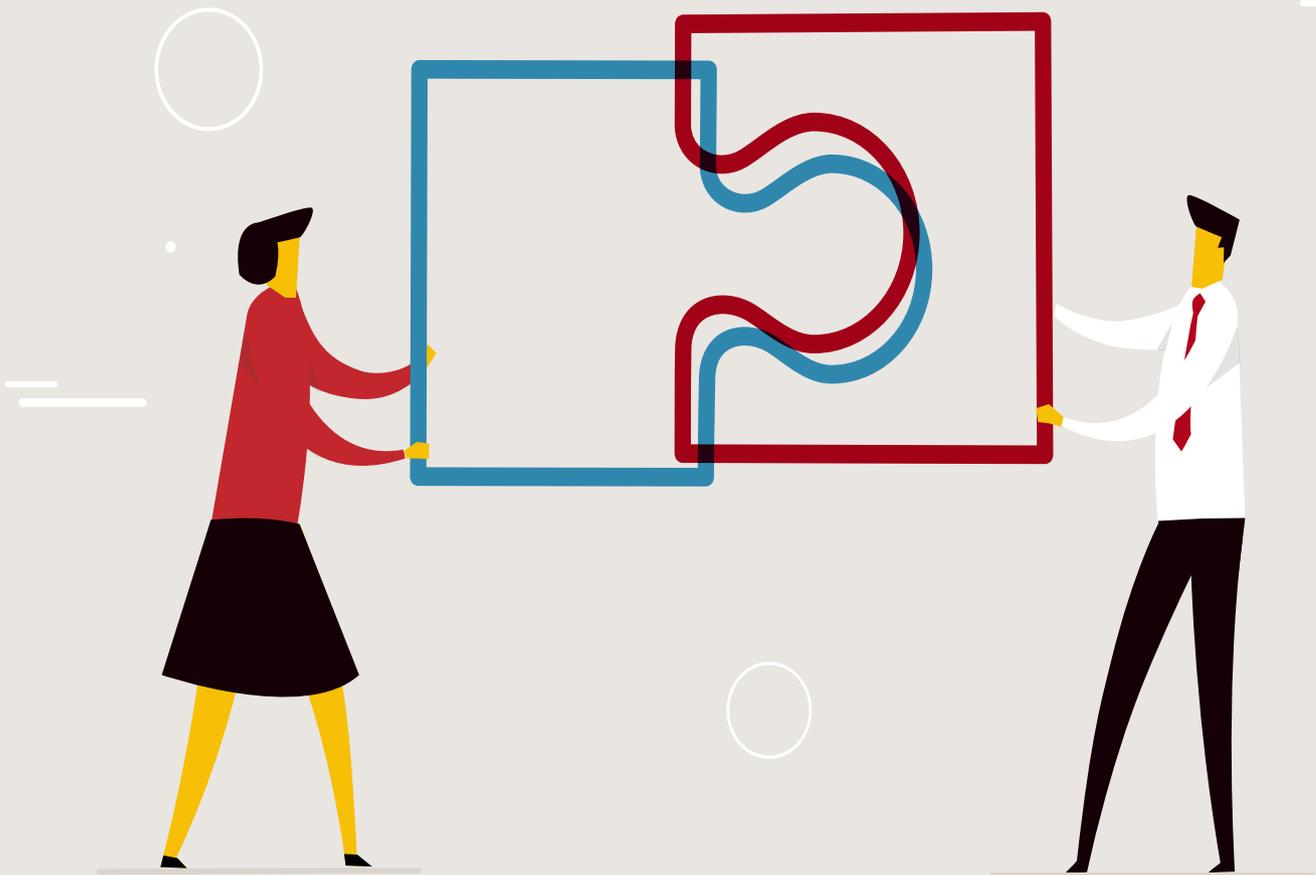


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FINANCIAL SERVICES PRACTICE | INSURANCE SECTOR

Getting beyond risk in insurance M&A

Mergers and acquisitions in the insurance industry get the numbers right, but often stumble on cultural obstacles.



It's no surprise that insurance companies excel at understanding the panoply of risks faced by their customers. After all, accounting for what can, has, or might happen is a core part of the business. Yet when it comes to mergers and acquisitions (M&A) many insurance companies only excel at half the job: assessing the risk of a potential takeover and expertly crunching the data. The other half—identifying cultural clashes that could scuttle integration—is often neglected. After a deal closes, and even during negotiations, insurance companies must move beyond the numbers and decide how, or even whether, to bring the two cultures together.

