaluation process

Once a firm has determined its acquisition strategy and profile, the screening and evaluation of potential candidates can commence. Screening is the process of identifying the universe of potential candidates, and narrowing the universe down to candidates warranting in-depth evaluation. Evaluation involves the careful investigation of the candidate concerned from a variety of perspectives including assessing the products and market position of the candidate; assessing selling and distribution policies; evaluating the management and labour practices of the candidate under investigation; understanding the competitive position of the candidate in its chosen market place; assessing its competitive advantage and the sustainability of its competitive position; evaluating the appropriateness of control and administration procedures; evaluating in depth the future prospects of the company, based on future market and industry trends; and finally evaluating the reasons for divesting. The objective behind the evaluation process, ultimately, is to determine the suitability of the potential acquisition, and to gather sufficient data to form an opinion on the financial worth of the candidate to the acquisitor, should the transaction be executed.

Screening process

Screening as an activity involves moving from the general to the particular. Payne (1987) suggests starting with the whole range of the economy, and using the acquisition profile as a filter to exclude incompatible sectors. Once attractive industry segments are specified, attractive companies within each segment can be identified, using sources such as trade directories, or professional advisors such as investment bankers, lawyers, accountants and management consultants. Payne (1987) also suggests maintaining a dossier on potential attractive acquisition candidates, with a view to timing an approach to candidate owners when the 'strategic window' is open. Anderson (1987), similarly, recommends the use of trade and financial publications, but warns that the best source is probably the acquisitor's own knowledge of its industry, coupled with personal contacts. McCarthy (1961) also urges the canvassing of trade directories, but additionally recommends that officials in an acquisitor's sales and operating divisions be requested to suggest potential candidates. Kierulff (1981) suggests placing advertisements in appropriate newspapers and journals to generate leads. Finally, Bain (1986) recommends an active search strategy be adopted, rather than trying to save money and time by waiting for a seller to approach the buyer. This gives the acquisitor time to evaluate selected candidates, rather than being forced into a quick sale by an intermediary, or a seller anxious to divest.

In the South African context, acquisitors will be best served by following the advice of Anderson (1987) and Bain (1986). In a comparatively small economy, with relatively few competitors, the acquisitor's own industrial knowledge and networks, rather than recourse to trade or financial journals or other professional advisors, is likely to yield the most positive results. Industry sources or networks are probably favourable sources for identifying 'strategic windows'. But a proactive, focused search process is likely to discover candidates before industry sources have alerted every potential acquisitor in earshot of a possible acquisition opportunity. The key in the South African context, where good acquisition candidates are fairly scarce, is to be first in line. Passively waiting for merchant bankers to present potential opportunities is likely to yield poor results, as in many instances professional advisors are only called in once the entrepreneur involved has failed to locate a buyer. Owners of valuable companies in South Africa often have a list of potential suitors before they commence selling: the challenge is to be on that list.

Evaluation process

The evaluation process, properly executed, is aimed at achieving three objectives: firstly, to evaluate the strategic and organizational fit between the target company and the acquisitor; secondly, to quantify the business and financial risk of the candidate under investigation; and finally to provide data which can be used as the basis for the financial valuation of the potential candidate. Slater & Weinhold (1981) contend that effective systems for identifying and evaluating acquisitions have four important properties: first, they must provide means of evaluating a candidate's potential for creating value for the acquisitor's shareholders; second they must reflect the special needs of the company using the system; third, they must be easy to use and not overly rigid; and fourth, the system must serve as a mechanism for communicating corporate goals and personal knowledge among the parties involved. These four properties serve to emphasize one factor: evaluation is not an independent, discrete process occurring after the acquisitor has determined its acquisition strategy: essentially the constructs of this strategy should provide the evaluation criteria used to filter whether or not a transaction will create value for shareholders. Furthermore, the fourth property emphasizes how evaluation is intertwined with implementation: even during evaluation expectations *vis-à-vis* outcomes can be identified, and explored by all the parties.

