Human Resource Issues in Merger and Acquisitions

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Abstract
Mergers and acquisitions are increasingly being used by firms to strengthen and maintain their position in the market place. They are seen by many as a relatively fast and efficient way to expand into new markets and incorporate new technologies. Yet their success is by no means assured. To the contrary, a majority fall short of their stated goals and objectives. While some failure can be explained by financial and market factors, a substantial number can be traced to neglected human resource issues and activities. Numerous studies confirm the need for firms to systematically address a variety of human resource issues and activities in their merger and acquisition activities. This article proposes a three-stage model of mergers and acquisitions that systematically identifies several human resource issues and activities. The article concludes with a description of the role and importance of the HR department and leader.

Keyword: human resource, human resource issues, merger and acquisitions,

Introduction
Companies today need to be fast growing, efficient, profitable, flexible, adaptable, and future-ready and have a dominant market position. Without these qualities, firms believe that it is virtually impossible to be competitive in today’s global economy. In some industries such as insurance or banking, firms may move into new markets. In others such as pharmaceuticals or software technology, firms may work with smaller firms that have developed or are developing new products that they can manufacture and/or distribute more efficiently, while other firms focus on their own internal growth, leadership and development. Regardless of industry, however, it appears that it has become all but impossible in our global environment for firms to compete with others without growing and expanding through deals that result in mergers or acquisitions. The factors that have driven the M&A activity in the past decade are forecast only to intensify: need for large economies of scale, deregulation, globalization, expanding markets, risk spreading, and need for rapid response to market conditions. Even in a tough financial environment and a declining stock market in 2000, the value of global mergers and acquisition exceeded $3.5 billion for the first time (Taylor, 2001). As a consequence of these realities, companies have become better at doing deals. Several have trained staff who can facilitate mergers and acquisitions. These odds, however, can be increased: some companies are quite successful in mergers and acquisitions. Yes, experience helps, but it is the learning from the experience that seems to be critical (Ashkenas et al., 2000). In general, what their experiences appear to suggest is that firms that have a systematic approach to deal making are more likely to be successful. Underlying this successful approach is the recognition of attention to many people issues (a.k.a., human capital) that exist throughout the stages of mergers and acquisitions. The purpose of this article is to articulate a systematic, people-oriented, approach for effectively doing mergers and acquisitions from beginning to integration and post-integration. We begin by identifying the types of mergers and acquisitions, the reasons for their successes and failures, and the many people issues involved. Then a three-stage model is described. This is followed by an overview of the implication for the Human Resource (HR) Departments and HR Professionals.
Mergers and Acquisitions
Mergers and acquisitions represent the end of the continuum of options companies have in combining with each other. Representing the least intense and complex form of combination is licensing. Next come alliances and partnerships and then joint ventures. Mergers and then acquisitions conclude the combination options. It is the mergers and acquisitions that are the combinations that have the greatest implications for size of investment, control, integration requirements, pains of separation, and people management issues.

Reasons
Horizontal mergers for market dominance; economies of scale, vertical mergers for channel control, hybrid mergers for risk spreading, cost cutting , synergies, defensive drivers, growth for world-class leadership and global reach ,survival; critical mass, acquisition of cash, deferred taxes, and excess debt capacity, move quickly and inexpensively, flexibility; leverage, bigger asset base to leverage borrowing, adopt potentially disruptive technologies, financial gain and personal power, gaining a core competence to do more combinations. There are two factors that will bring companies to the table major reasons for success in mergers and acquisitions include: Leadership, well-thought out goals and objectives, due diligence on hard and soft issues, well-managed M&A team, successful learning from previous experience, planning for combination and solidification steps completed early, key talent retained and extensive and timely communications to all stakeholders. These reasons are corroborated by the findings of Watson Wyatt’s Global M&A Survey where it is reported that the key lessons for the next M&A project suggest the need to:

- Develop a more realistic time scale, including allowance for the time required to prepare for effective due diligence
- Start the planning of integration processes sooner and get HR involved earlier
- Work to align expectations in the acquirer and acquired businesses
- Confront difficult decisions, including employee and human resource issues, earlier in the process. This indicates that there is a need for companies to be more critical of their own performance in a deal to make sure that lessons are learned for the future. Thus, while there are many reasons for success and failure in mergers and acquisitions, whether in North America, Europe, or Asia, at the core of many of them are people issues.