Our experience and research shows that many deals in cross-border M&A in the insurance sector founder around cultural issues. Too often, the industry views cultural differences as operational matters that can be hammered out, rather than behavioral differences that require a more considered approach. Boards of directors, which scrutinize the rationale and costs of a merger, often fail to consider cultural issues or monitor post-merger integration. As the global insurance sector consolidates and the number of deals increases, a keener understanding of how merging cultures can (and do) clash will become more important for success.

To look deeper into the challenge of cultural integration following M&A, Heidrick & Struggles talked with senior insurance executives experienced in acquisitions in Asia, Europe, and North America.

Most agree that clearer communications and an active approach to identifying and addressing cultural issues can improve the value captured from M&A. Yet many admit they overlook it: One executive said that at his organization several transactions were led by people who never visited the target company or its market, and had little local knowledge. "Having bought assets, we expected local market leaders who were new to the group to adopt our culture off the back of a series of written protocols and the occasional visit to London," he said. "We seldom asked them about the nuances of their marketplace."

Increased M&A activity

Ensuring that culture is top of mind will become increasingly important as the industry continues to rebound from the 2008 economic crisis. A study by Swiss Re reported 489 M&A deals were completed globally in 2014.¹ Although the volume remains well below the pre-crisis peak—674 deals in 2007—the insurer concluded that indications "suggest that momentum behind M&A is building."

In a separate study, Deloitte found the number of deals involving brokers grew 40% from 2013 to 2014.² Although in Deloitte's counting, deals involving underwriters edged lower from 2013 to 2014, the average value per deal almost tripled, from \$124 million in 2013 to \$359 million in 2014. Indeed, 2014 saw the announcement of eight insurance M&A deals with values of more than \$1 billion, dwarfing the volume of big-money deals in previous years. (For more, see sidebar, "Let's make a deal.") The largest transaction was the \$8.8 billion takeover of Friends Life by British insurer Aviva, creating the largest insurer in the United Kingdom.

¹ See *M&A in insurance: Start of a new wave?*, Swiss Re Sigma, Number 3, 2015, swissre.com.

² See *2015 Insurance M&A Outlook: Continuing acceleration*, Deloitte, 2015.

Let's make a deal

Several factors are contributing to increased M&A activity in the global insurance sector, but most consider the main impetus to be overall lower policy rates. Lower rates are seen as a byproduct of overcapacity, and the industry is consolidating to retain profitability and increase differentiation. Other factors include growing interest in insurance M&A from a broad range of backers, including hedge funds, private equity, and international investors. Companies are looking for ways to use vast cash reserves. A strong US dollar has made some cross-border deals less expensive for US companies. And insurers are recognizing the need for economies of scale, particularly as the costs of IT and system changes mount.

In addition, many companies in Asia are moving into global markets and looking for strategic acquisitions to drive their expansion plans. For example, in 2013 Sompo Japan Insurance bought UK-based Canopus Group, and in 2015 Mitsui Sumitomo Insurance (MSIG) bought Amlin, also of the United Kingdom. And among the recent deals originating from China, Peak Re, a unit of Fosun Investment, bought Bermuda-based Ironshore in 2015, and in 2016 Mingshen was finalizing its acquisition of UK-based Sirius from White Mountains.

Against this background, insurance companies are pushed toward M&A for a variety of reasons. The most common, still, is to bring together two companies with complementary businesses and strategies and capture greater value through scale efficiencies. In Asia in particular, such mergers are trending

as a way to support regional growth aspirations. For example, in 2014 Swiss Re paid \$122 million for RSA's China unit, Sun Alliance. RSA's strategy to divest out of Asia thereby provided Swiss Re with an established platform for its continued growth of direct insurance in China. This deal, and others like it, focused on serving an aging Asian population with products centered on retirement planning and financial safeguards.

Other strategic goals are also driving deals, for example, attempts to harness digital technology and reinvigorate tired corporate business models. In one case, US insurer Aetna in 2014 bought technology provider bswift, which offers cloud-based insurance exchanges and other digital products, for \$400 million. These types of deals focus on integrating the newest technologies, like mobile applications and big data analytics, as a core component of a company's business model, either to reach customers, provide market insights, or improve internal efficiencies. Such mergers are especially prone to cultural clashes as staid insurers butt against dynamic, high-tech entrepreneurs, often extinguishing the very spark that created value in the acquired company.

And finally, in a reflection of the industry's positive outlook, outside investors are also turning to the sector as a channel for steady yields. In one example, in 2014 the Canadian Pension Plan Investment Board acquired the US-based Wilton Re for \$1.8 billion.