Identity of evaluators

The first issue confronting an acquisitor faced with the challenge of evaluating a potential candidate is who should conduct the evaluation? Adler & Sneath (1987) recommend putting together a team whose mandate is to evaluate potential acquisitions objectively, stating that the team should comprise a banker, a lawyer and an accountant. Bain (1986) implies the use of outside consultants in the

Table 1 Identity of evaluators

Category of evaluator	Respondent number 1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Staff specialists specifically employed to evaluate acquisitions	x̲	x̲	x	x	x̲	x̲						x̲	x̲				x	x		
Non-specialists employed by the organization					x	x̲	x	x	x	x	x	x		x	x	x	x̲		x	x
Merchant bankers		x		x̲									x							
Auditors		x		x																
Other	x	x	x̲															x̲		

x̲ indicates most used

evaluation process. Numerous other options exist, including the use of a specialized, in-house evaluation team, or the *ad-hoc* appointment of company staff to evaluate acquisitions from time to time. The first question asked of respondents *vis-à-vis* their evaluation process was to identify the persons employed to do their evaluations. The responses obtained are detailed in Table 1.

Inspection of Table 1 reveals a clear pattern. Firstly, the most frequent category was non-specialists employed by organizations (14 mentions), with ten instances of only non-specialists being employed in the evaluation process. Secondly, ten of the respondents employed specific staff specialists to conduct evaluations, always in conjunction with others, ranging from other non-specialist employees (four mentions) to merchant bankers, auditors and others. Finally, merchant bankers, auditors and other advisors are used, though sparingly. Respondents were requested to specify 'others', and these included tax advisors, legal advisors and technical specialists. Respondent 2 indicated that merchant banks, auditors and tax specialists were used as support staff to in-house staff specialists. However, additional insights were obtained from respondents:

- Respondents 3 and 6 emphasized that evaluation was done by a combination of staff specialists and top management, who are personally involved. In the case of respondent 7, top management alone did the evaluation. In fact, eight respondents mentioned that top management were involved in the evaluation process specifically.
- Many respondents mentioned the use of specific evaluation teams. Respondent 8 stated his company had an acquisition committee, chaired by the Chief Executive Officer, including other members of the board, and including financial, legal and technical expertise within the group. The evaluation in the case of respondent 12 was done by a team including staff specialists, top management and senior divisional managers, while in the case of respondent 16 a team was usually formed to manage (and evaluate) the acquisition, usually headed by the divisional chairman, depending on size and importance. In the case of respondent 16, the evaluation team comprised a combination of directors and second level line managers.
- Finally, respondent 19, different from most other approaches, emphasized that evaluation was solely the responsibility of line management.

The findings regarding identity of evaluators show that evaluation in the South African context is considered by most to be a team effort, often the domain of top management, in conjunction with staff specialists; that professional advisors such as merchant bankers, auditors and others, though included, are involved at the periphery; and that those involved in the evaluation may be different from those ultimately responsible for implementing the transaction: in only two cases (respondents 16 and 19) evaluation was seen as a line management function.

That a team effort is preferred, and outside advisors used sparingly, is to be applauded: evaluation ultimately is an in-house responsibility, requiring a multiplicity of skills, including financial, production, marketing and other areas of expertise unlikely to reside in the mind of one person. That evaluation is seen as the domain of top management or staff specialists contains a potential danger: ideally, those responsible for implementation should be included in evaluation, to enhance their commitment to and 'ownership' of the implementation process. Evaluation, optimally, should be carried out by those responsible for making the transaction work, assisted by staff specialists, and reviewed by top management. This may not be the case where evaluation is solely the domain of top management, or staff specialists. De Noble, Gustafson & Hergert (1988) support this approach, specifically with regard to merger success: one of their eight lessons for merger success is 'get line management involved':

> 'As with all strategic decisions, line managers have the responsibility of successfully implementing specific elements of the acquisition plan... Whenever the planners of a strategy are not the implementors, there is a risk of developing unfeasible or inappropriate plans' (1988: 83).

To this could be added badly implemented plans.

General evaluation practices

Having established who does the evaluation, questions were then directed at respondent companies' general evaluation practices: i.e. how they went about the evaluation process. Respondents were first asked whether or not their organization used a formal checklist (hereafter the 'Evaluation Checklist') in their evaluation process. The research findings in this regard are reported in Table 2.

