MANAGEMENT REVIEW

Role of HR in Mergers and Acquisitions

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Abstract

Mergers and Acquisitions (M&A) have become the dominant mode of growth for firms seeking competitive advantage. As M&A continues globally, companies involved have the opportunity for increased involvement of HR. Mergers and acquisitions (M&A) have been a popular strategy for organizations to consolidate and grow for more than a century. However, research in this field indicates that M&A are more likely to fail than succeed, with failure rates estimated to be as high as seventy-five percent. People-related issues have been identified as important causes for the high failure rate, but these issues are largely neglected until after the deal is closed. Literature suggests that a larger role for HR professionals in the M&A process would enable organizations to identify potential problems early and devise appropriate solutions. This paper attempts at explaining the role of HR in M&A and explores the challenges and opportunities for HR professionals in M &A, both from domestic and cross-border perspectives.

Introduction

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. 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 (Lucenko, 2000; Galpin and Hemdon, 1999; Deogun and Scannell, 1998, 2001). The deals between many of the largest and most successful global firms such as Daimler–Chrysler, Chase–J.P. Morgan, McKinsey–Envision, UBS–Paine Webber, Credit Sussie–DLJ, Celltech–Medeva, SKB–Glaxo, NationsBank–Bank of America, AOL–Time Warner, Pfizer–Warner Lambert, Nestle´–Purina, Deutsche Telekom–Voice Stream and GE–Honeywell attest to this belief (Seriver, 2001; Fairlamb, 2000a; Lowry, 2000; Tierney and Green, 2000; Vlasic and Stertz, 2000a; Timmons, 2000; McLean, 2000; Ewing, 2000a,b,c; Barrett, 2000a; Silverman, 2001; Tompkins, 2001).

Keywords

Competitive advantage, globalization, mergers, acquisitions, strategic HRM

Table -1
List of mergers/acquisitions in service sector

Source: Rizvi, Yasmeen, Human capital development role of Human Resource (HR) during mergers and acquisitions, African Journal of Business Management Vol. 5(2), p.268, 18 January, 2011

Thus, the future appears to be ripe for a continuation of the trend for annual increases in merger and acquisition (M&A) activity. Yet their success is by no means assured. To the contrary, a majority fall short of their stated goals and objectives. While some failures can be attributed to financial and market factors, a substantial number can be traced to the 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.

Mergers and Acquisitions (M&A s) have become the dominant mode of growth for firms seeking competitive advantage in an increasingly complex and global business economy. With the advent of globalization, mergers and acquisitions have become rampant in the various sectors of industry. As Mergers and Acquisitions activity continues to step up globally, Companies involved in these transactions have the opportunity to adopt a different approach including the increased involvement of HR. Mergers and acquisitions (M&A) have been a popular strategy for organizations to consolidate and grow for more than a century. However, research in this field indicates that M&A are more likely to fail than succeed, with failure rates estimated to be as high as seventy-five percent. People-related issues have been identified as important causes for the high failure rate, but these issues are largely neglected until after the deal is closed. One explanation for this neglect is the low involvement of human resource (HR) professionals and the HR function during the M&A process.

Human Resources role in Merger and Acquisition transactions can have a critical impact on deal outcomes. Factors such as the success and failure rates of Merger and Acquisition, motives of merger and merger types and provide significant insight into the reasoning for the exceptional role of HR in M&A deals. In spite of the literature supporting the critical importance of Human Resources involvement in all phases of a transaction for the execution of successful M&A, the empirical evidence suggests that there is little actual participation of Human Resources at the strategic level.