The power of culture

While M&A is driven by a range of underlying strategic objectives, those with the greatest potential look beyond pure cost efficiencies. Success is drawn not just from spreadsheets, but also from cultural integration that produces better collaboration and new ideas.

Such cultural integration can take several forms. The parent company can absorb and dominate the culture of the acquired company (perhaps the most common form); the two cultures can coexist, with the acquired company retaining a certain level of autonomy; or the two cultures can intermix, creating a new and hopefully more ideal corporate culture. Regardless of the form that cultural integration takes, the evidence suggests that insurers everywhere find it challenging: for example, 39% of respondents in a 2016 Towers Watson survey of 750 global insurance executives cited “overcoming cultural and organizational differences” as a post-integration challenge.³

Yet when companies get culture right, the benefits are significant. The 2004 merger of US insurers Anthem and WellPoint Health Networks is a clear example. Soon after the \$16.5 billion merger was approved, Larry Glasscock, CEO of the new company (now called Anthem), made it clear that the merger signaled the birth of a new company and a new culture, rooted in internal trust and innovation. Glasscock first delivered the message to a newly formed executive-leadership team, comprising 15 leaders from both companies, then to 300 top managers in the new company, and finally to its more than 40,000 employees. Eventually the new culture would permeate every aspect of the new company, from hiring and orientation to performance management. By 2007, the company was named by *Forbes* magazine as one of the most

admired companies in the United States, had cut administration expenses in terms of share of overall revenue, and was on track to reach its growth targets. In 2016, Anthem itself is in the process of merging with Cigna and could profit from remembering these lessons.

Which integration model is best depends on a variety of factors, such as the relative size of the two companies, the optimal organizational structure after the merger, and the value created by various cultural characteristics. But identifying the right model is a crucial element of any M&A process. By planning strategies for assimilation with the same fervor as those for operational efficiencies, insurance companies can lower the risk of failure in M&A.

Before the deal is done

Spotting and addressing cultural challenges should start well before the papers are signed. Parallel to due diligence, acquiring companies should critically compare attitudes, work habits, customs, and other less overt characteristics of the two companies involved. The effort should be a routine part of the standard M&A process, rather than an ad hoc response if friction develops.

Gather data on culture

One useful tool for comparison is the corporate-culture profile, a diagnostic instrument based on survey data from both companies. Such surveys explore a range of corporate characteristics, such as attitudes toward personal accountability and collaboration, trust levels, and integrity. They also gauge strategic alignment and commitment and assess the strengths and weaknesses of each culture. A corporate-culture profile can quickly identify areas in which two cultures diverge, pinpoint areas that may require immediate attention, and highlight

³ For more, see “Defying gravity: Insurance M&A on the rise,” Towers Watson, January 2016, towerswatson.com.

areas of common ground that should be recognized and celebrated.

Often, acquiring insurance executives wrongly (and perhaps unconsciously) assume that two companies in the same business will have relatively compatible cultures. In cross-cultural M&A, such notions are wishful thinking at best and can lead to challenges. Staff with different training, work environments, and market experiences will naturally view work differently.⁴

Investigate the intangibles

Our conversations with insurance executives who are experienced in M&A highlighted specific themes that arise during negotiations. These concerns should be included in the process to lower the risk of cultural clash in an acquisition:

Geographic location. One executive who was involved in XL Capital's 2001 \$405 million takeover of Winterthur International, a unit of the Swiss insurer, said that cultural clashes delayed integrating the acquisition by years. "US and Swiss cultures couldn't be more different, and the conversations never even touched on the subject, only the data," he recalled. "US firms measure success on a quarterly basis, and Europeans have a long-term view on the business."

Foreign executives with marginal connections to local culture or sensitivities commonly lead the due-diligence process. As a result, it is generally superficial and ineffective in regard to these intangibles. Deals are rarely scuttled over cultural concerns, even though these tensions can delay extracting full value from a merger and potentially impact expected returns.

⁴ In acquiring assets outside the sector, such as technology companies, the danger is even more acute. The fast-moving culture of digital innovation often clashes with the more reserved pace of big insurance. To overcome this tension, some companies, including MetLife and Aviva, have set up innovation centers that operate separately from their parent companies.