Table 2 Use of formally developed evaluation checklist

Category of Response	Respondent number 1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Yes	x	x				x	x	x	x			x	x	x				x		
No			x	x	x					x	x				x	x	x		x	x

As illustrated in Table 2, the use of a formally developed Evaluation Checklist was equally spread among respondent organizations: ten organizations did possess and employ a formally developed checklist, while ten did not. Of the companies that used a checklist, some provided additional insight into the content of their checklists, and the reasons for employing such a tool. Respondent 1 had a checklist which evaluated the following aspects of a candidate: product/markets; management and staff; marketing and production risk areas; and suppliers. Respondent 8 possessed the most detailed checklist, which included items under the following headings: general information; financial information; secretarial information; marketing information; product information; research and development information; personnel information; financial analysis; marketing analysis; product analysis; and management analysis. Respondent 13 indicated the purpose of their checklist was to quantify a candidate's exposure to business, financial, management, customer, supplier, market, production and economic risk, while Respondent 12 reported their checklist was brief, aimed at ensuring that important considerations were not ignored. Respondent 9 used their checklist in 'standard' acquisitions only.

Some interesting responses were obtained in those cases where no formal checklist was employed. One respondent reported the existence of a very clear mental checklist, while another saw no need for a checklist as they were not 'in the business of mergers and acquisitions'. Finally, a third respondent indicated that evaluation was a subjective process and that in any event good post-acquisition management renders evaluation superfluous.

Respondents were then asked to indicate the length of time usually taken to conduct the evaluation of a potential candidate. The replies obtained are detailed in Table 3.

The responses obtained provide some useful insights into the time taken by respondents to evaluate candidates. Less than one month was mentioned most often (eight respondents), while six respondents reported their evaluations took between 1–3 months. More than three months was the least frequent time period (four respondents). Three respondents reported that the time taken is contingent upon certain variables, including size, complexity, risk, time available to evaluate, and the degree of standardization of the transaction. One respondent indicated his organization usually took several years to evaluate a candidate.

The research findings regarding the general evaluation practices adopted by the organizations surveyed surface three critical issues. Firstly, is evaluation really necessary? One respondent clearly indicated the process was unimportant, since in his view good post-acquisition management renders evaluation unnecessary. Such an approach is dangerous for many reasons: for a start, the fundamental premise that good post-merger management can render evaluation superfluous is an assumption, and a dangerous one at that. Sometimes, even competent post-merger management will fail to make a success of an acquisition unsuitable from the beginning. In addition, good, careful evaluation must make the post-merger management process easier in itself. Rather than being superfluous, appropriate evaluation probably contributes substantially to post-merger management success. Finally, without evaluation, strategic and organizational fit cannot be tested at all and is left to chance: how any post-merger activity can then turn strategic misfit into fit is difficult to see. In such circumstances, the only appropriate post-merger activity often becomes disposal, usually at considerable cost, in both human and financial terms.

The second critical issue raised relates to how structured should the process be? The findings indicate wide variance in this regard. Some organizations have developed formal checklists, with varying degrees of complexity. Another relied on a mental checklist, while a third saw no need for a

Table 3 Time taken to evaluate candidates

Time period	Respondent number 1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Less than one month			x			x				x		x		x				x	x	x
One to three months		x			x		x		x[4]		x		x							
Less than three months				x				x[3]							x		x			
Depends	x[1]			x[2]												x				

1. Depends on size, complexity, risk, strategic importance, and time available.
2. Depends on size: more than three months for larger acquisitions.
3. Typically takes several years.
4. If a standard acquisition; otherwise time varies.

checklist, since the organization was not 'in the business'. Clearly the degree of structure differed widely among respondents. In responding to the issue of structure and the evaluation process, a few comments are appropriate. Firstly, structure by itself does not guarantee adequate evaluation — the checklist employed may be inappropriate, or improperly used. However, properly formulated and correctly utilized, a checklist can provide a useful framework to an evaluation team, especially if the team is inexperienced at evaluation. As experience is gained and teaming curve benefits are reaped, the need for formal structure probably diminishes. Taking such a view (that inexperience requires structure) highlights the danger of the position taken by respondent 17: it is precisely because the organization 'is not in the business of mergers and acquisitions' that it needs some formalization or structure in its evaluation process. Secondly, there is a limit to the degree of structure or standardization that can be employed in the evaluation process. Obviously every transaction is a unique event, with many unique features, requiring customization. The evaluation checklist can therefore serve as a core guide, adapted by the evaluators to suit every occasion.

