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HR Issues and Activities in Mergers and Acquisitions

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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. Numerous examples are offered to illustrate the issues and activities in each of the three stages. The article concludes with a description of the role and importance of the HR department and leader. © 2001 Elsevier Science Ltd. All rights reserved.

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Introduction

Companies today need to be fast growing, efficient, profitable, flexible, adaptable, 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 (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, Nestlé–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). And the future appears to be ripe for a continuation of the trend for annual increases in merger and acquisition (M&A) activity:

> I personally see more consolidation: more partnerships, more strategic alliances, and more acquisitions. Jac Nasser, CEO, Ford Motor (Taylor, 2000)

And why not? 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 quickly, efficiently and thoroughly such as Michael Volpi at Cisco Systems (Holson, 2000; O'Reilly and Pfeffer, 2000) However, according to Jack Procity, partner-in-charge of business integration services at KPMG, many companies still have a long way to go when it comes to effectively integrating their businesses:

This might be OK for a $1 billion business taking on a $10–$30 million acquisition. But a $1 billion company taking another $1 billion company has to make it work. The business risk is too great for failure.[1]

Some cite recent mergers and acquisitions as evidence for this, e.g., Conseco and Greentree Financial; Case and New Holland; HRS and CUC International; DaimlerChrysler; McKession and HBO; and Mattel and The Learning Company (Arndt 2000a, 2001; Sirower, 1997; Weber and Barrett, 1999). Evidence beyond these specific examples suggests that they are more the norm than the exception (Charman, 1999).

Thus many companies seem to be confronted with the need to do mergers and acquisitions successfully, yet the odds of doing so are relatively low. 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 (Doz and Hamel, 1998; Hamel, 1991; Harbison, 1996; Sparks, 1998, 1999). With our focus on mergers and acquisitions, it is important to distinguish them. In a merger, two companies come together and create a new entity. In an acquisition, one company buys another one and manages it consistent with the acquirer's needs.

Types

Further implications for people management issues are types of mergers and acquisitions. In general there are mergers of equals which include the merger between Citicorp and Travellers forming Citigroup; and between Ciba and Sandoz forming Novartis. There are also mergers between unequals such as between Chase and J.P. Morgan creating JPMorgan-Chase.[2] Similarly there are two major types of acquisitions: those involving acquisition and integration such as those typically made by Cicso Systems; and those involving acquisition and separation such as between Unilever and Bestfoods. Acknowledging these types of mergers and acquisitions is critical in describing and acting upon the unique people management issues each has. For example, a merger of equals often compels the two companies to share in the staffing implications; whereas a merger of unequals results in the staffing implications being shared unequally (Kay and Shelton, 2000). An acquisition that involves integration has greater staffing implications than one that involves separation. Other differences are highlighted later in this article.

Reasons

There are numerous reasons for companies to merge or acquire. Some of the most frequent include:

- ❖ 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
- ❖ Talent, knowledge, and technology today[3]

Of these, it appears that the last one is rising in its level of importance:

There are two factors that will bring companies to the table this year (2001). First, although unemployment is rising, engineers and scientists are still in high demand, so much so that semiconductor and optical networking outfits are doing more of what bankers call HR deals (HR for Human Resource). In these acquisitions the employees are seen as more valuable than the company's product. Some banks are applying metrics like price-per-engineer to value these deals. (For example, Broadcom paid $18 million per engineer to buy chipmaker SiByte in November, a bit of a premium but far from a record.) 'HR buys are becoming more prominent. If a company can buy another firm cheap enough and pick up 50 or 100 networking engineers who have skills in technologies, it's not a bad idea,' says Mark Shafir, co-director of investment banking at Thomas Weisel Partners. These deals, though, will work only if the talent can be retained, he adds. (Creswell, 2001)

In addition, companies that are successful and inventive in combining, not only create value, but develop a core competence in combination management itself. This in turn, can give the company an edge over others who haven't been successful and/or have not learned from their past efforts.