Employers now recognize that human resource issues are the primary indicator of the success or failure of a deal. Benson. (Armour, 2000). The management of the human side of M&A activity, however, based upon the failure rates of M&As, appears to be a somewhat neglected focus of the top management's attention. '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. Given the well-publicized war for talent, I am constantly surprised by how little attention is paid to the matter of human capital during mergers,' says David Kidd, a partner at Egon Zehnder International in Chicago. (Light, 2001)

Theoretical frameworks for explaining M&A success and failure have traditionally focused on financial and strategic factors, for example the degree of "strategic fit" or industry relatedness between the acquiring and the target firm. Only recently, research endeavors have begun to analyze the "softer", less tangible social, cultural, and psychological issues involved in integrating merging or acquired firms. Factors such as cultural fit, the pattern of dominance between merging firms, management style similarity, combining firms' preferred mode of acculturation, and the social climate surrounding a merger or an acquisition have increasingly been recognized to be of critical importance to M&A success and failure.

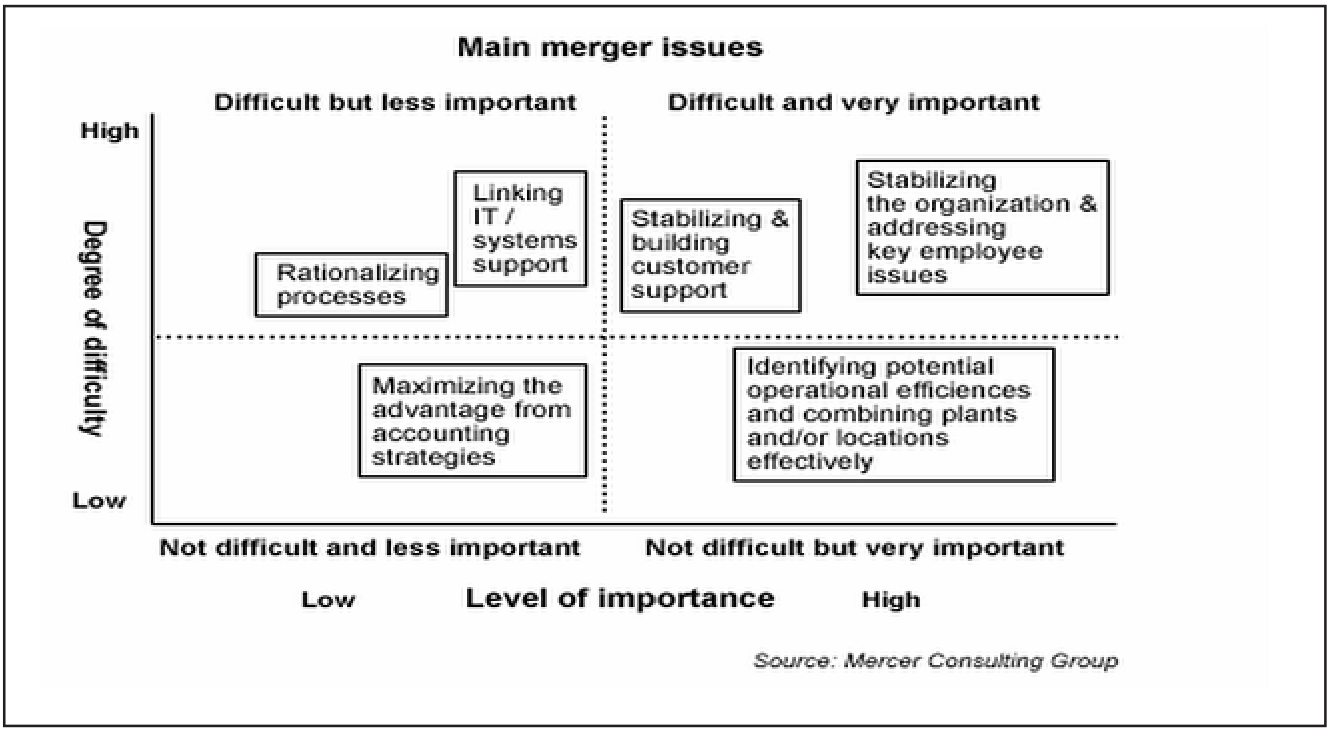
a) Literature Review

Selden and Colvin (2003) stated that 70 - 80% of acquisitions fail, meaning that they create no wealth for the share owners of the acquiring company. Successfully integrating the target and the acquirer's businesses after the transaction closes is critical to achieving the goal of the combination, which is, making the new entity worth more than the sum of its parts. One of the ways to accomplish this is to effectively implement the required changes and address the related dynamics occurring in the new entity. Most mergers and acquisitions deals fail to accomplish many of the strategic objectives so optimistically projected in the initial announcements. Schmidt (2003) has identified five major roadblocks to merger and acquisition (M& A) success, the last three of which are HR issues: Inability to sustain financial performance (64%), loss of productivity (62%), incompatible cultures (56%), loss of key talent (53%) and clash of management styles (53%). According to Marks (1997), human resource professionals should take an active role in educating senior executives about HR issues that can interfere with the success of the merger and with meeting key business objectives. His work has stated the important role of HRD to smoothen the transition.

It has been found in a survey (Schmidt, 2003) that there is a strong direct correlation between human resource involvement and 'success' in mergers and acquisitions. Since changing an organisation ultimately comes down to changing the practices, attitudes, and behaviors of the people who compose it, human resources departments are an essential component of change management. According to a study done by KPMG international on mergers and acquisition found that around 75 percent to 83 percent of the mergers fail (PR Newswire, 1999). Here we mean failure as lowered productivity, labour unrest, higher absenteeism, and the loss of shareholder value. And in some of the cases, it could also be inferred as the well publicized dissolution of combination of the above mentioned factors. As evident from above, human resources could be easily identified as one of the potential factor