The third critical issue raised relates to the time devoted to the evaluation process. As was the case in the degree of structure, the time devoted to evaluation differed widely among respondents. The literature recommends that thorough evaluations be done: this usually requires time, and the more, the better. As Adler & Sneath point out in a Fortune article:

> 'Mergers, like marriages, are complicated commitments. What you see is largely what you get. You had better first look hard to be sure it's what you want. Evaluate thoroughly' (1987: 44).

There is however, a danger in taking months to complete an evaluation: rumour of possible acquisition and change in control can wreak havoc among the stakeholders of a target organization — having investigators snooping around, overturning each stone makes confidentiality difficult to maintain. For this reason, and in particular in the case of listed companies (where rumour not only disturbs stakeholders, but also share price, usually in an upward direction), shorter evaluations are preferred. In fact, in many listed company contexts, evaluations are performed on publicly available information only. Similar to an arranged marriage, the parties discover their compatibility (or incompatibility) after the event. Time devoted to evaluation is therefore a double-edged sword. Clearly, a balance exists between maintaining confidentiality, and obtaining information upon which to base a decision. Also the conflict between confidentiality and time highlights the advantage of acquiring firms in the same or a related industry: a prospect in the same industry (optimally a direct competitor) is likely to be well known to the acquisitor prior to the acquisition. Evaluation, for this reason, is likely to be quicker and easier than in the case of an unknown firm in an unknown industry. Evaluation is therefore to a degree contextual, and the degree of structure, and indeed time required to complete the process, will differ according to the context.

Specific evaluation practices

After inquiring into the general evaluation practices of respondent organizations, questions were directed at three specific areas of evaluation: firstly, respondents were asked to indicate how their organizations evaluated the management of potential candidates; secondly, they were requested to share their views on the role of corporate culture in the merger/acquisition process, and where appropriate, how they evaluated the culture of the organizations they were investigating; and finally, respondents were asked questions about the evaluation of owner-managed concerns, and the evaluation of firms smaller than themselves.

Evaluation of management

The aptitude of a target's management in most transactions is of key concern to the acquisitor. Mostly, acquisitions are done as much for management skills as for assets. Rockwell (1968) is of the view that top management is at least as important as the assets purchased. As reported in the previous article in this series (Brews, 1987), many of the respondents underscored the importance of managerial competence in the acquisition process. For this reason, respondents were asked, in an open-ended question, to describe how their organizations evaluated the management of potential candidates. A wide range of responses were elicited, capable of segmentation into ten different categories. Listed in Table 4 are the categories and the number of mentions per category.

Table 4 Evaluation of management: processes employed

Process employed	Mentions
Through evaluation of historic results	12
Through personal interviews/contacts	8
By establishing industry reputation	3
By gut feel and intuition	3
In impressions made at meetings	2
Through canvassing suppliers and customers	2
By observing management at work	2
Through canvassing competitors	1
By investigating experience base	1
By observing personal characteristics	1

The findings regarding the evaluation of management are both positive and negative. The positive aspect is that a number of suggestions were made with regard to the evaluation of managerial competence. Unsurprisingly, the most popular method to evaluate managerial competence was analysis of historic results — in other words simply by performance. In addition, some respondents reported evaluating competence by canvassing other interest groups such as suppliers, customers, and competitors, while others reported reliance on intuition, impressions, observations and gut feeling. The negative aspect of the findings was that no suggestions were made with regard to evaluating managerial compatibility, rather than competence. In acquisitions of unrelated businesses, where the acquisitor plays the role of an investment holding company, managerial competence, and not compatibility, is probably of greater importance. However, in the case of horizontal or vertical integration, or any acquisition where the management of both parties are required to work closely together on a day-to-day basis, managerial compatibility may be as important as managerial competence. In such situations, effort must be directed at the evaluation stage to assess both competence and compatibility. Unfortunately no insight into evaluating compatibility was obtained from respondents, indicating a lack of awareness or attention in this regard.