Assumptions

Regardless of the reasons companies have for merging or combining, there are several basic assumptions being made, either explicitly or implicitly. These include:

- ❖ M&A's are the fastest and easiest ways to grow
- ❖ M&A's are likely to fall short of their initial goals
- ❖ M&A's are difficult to do
- ❖ Creating synergies is a major challenge
- ❖ Molding cultures is a major challenge
- ❖ Soft and hard due diligence are necessary but not sufficient conditions
- ❖ Pre-planning can help increase chances for success

It appears that companies that have gained from the experience of previous combination efforts recognize and address these assumptions more effectively than those that haven't. And the more firms have experiences, the more they appear to learn from each additional merger or acquisition, thus solidifying their core competency and competitive advantage (Ashkenas *et al.*, 2000).

Track Record

With the importance of and need for mergers and acquisitions growing, and the base of experience expanding, it may seem reasonable also to assume that success is more likely to occur than failure in these types of combinations. In fact,

Indeed, worse than this, mergers and acquisitions are more likely to fail than succeed. Statistics show that more than a staggering 75% fail. Only 15% of mergers and acquisitions in the US achieve their financial objectives, as measured by share value, return on investment, and postcombination profitability. In the European arena, a 1995 study of large combinations — deals valued at $500 million or more — showed one-half destroyed shareholder value, 30% had minimal impact, and only 17% created shareholder returns.

In fact, more than half of the companies involved in mergers worth US $5 billion or more in 1998, underperformed in their sector. Lehman Brothers, the US investment bank, found that of 33 companies involved in mega-mergers between December 1997 and August 1998, only 14 outperformed their market in the first six months following the announcement of the combination. Of the four sectors surveyed by Lehman, financial, oil, pharmaceutical, and telecommunications, oil companies showed the weakest performance with merged entities underperforming the sector by 17.6%. Lehman's long-term analysis of 34 companies involved in high profile combinations over the last 15 years, showed more than 50% lagged behind their industry peers within 18 months of the completion of the deal.[4]

Reasons for Failure. Mergers and acquisitions fail for a variety of reasons, often several simultaneously. Typical reasons for failure include:

- ❖ Expectations are unrealistic
- ❖ Hastily constructed strategy, poor planning, unskilled execution
- ❖ Failure/inability to unify behind a single macro message
- ❖ Talent is lost or mismanaged
- ❖ Power and politics are the driving forces, rather than productive objectives
- ❖ Requires an impossible degree of synergy
- ❖ Culture clashes between the two entities go unchecked
- ❖ Transition management fails
- ❖ The underestimation of transition costs
- ❖ Financial drain
- ❖ Defensive motivation
- ❖ Focus of executives is distracted from the core business (Charman, 1999; Sparks, 1999; Doz and Hamel, 1998).

Perhaps of these, culture clashes, gaps, or incompatibility and losses of key talent are cited the most frequently, although even these become intertwined with other reasons (Bianco, 2000; Fairlamb, 2000b).

By way of an example, many outsiders believed 'from the start, the culture gap made Daimler-Chrysler's post-marriage period of adjustment more difficult than that of any other merger around' (Gibney, 1999). DaimlerChrysler believed two company cultures could simply be put in a blender and poured out as a new synergistic company. Cultural issues were all but ignored and seemed only to be addressed by executives when making broad statements to the media regarding the differences in the two companies. Either Daimler and Chrysler did not fully realize the implications of cultural differences or they chose to focus on the operational and business synergies hoping that culture would sort itself out.

Many Daimler-Benz executives initially viewed

Chrysler as a primped-up matron would regard an earnest young suitor, Chrysler marketing chief Jim Holden recalls his first meeting at the Mercedes-Benz US headquarters in Montvale, NJ. As the Germans presented their view of the brand hierarchy — Mercedes on top and everything else far, far below — the tension in the room was palpable. Says Holden: 'We felt like we were marrying up, and it was clear that they thought they were marrying down.'[5]

During the initial stages of the merger, Chrysler President Thomas Stallkamp indicated that Daimler intended to adopt Chrysler's product development methods which emphasized teamwork rather than individual-oriented work procedures. Chrysler in turn would adopt Daimler practices such as rigid adherence to timetables and their methodological approach to problem-solving. However, evidence of the lack of true sharing and cooperation was soon to emerge and could be demonstrated by Daimler executives' refusal to use Chrysler parts in Mercedes vehicles.[6]