The Human Side of M&A Activity
Plenty of attention is paid to the legal, financial, and operational elements of mergers and acquisitions. But executives who have been through the merger process now recognize that in today’s economy, the management of the human side of change is the real key to maximizing the value of a deal. ‘Employers now recognize that human resource issues are the primary indicator of the success or failure of a deal. When we had mergers just five years ago, employers had much more leverage than they do now. Many mergers do not create the shareholder value expected of them. The combination of cultural differences and an ill-conceived human resource integration strategy is one of the most common reasons for that failure. So if people issues are so critical, why are they neglected? Possible reasons include: The belief that they are too soft, and, therefore, hard to manage, Lack of awareness or consensus that people issues are critical, No spokesperson to articulate these issues , No model or framework that can serve as a tool to systematically understand and manage the people issues; and therefore and The focus of attention in M&A activity is on other activities such as finance, accounting, and manufacturing Research, however, indicates that people issues occur at several phases or stages of M&A activity. More specifically, people issues in just the integration phase of mergers and acquisitions include: (1) retention of key talent; (2) communications; (3) retention of key managers; and (4) integration of corporate cultures. 10 From these flow numerous, more detailed people issues, e.g., evaluation and selection of duplicate managerial talent to determine who remains and who departs after the merger or acquisition. In the process of integrating corporate cultures, entire sets of human resource policies and
practice from both companies may be subject to evaluation, revision, or replacement. While these human resource issues are important in M&A activity throughout the world, their importance tends to vary by the type of M&A combination. For example, if it is an acquisition that will allow for separation of the acquired company, there may be fewer evaluation, selection, and replacement decisions than in acquisitions that result in complete integration of the two companies. Those become more evident and more manageable by detailing a model of M&A activity.

Three Stages Model of Mergers and Acquisitions
The experiences of companies in merger and acquisition activity suggest a model of M&A activity that has three stages: (1) pre-combination; (2) combination — integration of the partners; and (3) solidification and advancement. While these three stages are applicable to and encompass the larger set of business functions such as business strategy, finance, marketing, distribution, IT, and manufacturing, the issues highlighted here are those that reflect issues most closely associated with human resource management. Then to provide further focus and detail for these human resources (HR) issues in M&A activity, HR implications and actions for the several issues in each stage are identified.

Stage 1 — Pre-Combination
There are several human resource issues in this first stage of the M&A activity. While discussed together, the differences that may accompany a merger rather than an acquisition are noted. Because of the wide variation of mergers and acquisitions that are possible, however, details of all such possible differences are not fully articulated here. In this Pre-Combination stage the most significant. The HR issues are described first, followed by a discussion of the HR implications and actions. HR Issues. An important HR issue in the Pre-Combination stage of any M&A activity is identifying the reasons to initiate the activity. As described earlier, of the many possible reasons for an M&A, a substantial number are human resource related, e.g., acquisition of key talent. At companies like Cisco and GE, retention of key talent is often the number one concern. Here the M&A is announced because a major reason for the combination is to obtain that talent in the first place (Nee, 2001). Another important HR issue is the creation of a dedicated senior executive, such as Michael Volpi at Cisco, and a team to head the M&A process. As suggested earlier, a key reason for M&A failure is the lack of a capable leader who can focus completely on all the aspects of the M&A process, one of which is seeking out potential companies to merge with or acquire. Then after the identification of potential companies, comes the selection discussion of which one to choose. Regardless of how well the two other stages may be planned for and done, selection of the wrong partner is likely to diminish the possible success of the combination. Alternatively, selection of the right partner without a well-thought plan for managing the rest of the M&A process is also likely to diminish the possible success of the combination. A final HR issue highlighted in is the ‘planning to learn from the M&A process.’ According to Watson Wyatt’s recent global survey: Companies that embark on a program of M&A should build up a pool of talent, which they can redeploy to share and apply the learning gained around the organization. Similarly, they could and should be turning the knowledge and experience acquired in each deal into comprehensive, streamlined and pragmatic processes and knowledge centers, which can be applied to future deals. HR Implications and Actions. An immediate HR implication of this last HR issue is that firms that have a better understanding and knowledge base of the M&A process are likely to be more successful in their M&A activities. This understanding and this knowledge base, however, have to be shared and disseminated to have maximum impact because M&A activity is likely to affect everyone in the company, particularly if the combination results in extensive integration of the two companies. Significant HR implications result from the need to have a dedicated and skilled leader and team for M&A activities. This need is likely to be best served through the best use of a variety of HR practices working in concert, namely, recruitment, selection, development, appraisal, compensation, and labor relations. Conducting a thorough due diligence in the M&A process also has critical HR implications: ‘Many CEOs gloss over softer HR issues, including potential cultural
problems, only to realize later that they’ve made a huge mistake,’ says Mitchell Lee Marks, a San Francisco-based management consultant who has worked on more than 60 mergers over the last 15 years. Yet, the results of the extensive Watson Wyatt M&A survey concluded that the priority assigned to HR and communication in due diligence is comparatively low. Receiving more attention in due diligence are such functions as strategic business development, finance, operations, marketing, and sales. While these functions continue to be the essence of the ‘hard’ due diligence process, the human resource oriented audit, the ‘soft due diligence,’ is gaining respect and use: At Cooper Industries, a Houston-based manufacturer of electrical products, tools, and hardware with 28,100 employees and $3.6 billion in 1998 sales, M&A activity is a regular part of the picture. The company typically pulls the trigger on 10 to 15 deals a year, acquiring both public and private companies. George Moriarty, assistant director of pension design, typically spends several days poring over records, with the assistance of a detailed checklist. Among other things, he examines day-to-day business costs and looks for potential liability, especially related to retiree medical benefits, severance pay obligations and employment contracts for executives. When the deal involves an overseas acquisition, he often spends hours interviewing senior executives of the targeted firm. The entire due diligence process usually takes a week to 10 days, though complex deals can require three or four weeks of analysis.