Evaluation of culture

The cultures of organizations involved in mergers or acquisitions can significantly influence the outcomes of transactions. Often, one of the major tasks facing the management of newly merged or acquired companies is coping with the dysfunction caused by culture clash or mismatch: inappropriately matched cultures can cause merger or acquisition failure (Brews, 1987; Gerber, 1987; Schein, 1985; Buono et al., 1985; Jemison & Sitkin, 1986). How acculturation is achieved can effect the level of acculturative stress, and ultimately facilitate or hinder the implementation process (Nahavandi & Malekzadeh, 1988). The ability to evaluate both one's own and a target's culture must therefore be an advantageous skill in the merger or acquisition process. Accordingly, three questions focusing on culture were included in the research: firstly, respondents were asked to articulate their definitions of organizational culture — since the very definition of the concept is somewhat problematic, it was considered necessary to surface respondent conceptualizations to ensure that when evaluation of culture was discussed, researcher and respondent were on the same wavelength; secondly, respondents were asked to clarify what role corporate culture played in the merger/acquisition process if the role is considered unimportant, evaluation of corporate culture is unnecessary; and thirdly, assuming that corporate culture was considered to play a role in the merger/acquisition process, respondents were asked to describe how their organizations evaluated the cultures of potential candidates.

The research findings relating to these three questions are reported below. In the research, Schein's (1985) widely accepted conceptualization of culture was adopted. Similar to other writers (Sathe, 1986; Dyer, 1986) Schein conceptualizes culture as a multi-level phenomenon: the first level being the definition of culture itself, what culture actually is. According to Schein culture is:

> '... a pattern of basic assumptions — invented, discovered, or developed by a given group as it learns to cope with its problems of external adaptation and internal integration — that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think and feel in relation to those problems' (1985: 9).

At this level culture is invisible. At the second level, culture, according to Schein (1985), manifests itself in a set of values (what culture produces) which have a higher level of awareness than the underlying basic assumptions. Finally, the third level, though visible, but often not decipherable, comprises the artifacts of an organization's culture (how culture is reflected). Artifacts include physical, behavioural and verbal artifacts, all of which are overt expressions or surface manifestations of an organization's values, and basic assumptions.

Respondents' conceptualizations of culture were classified according to Schein's multi-level schemata of culture. Reported in Table 5 are the research findings, classified according to Schein's levels: what culture is — a set of basic assumptions; what culture produces — a set of values; and how culture is reflected — in physical, verbal and behavioural artifacts.

Inspection of Table 5 provides some interesting insights into respondent understanding of organization culture, as defined by Schein. Firstly, six respondents provided conceptualizations which could not be classified according to the schemata, indicating, unfortunately, a lack of understanding of the concept. Secondly, no respondents conceptualized culture across all three levels: what culture is; what culture produces; and how culture is reflected. Eight respondents conceptualized culture in terms of what it produces, and how it is reflected, while four respondents conceptualized culture in terms of what it produces. Finally, two respondents conceptualized culture only in terms of its reflection. Respondents 2 and 11 provided the most comprehensive conceptualizations. According to respondent 2, 'corporate culture is a combination of philosophies and norms generated over long periods of time by very senior management (what culture produces), which provides a framework which determines behaviour of junior management (the reflection of culture)'. Respondent 11 considered culture the

Table 5 Respondent conceptualization of organizational culture

Levels of culture	Respondent number																			
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
What culture is: a set of basic assumptions				—			—	—		—						—				—
What culture produces: a set of values, norms, beliefs, attitudes	x	x	x		x	x			x		x	x	x	x	x				x	
How culture is reflected: in artifacts, i.e. policies, behaviours, etc.	x	x			x						x	x		x	x		x	x	x	

— indicates no meaningful response

'generally accepted norms, ethics and values to which the majority of corporate management and decision-making employees adhere (what culture produces), as evidenced by their words and even more substantially by their actions and decisions (the reflections of culture).' Respondent 14, similarly, though less comprehensively, conceptualized culture as 'the value system (what culture produces) which defines the network of communications governing the behaviour and attitude of management towards assets and people (the reflection of culture)'.