in M&A failure (A & Shin, 2004) (Sthal & Mendenhall, 2004) (Weber, Shenkar, & Raveh, 1996). With the focus towards integration of human capital during merger and acquisitions, human resource (HR) managers are coming more into the picture, and organisations expect them to play a more strategic role, especially so in the case of extensive organisational changes (Bjorkman & Soderberg, 2003). The role of HR becomes more and more complex, as HR needs to integrate its own practices and also provide for two more roles i.e. a strategic role for companywide integration and a support role for business unit transaction (Galpin & Herndon, 2000)

Every merger and acquisition can be classified into different categories and the issues which become relevant to it are quite dependent on the organisations which are going through the process, and their synergic dependence. According to one of the studies conducted by Mercer Consulting group, some of the key issues which came out to relevance have been explained in the Figure 1 (Harrison). This study analyzed the process of integration on the basis of degree of difficulty and level of importance.

Figure -1



Business research shows that organizational and cultural problems are more likely to derail a merger than are financial factors.

Based on the above studies, the key point which emerges is that addressing the key employee issues become strategically important for maintaining the competitive advantage

a) Objectives of the Study

The present study has the following objectives:

1. To review the existing literature on the HR involvement in the merger and acquisition process
2. To review and explain the changing role of HR professionals in the changed business integration process.
3. To systematically address a variety of human resource issues in merger and acquisition activities.
4. To explore the emerging challenges and opportunities for the HR professionals in M&A.
5. To suggest measures for the successful completion of M&A activities with people centric intervention.

b) Research Methodology

A qualitative study has been carried out to address the research objectives. Apart from reviewing the studies undertaken earlier, the views and opinions of HR leaders associated with merged and acquired companies have been extracted from the retrieved web resources for the purpose of undertaking this qualitative study. With a view to explore the role set of the HR professionals during the process of M&A, the opinions of HR heads ***vis-a vis*** the functions of the HR department of the merged and acquired company have been referred.

Changing Role of HR in M&A

HR plays a key role in the merger and acquisition process from inception to completion. The data collected for purpose of the study along with the opinions extracted from the internet sites reveal that the HR department particularly the HR manager plays a crucial role during the merger and acquisition.

a) Due Diligence

Due diligence is more than a financial evaluation. It's essential to assess the valued human assets that never show up on a balance sheet, in order to determine the true value of the deal and its likelihood of success. Each function has to be understood, including the field organization of stores or salespeople if applicable. Often, what exists in the field is overlooked, yet it's there that the true business of a company is conducted. Each key individual should be assessed against a set of clearly defined competencies that are aligned to the needs of the new group.