Management level. One exception was an aborted attempt by a global insurer interested in acquiring a niche firm in India. The acquirer found a sharp contrast between attitudes held by executives and staff at the target company. Senior executives were focused on growth, and mid-level managers worked in fear of disappointing them. Even though the financials were promising, the deal fell through over integration concerns. "You almost always only get exposure to top management during the due-diligence phase, and it's a dress-up show," said an executive close to the deal.

Potential problems can be avoided—or at least identified—by asking questions that go beyond a company's books and by meeting all levels of staff. For example, ask senior managers about long-term strategies, business operations, styles of working, and relations with mid- and low-level managers. Along with their answers, their approach—for instance, consultative or aggressive—should also be noted.

Mind-set. Acquiring companies should also spend time with staff at all levels, assessing work habits and attitudes. Along with meetings at the workplace, off-site events can also be beneficial. "Buyers with a high EQ [emotional quotient] tend to have the ability to truly get the heartbeat of a business," said the former regional leader for a global insurer, himself an M&A veteran. "Spend time getting to know the top and middle team outside of the work environment to understand their values and drive."

Encourage clear, honest communication

In general, workers at an acquired company understand—and sometimes fear—that job cuts are possible. Painting too rosy a picture ahead of a deal could create tensions later when reality hits. "Be honest from the outset," suggested a senior manager at a European insurer. "You're buying a business for their book, and you need to cut costs."

Honest communication during negotiations and due diligence can help expose attitudes toward potential job cuts and identify any measures that are seen as off limits. When a global company negotiated a takeover of a Malaysian life insurer, the acquirer presented a clear plan for adjusting leadership roles, pointing out gaps and explaining how they would be filled, said an executive close to the deal. The plan was presented at meetings to ensure alignment. “The acquirer needs to understand and respect non-negotiables relating to culture and not just look at the numbers,” this executive said.

Open communications at this stage can also create a clear picture of how integration will be handled if the takeover is completed. For example, acquiring companies often promise a short period with no major changes immediately following an acquisition. This interval allows senior executives and staff at both companies to become better acquainted and can help produce a more appropriate integration plan for capturing the full value of the merger.

In the case of the Malaysian insurer, for example, the acquirer agreed that there would be no major changes during the first six months. Once the grace period was over, changes were to be gradual and subtle, rather than abrupt and disruptive, said a top executive who worked on the integration. The executive noted that continuity between the due-diligence and integration teams was also important to ensure that the basis for such agreements was understood and that the agreements held. The approach was likely helped by lessons learned during an earlier acquisition in which the global parent and acquired company struggled for several years under two separate management teams.

Collaborate, don't dominate

Creating a collaborative atmosphere—one that doesn't alienate staff at the company being acquired—begins with first impressions. Companies that tout their superiority or power can find cultural

integration more difficult. In one case, the due-diligence team from a US acquirer flew into Asia on private jets, stayed at the best hotels, and boasted of their lifestyle to staff at the target company, creating emotional distance between them.

“Historically the insurance buyers have an absorb-and-impose approach to culture,” a top executive at a Japanese insurer said. “US companies are known to be the worst acquirers. They generally look at immediate financial results and key performance indicators rather than the long-term picture. Buyers will tend to focus on protecting their core headquarters' market first and other regions are at the bottom of the list.”

Throughout the acquisition process, staff at the targeted company should be treated as any other corporate colleague. Corporate hierarchies and chains of command exist, of course, but when they are the defining aspect of personal relationships, staff at acquired companies can become more anxious and less collaborative, posing an obstacle to integration. One executive observed, “Nothing raises hackles more than feeling you have been absorbed into a large and seemingly uncaring behemoth when, up until a few weeks earlier, you were top of the tree in your local market.”

After the papers are signed

If efforts before the deal can be seen as cultural intelligence-gathering, those after the deal focus on execution. After all, each integration effort is unique in its cultural aspects. A company may have a standard approach for combining product service lines, for example, but bringing staff members with diverse backgrounds together effectively requires a tailored approach.

For years, French insurer AXA followed a generally successful pattern that it rigorously applied to its M&A activities. Conversion in some areas, such as branding, corporate values, shared services, and IT infrastructure, were not up for negotiation, but acquired companies were allowed greater flexibility in others, according to a former country leader for AXA. But even AXA's template is being tested by today's volatile and highly competitive market.

Our experience and discussions with insurance executives demonstrate several points that are helpful to keep in mind during this phase of a takeover.

Don't rush big changes ...