Respondents 17 and 18, who conceptualized culture in terms of its artifacts only, saw culture as 'the way the business is run' and 'the management style of the organization' respectively, indicating a fairly superficial understanding of the concept.

The conceptualizations provided by respondents (apart from those which could not be classified according to Schein's schemata and were therefore rejected) indicate, in a few cases, an adequate understanding of organizational culture. However, in most instances, respondent understanding of the concept is inadequate and superficial, making it even more difficult for such respondents to evaluate culture: without a thorough understanding of what organizational culture is, the identification and evaluation of target company cultures becomes difficult, if not impossible, as does surfacing the potential for cultural clash or mismatch in any proposed transactions.

The second question asked of respondents in the cultural realm sought their views on the importance and role of culture in the merger/acquisition process. Ten respondents thought the role of culture vital or significant. Three respondents were less certain about the role of culture in the merger/acquisition process. Respondent 4, while acknowledging culture did play a part in mergers or acquisitions, refused to be drawn on the extent of this role. Respondent 19, similarly, preferred not to comment upon the extent of the role, and merely indicated that the cultures of merger or acquisition candidates should be compatible.

Respondent 11 suggested that cultures which were alien needed to be identified, and tolerated, or changed. The remaining seven respondents saw either no, or little role for culture in the merger/acquisition process. Four respondents (15, 17, 18 and 20) stated categorically that culture had no role to play. Two of these four provided reasons for their views: in the case of respondent 15, all acquired companies operated independently, meaning that differing cultures were unimportant; and in the case of respondent 18, usually assets (and not people) were acquired — culture obviously relates to people, and not assets. The remaining three respondents (2, 10 and 16) acknowledged culture had a role to play, but according to them, the role was insignificant.

The research findings with regard to the role of culture in the merger/acquisition process, similar to the findings in other sections of the research programme, are quite varied: ten respondents considered culture a crucial variable in the merger/acquisition process; three respondents were uncertain about the role played by culture; while seven respondents were of the view that culture played either an insignificant or no role in the merger/acquisition process. These findings force one inescapable conclusion: culture, or the manifestations of culture clash or mismatch, can be more devastating in some situations than others — asset strippers, or acquisitors intent on acquiring only assets, or plant capacity, need not be concerned about culture. Equally, acquisitors operating in an investment holding company context, where they act more like portfolio managers than general managers, need not be overly concerned about culture or culture clash: as long as investment returns are acceptable (given the risk), their independent, autonomous units can be left alone to continue their good work — if returns become unacceptable, the portfolio can be adjusted through disposal. However, similar organizations intent upon successfully merging, and obtaining synergy from the merger, would be well advised to seek a good cultural fit: mismatch in such a context can be disastrous, and jeopardize the entire transaction. This would be especially so in the merger or acquisition of companies operating in services, where the successful combination of people is the key ingredient of success.

The final question relating to culture dealt with the evaluation of culture. In an open-ended question, respondents were asked how their organizations evaluated the culture of potential candidates. The four respondents who saw no role for culture in the merger/acquisition process considered this question inapplicable, and accordingly gave no response. Respondents 8 and 16, unfortunately, gave no meaningful response, while respondent 10 saw no need to evaluate the culture, since culture had a 'very little' role to play in the merger/acquisition process. According to respondent 2, corporate culture would not be evaluated anyway, and no attempt was made to evaluate culture because of this. The remaining twelve respondents provided descriptions of varying sophistication and complexity regarding the fashion in which their organizations evaluated the culture of potential candidates. Some of the more comprehensive descriptions were:

- we evaluate culture by personal observation of offices, dress codes, management and employee ages, nationality, religious bias, working hours and employee attitudes at floor levels towards customers (respondent 3);
- we evaluate the inter-relationships between the Chief Executive Officer and other members of the management; we look for clues given by the Chief Executive Officer, and people reporting to him — this is likely to be reflected throughout the organization (respondent 13); and
- we evaluate documented policies and philosophies, and interview personnel at different levels, and discuss candidate cultures with clients and suppliers (respondent 19).