Daimler's Chief of Passenger Cars, Juergen Hubbert, as recently as August 2000 was quoted as saying, 'We have a clear understanding: one company, one vision, one chairman, two cultures' (The Economist, 2000) While it is true that since the departure of Robert Eaton (Chrysler's former chairman) only one chairman (Juergën Schrempp) runs the company, Hubbert's other assertions are in question. Although DaimlerChrysler may be 'one' company in name, the fact remains that two separate operational headquarters were maintained; one in Michigan and one in Germany. Business operations continued to be separate as evidenced by 'Daimler's' decision to allow 'Chrysler' more leeway in the design and production of its vehicles, which more closely emulated the practices of the 'old Chrysler.' Daimler and Chrysler each had their own agenda focusing on different aspects of the automobile market, making one vision difficult to see. Finally, with the acknowledged existence of two cultures, how could DaimlerChrysler truly become one company with one vision?

By way of another example, loss of key talent is another significant reason given for a failed merger or acquisition. Consistent with NationsBank's (aka, Bank of America) strategy of acquisition, CEO Hugh McColl paid a premium price of $1.2 billion for Montgomery Securities in October 1997. Subsequently:

> Most of the best investment bankers walked out after a series of rows with Montgomery's management, and culture clashes with the commercial bankers at headquarters. They are now ensconced in the thriving firm of Thomas Weisel, run by Montgomery's eponymous former boss. Though Bank of America spent a further fortune trying to revive the investment bank, Montgomery is no longer the serious force it once was in Silicon Valley. (Anon, 2000a,b)

Reasons for Success. Perhaps not surprisingly some of the 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
- ❖ Extensive and timely communications to all stakeholders[7]

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
- ❖ Change managers quickly if they fail to adapt

Watson Wyatt observed a disparity between the number of respondents who felt that they had been relatively successful in their M&A experience, and the overall success rate of deals. 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.[8]

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.[9]

> '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. The full employment economy has been a huge problem,' says Laura Carlson, a Minneapolis corporate finance lawyer at Faegre and 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)

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
- ❖ 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.

In addition to these people issues in the *integration* phase of M & A activity, there are several other people issues that are evident in the phases *before* and *after* integration. Those become more evident and more manageable by detailing a model of M&A activity.

Three Stage 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 — the new entity (Charman, 1999; Habeck *et al.*, 1999). 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 HR issues and their more specific implications and actions for M&A activity are illustrated in Figure 1. The HR issues are described first, followed by a discussion of the HR implications and actions.

HR Issues. As highlighted in Figure 1, 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.[11]

A final HR issue highlighted in Figure 1 is the 'plan-

HR Issues

- Identifying reasons for the M & A
- Forming M & A team/leader
- Searching for potential partners
- Selecting a partner
- Planning for managing the process of the M and/or A
- Planning to learn from the process

HR Implications and Actions

- Knowledge and understanding need to be disseminated
- Leadership needs to be in place
- Composition of team impacts success
- Systematic and extensive pre-selection and selection are essential
- Conducting thorough due diligence of all areas is vital
- Cultural assessment
- Planning for combination minimizes problems later
- Creating practices for learning and knowledge transfer

Figure 1 Stage 1 — Pre-Combination

ning 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.[12]

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.[13]

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.[14] 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. Cooper Industries uses anywhere from 7 to 20 people, depending on the complexity of the due diligence. Moriarty is one of three or four HR professionals who focus on different aspects of the deal. He says, 'The idea is to understand exactly what you are buying. It's rare to spot something that kills the deal, but it isn't uncommon to uncover some information that leads to re-valuing of the deal.' Moreover, the due diligence can identify personnel who are crucial to the transaction. That allows Cooper Industries to enter long-term contracts with key executives and others, or lower the value of the deal based on the possibility that these individuals might leave for another company (Greengard, 2000, p. 69).

Consequently, cultural assessments, as an element of soft due diligence, are also becoming common (Numerof and Abrams, 1998).

Cultural assessments involve describing and evaluating the two companies' philosophies and values regarding such issues as: leadership styles; time horizons; relative value of stakeholders; risk tolerance; and the value of teamwork versus individual performance and recognition.[15] In the DaimlerChrysler combination, the importance of cultural differences, initially downplayed, became the reason for allowing the business units to function as they wished as long as they achieved their goals (Tierney, 2000; Andrews and Bradsher, 2000).