Staffing the new organization with the right people requires systematically determining the roles needed and identifying the people who are best able to fill them. Valuable people, central to the success of the integration, may be lost because staffing decisions are made without a plan, without any thought to an equitable process of assessment, and without taking the future needs of the business into account.

Irrespective of the structure of the deal, conducting a thorough HR due diligence exercise is essential for the purchaser and mitigates the risk of warranty claims against the vendor. For a purchaser, it is also one of the first opportunities HR will get to find out about the people whom it will manage going forward. HR managers should collate or review the following key documents and information:

- Employment contracts
- Handbooks and policies;
- Benefit plans and schemes provided to employees;
- Union recognition and collective agreements;
- Other information/consultation bodies' documentation;
- Other relevant details, such as absent employees leave, outstanding disciplinary actions and grievances, recent levels of industrial action and recent work accident rates; past and existing employee claims.

b) Cultural Compatibility

By understanding the similarities and differences between the two companies early in the game, it is possible to avoid a culture clash. To understand the cultures involved, the HR has to look at the history of each company, its reputation in the industry, and its products and services. Although those are fixed, other factors that influence how a company operates and how employees, customers, and other stakeholders interact are critical to the effective functioning of the newly formed organization. Even location can affect the fit. So it's important to identify cultural areas of dissonance so that people can dispel misconceptions and begin creating a culture that's right for the new organization. That's often left until after the final papers are signed, which is risky because culture mismatches can be the Achilles' heel of many deals. Often, the most seemingly inconsequential programmes and policies have great symbolic impact. Practices regarding casual dress, attitudes about long hours, and how offices are apportioned are deeply ingrained and must be dealt with.

One can't consider culture compatibility without touching on the different views that the acquirer and the acquired have about the new company. The acquirer assumes that the new company will closely resemble the original but with greater mass and capabilities. The acquired company expects that many of its strengths will be crucial to the new company.

c) Integration Planning

Without a clear plan and timetable, a merger or acquisition can fail. The integration effort must be led by a full-time dedicated team. There should be an integration project manager free from any routine responsibilities, whose sole job is to manage the overall plan. The integration manager needs a special set of competencies (including project management), broad experience in the parent business, and specific functional expertise relevant to the new business. He or she should be willing to make tough decisions quickly, handle conflict, and work well across functions and management levels. Skill as a communicator is essential. Before a successful integration can begin, proper planning for that success needs to take place. Unfortunately, many integration initiatives fail from the start because the integration begins before any thought is given to the course that the integration will take. The primary role of HR during this phase is to:

a) Develop strategies for retaining key people

b) Examine compensation and benefit programmes

c) Identify barriers to a merged culture.

d) Create and execute a comprehensive plan for communicating with the new organization.

Early HR involvement and a robust discovery process will help prepare the organizations for integration. As a best practice, many companies form integration teams separate from the acquisition or due diligence teams. HR professionals can provide leadership by identifying potential members and forming the integration team. Then HR serves as the common thread between due diligence and integration.

d) Managing Change

Managing change is of utmost importance when completing integration. The change curve contains three periods of change: first, *awareness*, then *acceptance*, and, finally, *adoption*. During the *awareness* period, it's important for managers to raise company consciousness about the coming change. It will not be uncommon for employees to feel denial, anxious thoughts, and emotions over the change, or outright shock that the change is taking place. Employees' morale and their productivity are likely to drop off. Managers will need to make sure employees understand the company's new direction and what it will mean to them as they navigate the change. This can lower the impact of the negative emotions. Employees can make their own decisions regarding the changes during the *acceptance* phase. They may make decisions about their work schedules or whether or not they will telecommute, for example. These decisions can create stress, as they will affect the employees' future with the company down the road. Approach-avoidance behavior is common at this stage; employees may understand and want to implement the new changes,

e) Effective communication

Communication refers to the messages that are shared with all of the stakeholders in the integration process. These stakeholders include internal stakeholders like the top management team, the board, and associates. External stakeholders include the two companies' shareholders and customers too. If the messages and themes that are expressed to all parties are not consistent, then confusion, fear, and a lack of faith in the integration process are likely to occur.