In many takeovers, cutting costs (and jobs) at the acquired company is one of the first priorities. But moving too fast can cause unnecessary friction and inadvertently force valuable talent out the door. By taking a long-term view of the value potential of an acquisition, companies can take the time needed to understand cultural differences, and then focus only on those that may directly prevent the company from reaching its goals. As two businesses merge, it's natural for workers to become protective of their positions, and even paranoid about their future. The acquiring company must take pains to demonstrate that any cuts to duplicated roles will be decided based on merit, rather than internal connections.

Some insurers can be very deliberate with any changes they make to an acquired company.

"Japanese companies, when acquiring outside their home market and when they do it right, take a long-term view," said an executive at a Japanese insurer. "They don't impose their culture since it's so different. Instead, they spend a lot of time learning what works and what doesn't before implementing changes."

Some companies spend the first three or four months after an acquisition getting to know how the new company works. They might stage a night out with

junior management away from their superiors to get a better idea of how they see the business. Such measures could help pinpoint where a company's legacy culture might interfere with business objections. For example, if lower-level managers say they simply follow their boss' orders, there could be a misalignment on staff empowerment that could reduce innovation and block flows of information.

Once the integration is fully under way, continuing informal staff meetings at all levels can help define new cultural norms (such as greater entrepreneurship and accountability or the value of clients), reinforce key messages, and gauge progress.

In one example, an insurance executive recalled that when a North American holding company recently moved to acquire an Asian arm of another global insurer, it tried a new integration approach. Instead of forcing job cuts, the acquirer left the organizational chart for the acquisition open and slowly introduced the company to the new leadership approach and cultural norms. Managers who weren't comfortable with the new thinking left relatively quickly of their own accord. The executive said there were no conflicts around the departures, and in the end the company lost about 20 from a staff of 400. With the money saved by avoiding remunerations to retain the highest-performing managers, it offered each employee a 40% interim bonus after six months, which helped boost morale.

... but when the time comes, act

Once a decision is made to cut staff or to take another significant step, the acquiring company should act quickly and completely. Drawing out painful measures only accentuates lingering staff anxieties and delays the return to normalcy.

For example, when a British insurer took over a national business in Asia recently, it agreed to retain all staff for two years, partly to appease local unions. As a result, the local workers who were upset with

the merger (about 10% of the staff) didn't cooperate with the new leadership, and their attitude lowered morale and productivity across the organization. After about a year, the acquirer paid out the intransigent workers to leave early.

Create a strong team

Just as an acquiring company should be aware of its first impressions during due diligence, its leaders should work to build a team of peers with the acquired company's staff during integration. Too often, buyers approach acquisitions like a conquering army, imposing its rules without much consideration of the implications. Many of the executives we spoke with noted that US insurers are especially notorious for this approach.

When a global insurer bought the Asian unit of a European company, a number of unnecessary dictates upset the Asia staff, partly because they were perceived as ignoring cultural differences, an executive involved with the integration recalled. For example, the parent company banned sending text messages on company phones, even though text messaging was the primary channel the Asian staff used to reach its 5,000 independent agents. The Asian workers had to buy and use personal phones to do their jobs, the executive continued, adding that the acquirer also reneged on a promise to upgrade local offices after deciding it was too costly.

Along with exerting dominance over an acquisition, singling out staff for special treatment can also lead to discord. A common error is offering retention pay to only a few executives, rather than across the board.

Be candid about the downside

The importance of clear and honest communication continues into the integration phase, and indeed beyond it as a matter of course. New structures or other big changes should be broadcast quickly and widely to prevent destabilizing rumors from taking hold. Any messages about upcoming changes should be non-ambiguous and professional, especially for

measures that could be perceived as negative. There is no good time for bad news, yet uncertainty is often more corrosive than the reality.

When QBE bought Zurich Insurance's Singapore unit in 2004, the Australian insurer was clear on the implications, an executive close to the merger said. Among these were that costs would be reduced at the top, and anyone in a position with more than one claimant would have to reapply for the position, undergo interviews, demonstrate their capabilities, and show that they fit the new culture, all within three months. Everyone adhered to the schedule and there were no surprises or unnecessary conflict, the executive said.



The global insurance sector appears ripe for a new wave of consolidation as companies investigate entry into new markets and access to new technologies. As they pore over the numbers and explore the strategic rationale behind various moves, would-be dealmakers should also take stock of culture.

Industry leaders have long been excellent at weighing the financial risks and rewards of an acquisition, but they often fall short when considering the cultural aspects—if they consider culture at all. Cultural differences, however, can often ruin an otherwise well-planned acquisition. By purposely including culture in the negotiation process and after the deal is signed, companies can improve their odds of success. ■

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