An important finding from the Watson Wyatt survey was that the above-described HR issues are best addressed through comprehensive planning and follow-through. Experience and learning from past M&A activity can help inform the planning and follow-through, but this learning process must also be well managed. Learning, knowledge sharing and transfer are acknowledged as important not only in M&A activities, but also in joint venture activity (Lei *et al.*, 1997; Schuler, 2001). Knowledge and learning can be systematically supported by a variety of human resources practices.[16]

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 skilfully 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 people[17]

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[18]

Companies the J&J study found who were particularly good at integration are listed in:

- ❖ *Sales and Marketing Management Best Sales Forces*: (e.g., Enron, Cisco, GE Capital, Xerox, America Online)
- ❖ *Fortune's* Most Admired Companies: (e.g., GE, Microsoft, Intel)
- ❖ *Fortune's* Best Places to Work (e.g., Deloitte and Touche, MBNA, Cisco, Microsoft)

HR Implications and Actions. Perhaps the most critical HR issue for the success of this integration stage is selection of the integration manager.[19] Combinations that were guided by the integration manager:

- ❖ Retained a higher % of the acquired companies' leaders
- ❖ Retained a higher % of the total employees
- ❖ Achieved business goals earlier

The results suggest several things about the integration manager:

HR Issues	HR Implications and Actions
• Selecting the integration manager	• Selecting the appropriate candidate
• Designing/implementing teams	• Creating team design and selection are critical for transition and combination success
• Creating the new structure/strategies/ leadership	• Communicating is essential
• Retaining key employees	• Deciding on who stays and goes
• Motivating the employees	• Establishing a new culture, structure, and HR policies and practices is essential
• Managing the change process	
• Communicating with and involving stakeholders	
• Deciding on the HR policies and practices	

Figure 2 Stage 2 — Combination — Integration of the Companies

- ❖ It is important to have an integration manager to focus exclusively on the particular acquisition or merger
- ❖ This person is not one of the people running the business
- ❖ Usually it is someone on loan to the business for a period of time to focus solely on integration issues
- ❖ This person helps to provide continuity between the deal team and management of the new company. Such people 'understand the company,' 'feel ownership,' and 'are passionate about making it work'
- ❖ The integration manager may be part of a 'steering committee' along with other top executives. This is the group responsible for setting the role, process and objectives of the integration and overseeing the progress of integration teams across various M&A projects.[20]

The roles of the integration manager are several including serving as a:

- ❖ Project Manager
- ❖ Communicator
- ❖ Advisor
- ❖ Advocate
- ❖ Relationship Builder
- ❖ Facilitator
- ❖ Team Leader
- ❖ Ombudsperson
- ❖ Negotiator[21]

Assisting the integration manager are integration teams (Marks and Mirvis, 2000). DaimlerChrysler created over 100 integration teams. Specific teams were assigned to various functional areas and organizational levels within the two companies.[22] J&J found that integration teams should be first focused on key priorities or value drivers:

- ❖ One of the first steps in the integration planning process that happens between signing and closing is to better identify those few key value drivers that will significantly impact the performance of the new acquisition
- ❖ Recognize that there will be a number of day-to-day systems and processes that must be integrated in order to support efforts to attain synergies. Examples are sales reporting systems, certain IT systems, access to the global e-mail network, and the distribution chain
- ❖ It is important to limit these activities to areas that are required to support the achievement of key synergies
- ❖ One J&J executive has stated: 'We only attacked things that would bring benefits to the business. We did not integrate just for the sake of integrating'
- ❖ Once these key areas are identified, it may help to make sure that each one of these value drivers has a team of people associated with it and those teams are tracked for their progress[23]

Another critical HR issue is the selection of a leader who will actually manage the new business combination. If an acquired business has unclear or absent leadership, the result will be crippling uncertainty, lack of direction, stalled new product development, and the postponement of important decisions. Strong leadership is essential to acquisition success — perhaps the single most important success factor. A strong leader's influence will be quickly recognized and praised.[24]

Successful leaders of the new business are described as being:

- ❖ Sensitive to cultural differences
- ❖ Open-minded
- ❖ Flexible
- ❖ Able to recognize the relative strengths and weaknesses of both companies
- ❖ Committed to retaining key employees
- ❖ Good listeners
- ❖ Visionary
- ❖ Able to filter out distractions and focus on integrating key business drivers such as R&D and customer interfaces[25]

To the extent that the acquired firm is closely integrated with the acquirer, it is critical that the leader of the acquiring company has a solid knowledge about the acquired company.