The need to communicate extends well into the latter stages of the integration but must begin with the announcements. Often, communication efforts are fragmented with different messages and information flowing to investors, employees, managers, and customers. Messages to all stakeholders must be well planned and consistent. There can never be enough repetition. Two-way communication always helps comprehension. All avenues should be used: written, one-on-one meetings, and small and large group meetings. People need a chance to probe, discuss, ask questions, and arrive at a personal level of understanding that they can't get from a piece of paper.

The goal of communications should be not only to inform, but also to engage employees' hearts and minds. By presenting a clear vision of the future and gaining commitment to it, the new company begins to build the loyalty that's crucial to survival.

f) The synergies

There are two kinds of synergies that companies seek through a merger or acquisition: growth and economies of scale. The role of HR is to identify key human assets in the target company, set up retention arrangements to keep critical talent, and create development plans for people to prepare them to achieve the anticipated corporate growth. Other issues which need attention to maximize the growth synergy are reward and recognition programmes, team development, and integration of benefit and compensation programmes—ensuring that they are competitive to attract and retain desirable employees.

When mergers are contemplated, synergy and value often depend on the effective transfer of knowledge. As knowledge becomes an increasingly important corporate asset, it's critical to capture the best practices of each company for maximum return. It starts with the relatively easy task of identifying the people and processes needed to keep the business operating as usual. It moves to training on systems, specific job skills, and procedures. Ultimately, it involves capturing the tacit knowledge and informal networks that enable an organization to get things done.

g) Retaining the key talent

Some talent may be needed only during the transition period, after which their responsibilities can be handed off. Others may be needed for much longer. Each person must be considered, and a plan must be put together for that person. The kind of agreement that's drawn up and how far it goes to keep key talent will differ from organization to organization. But it's best not to give away too much or keep someone who will never adapt to the new structure, simply because he or she is talented or highly thought of. The appropriate fit of any one person in the new culture can be as critical to success as talent. Frequently used retention tool is the bonus. But for the people who are eligible, a bonus can make them feel special and entice them to stay for the period covered by the payout.

h) Incorporating the New Leaders

It is important for the acquiring company to conduct a *skills assessment* with the leadership of the company being acquired. In this way, the acquiring company can determine what the leadership potential is and how best to incorporate it into the new company. These skill assessments can take several forms, including feedback from their supervisors, annual performance reviews, and interviews with the employees. New leaders are important to the acquiring company as leaders represent some of the most valuable human capital in the new company. As such, they would be very expensive to replace.

i) Reinforcing the new culture

When two organisations with different cultures merge, the management should be helped to preserve the best aspects of the old company and to carry them into the new company. What cultural characteristics and values senior executives want to preserve from their respective companies should be understood along with understanding what they do not want to keep and what new characteristics they want to introduce in the new organisation. A list should be made and each level of management should be asked for feedback. Management should be provided with a development tool. All levels of management should be surveyed about three months after the merger, to assess progress toward the new culture and feedback should be provided to managers.

j) Creating a climate of trust

Trust is important in a number of ways: it can improve the quality of employee work performance, problem solving, and communication, and can enhance employee commitment and citizenship behavior. Trust can also improve manager-subordinate relationships, implementation of self-managed work groups, and the firm's ability to adapt to complexity and change. Further, trust can decrease agency and transaction costs by limiting the need for monitoring and control and, ultimately, can provide firms with a competitive advantage. Hence the HR manager should create a trusting climate at the merged/ acquired company's work place.