Most evaluation processes were, however, even more crude and unsophisticated: we evaluate on an intuitive basis — can we work with the incumbent management? (respondent 4); by personal contact (respondent 5); by looking at the reputation (respondent 6); by personal observation and contact (respondent 11); and we measure the candidate's morality with our own, and observe the values of the Chief Executive Officer (respondent 9).

The research findings regarding the evaluation of culture reveal that though many respondents acknowledge the importance of culture in the merger/acquisition process, none employ an adequate methodology to measure or quantify a candidates' culture. The more sophisticated focus on observing the artifacts or manifestations of culture (such as documented policies and philosophies, dress codes, office buildings or managerial behaviour, etc.) while the less sophisticated rely on intuition, reputation or personal contact. Unfortunately, this is inadequate. The deciphering of an organization's culture is a complex, difficult process, requiring considerable insight and skill. Many methodologies to decipher an organization's culture have been suggested (Schein, 1985; Wilkens, 1983; Deal & Kennedy, 1982, Dyer, 1986; Pettigrew, 1979; and Brews & Blom, 1988), ranging from merely observing the artifacts of culture, to more complex approaches which essentially involve developing a schemata which explains how a set of basic assumptions in an organization have produced a set of values which are reflected in verbal, physical and behavioural artifacts. Acquisitors are unlikely to possess in-house skills to conduct such an investigation. Ideally, acquisitors serious about deciphering either their own or a candidate's culture, would be well advised to consult with outside specialists specifically trained in the process. Relying on home grown, crude tools (which the research has shown is the case among respondents interviewed) will at best achieve little, and at worst may thoroughly misdirect acquisitors about the cultures of organizations they are acquiring.

Evaluation of owner managed and smaller concerns

The final specific evaluation practices investigated in the research related to the evaluation of owner managed and smaller concerns. These two specific categories of firms were singled out for attention because of the unique challenges faced when acquiring such firms. Size mismatch, more specifically where an acquisitor acquires a company significantly smaller than itself, has been shown to be a cause of acquisition failure (Brews, 1987; Ketching, 1967). This is primarily due to the fact that often the effort required from management to revitalize or resuscitate a failing small acquisition is considered too costly, or simply too much bother; the easier alternative of disposing of the failed company is preferred. With regard to owner managed firms, often the owner/manager faces a transition challenge from owner to corporate employee, which carries with it an adjustment in status owner/managers may find difficult to accept. In two open-ended questions, respondents were asked to relate any difficulties experienced in the evaluation or acquisition of owner managed and smaller concerns.

As was the case in other sections of the research, responses relating to owner managed firms were varied. Ten of the twenty respondents cited special difficulties regarding such firms. Two respondents stated categorically that their organizations would not acquire owner managed enterprises. One of these two respondents expanded his response by referring to the acquisition of an owner managed firm as a 'no-win situation'. If the owner manager sells the firm and leaves, the company is most likely to fail, either because the firm is weakened by the loss, or because the owner manager is likely to take the business with him. On the other hand, if the owner manager sells the firm and remains, the tendency is that he will run the firm with an open cheque book, and treat the acquisitor's cash as limitless. One respondent indicated that his firm's policy was that if the support of the owner manager was not obtained, the transaction would not be entered into.

Several respondents alluded to other difficulties experienced in obtaining the support or co-operation of the owner manager: the relationship is often very difficult — the owner manager does not want to belong to a group, but wants to do his own thing, maintain his independence. Reporting procedures are often difficult, as is getting information from the owner manager (respondent 2); owner managers often have difficulty reporting to someone. Also, once the owner manager has his capital, the necessity of applying himself to the job diminishes. In addition, owner managed cultures are difficult to accommodate in a group of companies (respondent 7); owner managers do not wish to lose personal freedoms associated with personal ownership and decision making. They also seem unable to adapt to different ideas/norms of performance (respondent 11); the transition is difficult. Getting head office control is a challenge. Different cultures are often a problem (respondent 4); and remuneration packages have to be straightened out, discipline is often needed. Owner/managers have difficulty in accepting reporting structures — the corporate, professional management context is often hard to adjust to (respondent 17). Finally, one respondent (respondent 2) indicated his organization's policy regarding the retention of owner/managers: the owner/manager is usually the reason behind the company's success — without him the company dies. Management succession is very important. An employment contract/restraint of trade is essential, and pricing and method of payment is based on future results.