Some of the essential tasks this new business leader can perform include:

- ❖ Providing structure and strategy
- ❖ Managing the change process
- ❖ Retaining and motivating key employees
- ❖ Communicating with all stakeholders

It appears to be crucial that restructuring should be done early, fast, and once. This minimizes the uncertainty of 'waiting for the other shoe to drop.' A historical problem has been a tendency to restructure slowly and to rely heavily on people rather than structures and processes. A lesson learned by the folks at GE Capital that greatly aids successful integration is:

> Decisions about management structure, key roles, reporting relationships, layoffs, restructuring, and other career-affecting aspects of the integration should be made, announced, and implemented as soon as possible after the deal is signed — within days, if possible. Creeping changes, uncertainty, and anxiety that last for months are debilitating and immediately start to drain value from an acquisition (Ashkenas *et al*., 2000, p. 172).

The experiences at Johnson & Johnson affirm the lessons at GE Capital and suggest not to dismantle something until its use is understood and there is something to replace it with; and that restructuring should not be confused with integrating. It is one piece in a larger process. To facilitate this restructuring phase, the leader can manage the process of change itself.

There is no doubting the pressure of work caused by the need to manage integration as well as 'doing the day job'. Add to that the tendency for people to resist change and the shortage of appropriately qualified management talent and you have a recipe for an over-stressed, under-performing work environment.[26]

Managing this involves preparing the staff for the change, involving them to help ensure understanding, preparing a schedule for the changes, making the changes, and then putting in place all the structures, policies and practices to support the new operation.

Integral to the integration and the activities of restructuring and change management are the activities involving staff selection, retention, and motivation; communications and cultural integration. Watson Wyatt's survey results found that:

- In the US, Europe, and around the world, retention of key talent, communication and cultural integration are rated most often as critical activities in the HR integration plan, as illustrated in Figure 3
- Cultural incompatibility is by far the most common 'bottleneck' affecting the integration process, cited by 42 per cent of European respondents
- Clearly, more advance planning and work done in the areas of retention, communication and cultural integration will help achieve success in M&A's[27]

The J&J study found that:

- Many acquired businesses lose key people after the acquisition
- Retention of key employees is crucial to achieving performance goals through the transition period and the long-term competitive advantage associated with specialized knowledge
- Uncertainty due to unclear strategy, no prior HR assessment, and insufficient communication can drive away many desirable employees

According to Kay and Shelton:

People problems are a major cause of failed mergers, and you must ensure that most if not all of the people you want are still in place at the end of the integration period. This is best achieved by carrying out an employee selection process whose pace and substance match the kind of merger involved. (Kay and Shelton, 2000, p. 28)

This selection process needs to be closely aligned with incentives for these employees to remain. So acquiring companies today are:

- *Negotiating financial deals with key employees*. Senior employees may be covered by agreements that allow stock options to be exercised when there is a change in ownership. To keep these workers from taking the money and running, acquiring firms are offering new packages that vest over time.
- *Giving retention bonuses*. Companies are offering cash to workers who stay through a merger or until a specific project is completed.
  Florida Power, for example, has given retention bonuses to more than 200 employees to keep them on staff during this year's merger of its parent company and Carolina Power & Light. It also increased severance packages to keep employees who were worried about pending layoffs, from jumping ship prematurely.
  'It's all about helping them to stay on,' says Melanie Forbrick, a spokesperson for Florida Power in St. Petersburg. 'Overall, it's worked.'
- *Writing employment agreements*. Employees who get financial incentives may be asked to sign written agreements indicating they will remain with the new entity for a specific time span. The agreements are generally signed before the deal closes.
  'It's really identifying your winners at all levels, in top sales, marketing, and technical leaders,' says Jeff Christian, a Cleveland-based executive recruiter.[28]

Managing the communication process is also a valuable way to retain and motivate key employees. It also plays a critical role in the process of change and the entire stage of integration. The process of communicating can take several forms:

Acquiring companies are using the Internet, internal company Intranets and e-mail to dispel rumors and keep employees updated about pending changes.