Managing M&A for Success: Challenges and Opportunities for HR

The following tips can help meet the challenges for the HR managers during domestic and international mergers and acquisitions

a) Avoiding Quick Changes

The finding that a reduction involving either hourly or exempt employees within two months of an M&A event was significantly associated with failure supports proponents of slow approach to change (e.g. Shrivastava 1986; McCann and Gilkey 1988) but is contrary to the recommendations for quick change of Buono and Bowditch (1989). One explanation for the importance of the timing of workforce reductions is that if reductions are undertaken quickly, they cannot be based on a proper understanding of the acquired organization (Fombrun, Tichy, and Devanna 1984). Similarly, the higher incidence of failure with quick reductions may indicate a truncated or nonexistent transition phase. Without interventions at this stage to reduce levels of uncertainty and insecurity, integration activities are less likely to be successful (Marks and Mirvis 1985/86).

b) Avoiding Sudden Reductions

The finding that the magnitude of the reduction in the workforce was a significant element in failures (a reduction of more than 10 percent of the target's hourly or exempt workforce was more than five times as likely to be associated with a failed event) is consistent with research by Bohl (1989, 54), which suggested a positive correlation between the incidence of post-event integration problems and the magnitude of the reduction. Shrivastava (1986) contends that too much change in the integration stage can be critically disruptive. Similarly, the predominance of failure in larger reductions may be the result of higher levels of stress (Schweiger and Ivancevich 1985) and increased employee resistance (Tichy and Ulrich 1984).

This explanation would suggest a lower incidence of redundancy between the two firms and thus a smaller required reduction (McCann and Gilkey 1988). In other words, success or failure may be less a function of the magnitude of the workforce reduction per se and more a function of the attributes of the acquired firm.

c) Undertaking a Culture Survey

The HR leadership has an opportunity before the merger to ensure that both organizations have a strategy mapped out in advance. Once the merger starts taking place, people will often be too busy to keep a strategic perspective. Before the merger takes place, the leaders of both organizations - at least, of the dominant firm - should have a strategy mapped out, including communications to employees and customers, where layoffs will take place (if any do), and how the cultures should be merged. A SWOT (strengths, weaknesses, opportunities, and threats) analysis should be done for the combined company. If possible, a brief culture survey should be undertaken in both the companies to discover the cultural differences. This will prevent disconcerting delays between the announcement and the implementation of the merger/takeover. If the real purpose of the merger is to acquire another company's assets, in terms of a particular product or brand, its factories or patents, etc., that should be acknowledged and dealt with.

d) Addressing Special Issues in Cross-Border M&A

The dynamics of cross-border mergers and acquisitions are relatively similar to those of domestic M&As. But, due to their international nature, they also involve typical challenges, as countries have different economic and cultural structures. Cross-border merger and acquisitions can be used to access new markets, as well as expand the market for a firm's current goods.

In cross-border mergers and acquisitions, information regarding the merging or acquiring company is imposed and their impact on employees is more urgent for the acquired firm in order to understand the goals or ideas and the philosophy of the foreign acquiring company. Merger and Acquisition activity presents a different and unique set of challenge for the human resource managers in both acquiring and acquired firms. This activity is found to have serious impact on the performance of the employees during the period of transition. Hence the HR managers are required to take precaution while dealing with people related issues during and even after the merger or acquisition.

Conclusion

In a merger & acquisition, role of an HR professional has emerged as a very critical function. At each stage of merger and acquisition process, HR plays a strategic role. The importance of role of HR part in integration of the merged companies should not be taken lightly and should be handled very carefully and with due planning. At pre acquisition stage, due diligence should be taken before the start of the process and HR must carve out its role in this due diligence stage. Cultural compatibility should also be considered before taking any decision regarding integration of the two companies. HR managers should analyze the cultural similarities and differences between the two companies. Communication also plays an important role in the integration process. If the HR department does not give due diligence while deciding the strategy for integration of the merged companies then it might sabotage the entire merger and might result in failure of the merger. The strategic HR management literature suggests that a larger role for HR professionals in the M&A process would enable organizations to identify potential problems early and devise appropriate solutions

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