Responses regarding the acquisition of smaller concerns repeated several of the themes encountered in the acquisition of owner/manager concerns: a lack of reporting systems and structures often causes integration difficulty; a conflict of corporate cultures often frustrates integration; and control can often be difficult in smaller concerns.

The responses obtained regarding the evaluation of owner managed or smaller concerns serve to emphasize the difficulties and challenges encountered when acquiring such firms. As a few of the responses illustrate, some organizations have adopted a policy prohibiting the acquisition of owner managed concerns. Other responses show that the integration of owner managed or smaller concerns presents unique problems: the owner manager faces a transition challenge, and evaluating and discussing this challenge with owner managers prior to conclusion of the merger/acquisition transaction is vital. Reporting and control procedures should be agreed upon and discussed in depth during the negotiation process, rather than imposed after agreement is reached. Most importantly, the owner manager's attitude towards operating in a corporate or professional management context and culture should be assessed and evaluated, while finally the compensation and incentives employed to retain and motivate the owner manager should be specifically considered.

Conclusion

The purpose of this article has been to report a portion of the findings of research conducted recently into the acquisition practices of twenty acquisition intensive companies in South Africa. In this article I have focused on the screening and evaluation of potential candidates. In summary the article shows that:

— A proactive, focused search and screening process (based on industry knowledge and private networks) is most suitable to the South African context.

— Evaluation responsibility is considered primarily a team effort, and the domain of top management, assisted by staff personnel where necessary. In-house non-specialists were also utilized, on an *ad hoc* basis, with outsider advisors such as merchant bankers and auditors being used sparingly. Unfortunately, only two respondents involved line management in the evaluation process.

— Formally developed acquisition evaluation checklists are used, though only in fifty percent of the organizations represented. Flexibility in the use of evaluation checklists was emphasized, mainly because each acquisition possesses unique characteristics not covered in a standard checklist. The optimal approach is to use the checklist as a core guide, supplemented by additional questions or areas of investigation as each situation warrants.

— Time should be invested in the acquisition evaluation process, though most respondents reported that evaluations typically took less than a month to complete. Seventy percent of respondents indicated evaluation took less than three months. Fifteen percent of respondents, however, reported that the time taken to complete the evaluation process was dependent on the size, complexity, risk and even the time available to complete the evaluation.

— While several methods to evaluate managerial competence were discovered, no processes to evaluate managerial compatibility were utilized by any organizations represented in the research. In some merger/acquisition contexts, managerial compatibility (rather than managerial competence alone) may also be vital to event success. Organizational culture, as a variable contributing to transaction success (or failure) depends upon the context. In some situations, culture clash or mismatch can directly cause transaction failure, while in other situations, culture as a variable is much less important, if important at all. The need to evaluate the culture of a potential candidate is thus contingent upon the type of transaction itself. No adequate methodologies to evaluate a candidate's culture were discovered. Typically, home grown, crude tools were used by respondent organizations to measure the cultures of candidates under investigation, indicating a serious deficiency in evaluation practices in this regard.

— The evaluation of owner managed or smaller concerns requires special consideration, especially with regard to the ability of the owner manager to adapt to the change in status from owner manager to professional manager. In addition, reporting and control procedures were surfaced as cause for concern in the acquisition of owner managed and smaller firms, together with the compensation and incentives employed to retain and motivate the owner manager after completion of the transaction.

Generally, the article serves to highlight a number of issues which should be considered by those responsible for the screening and evaluation of potential merger or acquisition candidates. In addition, a number of suggestions are made regarding aspects of the screening and evaluation process, which, if properly and comprehensively carried out, while not guaranteeing transaction success, should minimize the chance of failure being attributable to inadequate candidate evaluation.

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