People Activity	%
Retention of key talent	76
Communication	71
Retention of key managers	67
Integration of corporate cultures	51

Source: Kay, I.T. and Shelton, M. (2000)"The People Problem in Mergers," The McKinsey Quarterly, (Number 4): 28

Figure 3 Percent of Respondents who Believe People Activity is 'Critical'

> Some talk directly with the newly acquired hires they are determined to keep. When his former company, Intervu, took over Seattle-based Internet software firm Netpodium, CEO Harry Gruber met with every engineer at the newly acquired firm.
>
> 'All of our senior people went up [to the company headquarters],' Gruber says (Marks, 2000).

The J&J study found that:

- ❖ Communication is critically important.
- ❖ Where it is practised effectively, it is seen as very positive.
  Acquired companies have reported satisfaction with communication as practised by many individual J&J employees, both with the initial welcome they received from J&J, and with the communication in 'mandatory transactional' areas including benefits, options and payroll.
- ❖ It is important that the communication/information be proactive and correct. For example, do not say *merger* when you mean *acquisition*.[29]
- ❖ A lack of communication can lead to confusion, decreased productivity as acquired company employees try to learn how to function within their new corporation, high levels of uncertainty, and low morale.

A final HR issue is the need to create policies and practices for learning and knowledge sharing and transfer. As J&J found, many of the same lessons were learned repeatedly and simultaneously across business units as well as from other companies. Thus, sharing those lessons enhances integration and improves the likelihood of success. Forums for information sharing and the Intranet are tools that companies can use to facilitate the sharing knowledge.

Helping ensure that knowledge and learning are shared across units are HR policies and practices that appraise and reward employee sharing, flexibility, development and long-term orientation (McGill *et al*., 1992).

Overall, this second stage of integration in an M&A activity is extensive and complex. Whereas Stage 1 activities set the scene for M&A activity, those in Stage 2 are the ones that make the activity come to life. Clearly there are differences here between a merger and an acquisition, differences between a merger of equals and non-equals, and differences between an acquisition with inclusion and an acquisition with separation. These differences probably impact the degree of applicability rather than the kind of activities shown in Figures 1 and 2. Nonetheless these differences must be kept in mind, particularly in the Stage 3.

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 in Figure 4.

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 unequals. DaimlerChrysler, an acquisition of relative equals, provides an example. DaimlerChrysler went through this for more than two years after the formal combination was completed[30] They addressed virtually all the issues listed in Figure 4.

Shown at the top of Figure 4 is 'solidifying leadership and staffing.' 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 (Tierney, 2000; Vlasic and Stertz, 2000b).

HR Issues	HR Implications and Actions
• Solidifying leadership and staffing	• Elective leadership and staffing of the new entity are essential
• Assessing the new strategies and structures	• Creating and evaluating a new structure
• Assessing the new culture	• Melding two cultures needs assessment revision
• Assessing the new HR P & P	• The concerns of all stakeholders need to be addressed and satisfied
• Assessing the concerns of stakeholders	• The new entity must learn
• Revising as needed	
• Learning from the process	

Figure 4 Stage 3 — Solidification and Assessment

At the beginning of 2001, Dieter Zetsche, a veteran Daimler executive took over Chrysler's leadership, replacing a former Chrysler head James Holden. Zetsche in turn has created his own top management team composed of one Daimler veteran and five Chrysler veterans. All these changes were made because the earlier top management team of former Chrysler veterans failed in its efforts to stop the 'breathtakingly fast decline of the bottom line' (Green and Tierney, p. 48).

Similarly, the strategy and structure had to be assessed and revised. The new top management is being given more control over the Chrysler Group largely because a senior Daimler executive is running it. He and his team developed a new strategy of cost cutting by reducing supplier costs and reducing product offerings. Instead of running the Chrysler Group as a cash-rich growth business, management is managing it as a turnaround. Consequently, staff is being reduced as well. Along with this the culture changed, both to reflect the new strategy and the new leadership. Zetsche and his team are much more egalitarian: 'They are eating in the employee cafeteria rather than the executive dining room at the headquarters in Auburn Hills, Michigan' (Muller *et al.*, 2001, p. 49). This new culture, combined with the new strategy and structure, is reshaping the thrust of performance appraisal and compensation to focus more on cost cutting objectives, supplier management, flexibility and employee morale.