Stage 2 — Combination — Integrating the Companies

Although we are now at the second stage of the M&A process, it is important to acknowledge the base that has been established by the activities in the first stage. For example, for Stage 2 to be effective, it is important that planning for their integration activities be skillfully prepared in Stage 1: ‘lack of integration planning is found in 80% of the M&A’s that underperform’ (Charman, 1999; Habeck et al., 1999). This crucial second stage incorporates a wide variety of activities as shown in Figure 2. In general, integration is the process by which two companies combine after a merger or an acquisition is announced and pre combination activities are completed. Regardless of the specific area of breakdown or weakness, when poor integration occurs:

- Productivity drops by 50 per cent
- Leadership attrition soars 47 per cent within 3 years
- Employee satisfaction drops 14 per cent
- 90 per cent of high-tech mergers fail to deliver expected increases
- 80 per cent of employees begin to feel management cares more about financials than product quality or people17 Based upon the intensive J&J study of the M&A process, it was found that:
  - A systematic, explicit integration process is at the heart of a successful acquisition
  - All acquisitions require some degree of integration in both the area of day-to-day systems and processes and in achieving key synergies
  - It is important to tailor what is integrated and how it is done to the specific strengths and weaknesses of the acquired company
  - Integration efforts will differ depending on the company’s characteristics

Maintaining the ability to focus on the few key value drivers is a critical part of the integration process Companies. HR Implications and Actions. Perhaps the most critical HR issue for the success of this integration stage is selection of the integration manager. Combinations that were guided by the integration manager: Retained a higher % of the acquired companies’ leaders, retained a higher % of the total employees and achieved business goals earlier.

Stage 3 — Solidification and Assessment of the New Entity

Particularly for a merger of equals with high levels of inclusion, there is a clear and specific new entity that is created. This new entity, the new company, e.g., DaimlerChrysler, needs to address several HR issues to ensure its viability and success. These HR issues and their implications are outlined. HR Issues and HR Implications and Actions. As the new combination takes shape, it faces issues of readjusting, solidifying and fine-tuning. These issues take on varying degrees of intensity, although not
importance, depending upon whether it is a merger of inclusion rather than one of separation or an acquisition of relative equals versus unequal’s. Daimler Chrysler, an acquisition of relative equals, provides an example. DaimlerChrysler went through this for more than two years after the formal combination was completed. During the past two years since the combination was announced, Daimler has gone through several leadership changes in the Chrysler Group, as the unit is now called. There are many activities that are consistent with and appropriate for the HR professional’s skills and competencies. These include:

1. Developing key strategies for a company’s M&A activities. 85% per cent of HR executives say they should be involved.

2. Managing the soft due diligence activity. This can mean: Gaining knowledge of the make-up and motivation of the two workforces, Accessing management team of the other company, conducting analysis of its organizational structure, Comparing benefits, compensation policies, and labor contracts of both firms and Assessing the cultural match between the two firms.

3. Providing input into managing the process of change: HR is a change champion providing the change management skills to align the right people with the appropriate knowledge and skills base to meet the shared goals of the enterprise (Charman, 1999).

4. Advising top management on the merged company’s new organizational structure. Almost 75% of HR executives think this, and only 9% think that HR should have full responsibility.

5. Creating transition teams, especially those that will: Develop infrastructure for new organization, Process and design systems, Address cultural issues, Provide training, managing the activities associated with staffing, in particular, developing and overseeing, Selection processes, Retention strategies and Separation strategies.

6. Overseeing the communications. Developing a communication plan aimed at realizing a vision of the new organization through: Assessing issues re: audience, timing, method and message, Information delivery, Information gathering, Change galvanization and Helping employees cope with change.

Conclusions

There are numerous conclusions that can be made about M&A activity,

- Companies should put their best people in charge of implementing M&A deals.
- More emphasis needs to be placed on early planning of the integration process.
- Difficult decisions should be dealt with quickly.
- The time taken to complete the integration of a deal should not be underestimated.
- Employee communications, retention of key employees and cultural integration are the most important activities in the HR area for successful M&A integration.
- Acquired company employees often identify cultural elements (e.g., flexibility in decision-making) as integral to the company’s success.
- It is important to be sensitive to cultural differences.
- Acquired companies often view their culture as faster moving than that of their new, larger parent.
- It is possible that each side will perceive its culture as ‘better’ and does not want to give it up.
- Unmanaged cultural differences will lead to miscommunications and misunderstandings.
- It is also important to remember that each separate integration activity changes the acquired company in some way. It is important to recognize and preserve the important elements of the acquired company’s culture.
- HR professionals still need to prove their worth in order to get a more central role in the M&A process.
- Companies with M&A as part of their future strategy should review how they have managed.
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