DaimlerChrysler CEO Jurgën Schrempp, reflecting on these changes in the post-combination stage of the acquisition, estimates that recovery will take two to four years. Initially, back in 1998 upon purchasing Chrysler, Shrempp discussed immediate global synergies and probability. Perhaps the earlier success in its acquisition of Freightliner gave him the confidence that the Chrysler acquisition would be as successful. The contrasting experiences provided DaimlerChrysler with excellent opportunities for learning.

This brief description of just one combination illustrates the HR issues and activities that can be expected to occur after the Combination Stage has been completed. Of course, change is a constant in almost any company today, as the macro factors in the global environment continue to change and present new conditions for all companies.

Role of the HR Department in M&A Activity

As illustrated in the Three-Stage Model of M&A's, there are many people issues on which the relative success or failure depends, particularly at the combination or implementation stage. Yet research indicates that only 35 per cent of senior HR executives are involved in M&A activities (Liberatore, 2000; Giles, 2000). Not surprisingly, other research reports that:

> 80% of combinations fail at the implementation stage as a result of the following factors; an inadequate road map, senior HR professionals brought in too little, too late; senior HR professionals lacking in either/both business/global experience; an inadequate skills base overall; and ultimately, failed organizational change. (Charman, 1999; Greengard, 2000)

Yet 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 (Liberatore, 2000)
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
   - ❖ 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 per cent of HR executives think this, and only 9 per cent think that HR should have *full responsibility* (Charman, 1999)
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
   - ❖ 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
   - ❖ Helping employees cope with change[31]

7. Managing the learning processes, e.g.,
   - ❖ Building learning into the partnership agreement
   - ❖ Staffing to learn
   - ❖ Setting up learning-driven career plans
   - ❖ Using training to stimulate the learning process
   - ❖ Responsibility for learning should be specified
   - ❖ Rewarding learning activities
8. Re-casting the HR department itself:
   - ❖ Develop new policies and practices consistent with vision of new organization
   - ❖ Develop HR structure and staffing
   - ❖ Determine service delivery model
9. Identifying and embracing *new roles* for the HR leader, namely,
   - ❖ Partnership
   - ❖ Change Facilitator
   - ❖ Strategy Implementor
   - ❖ Strategy Formulator
   - ❖ Innovator
   - ❖ *Collaborator*
10. Identifying and developing *new competencies*, such as those shown in Figure 5.

Conclusions

There are numerous conclusions that can be made about M&A activity, both at the company level and at the HR level.[32]

At the Company Level

- ❖ It is important that business and integration strategies be clear
- ❖ When the deal is concluded, there must be a clear vision of what the new combination will look like:
  - How will it be structured and run?
  - Will it be stand-alone or connected?
- ❖ It is important that such decisions be made as early as possible and avoid ambiguity in decision-making guidance
- ❖ It is critical to have a clear plan on whether to merge acquired companies or leave them alone
- ❖ It is important that performance expectations be reasonable and take into account market conditions, capital investment requirement, etc.
- ❖ The seller's picture is too often the starting point for ongoing operations (e.g., artificially inflated sales, lagging capital investment) — but is not realistic as a performance goal
- ❖ Inflated performance expectations can lead executives to adopt short-term focus and delay making investments in the business
- ❖ Financial expectations must be made clear, along with expectations with respect to other things
- ❖ Discovery is a broader concept than legal 'due diligence,' covering internal and external analysis, of all key functions and culture (soft and hard due diligence).
- ❖ Thinking through the membership of due diligence teams and the responsibilities of key participants is critical
- ❖ It is important to also make sure that areas such as HR, IT, Operations and R&D are represented on the teams — participation will depend upon key value drivers of the deal
- ❖ This has implications for capital expenditures, new product development, management retention, etc.
- ❖ For acquisitions or mergers in new markets, it is essential to understand market dynamics and customers

At the HR Level

- ❖ 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

Business competencies
- Industry knowledge
- Competitor understanding
- Financial understanding
- Global perspective/knowledge
- Strategic visioning
- Partner orientation
- Multiple stakeholder sensitivity
- Merger and acquisition knowledge

Change and knowledge management competencies
- Consulting and communicating
- Group process facilitation
- Designing and working in flexible structure
- Partnering and parenting
- Negotiating
- Network building
- HR alignment
- Managing learning transfer

Leadership competencies
- Strategic analysis
- Managing cultural diversity
- Creator of learning culture
- Planning skills
- Adaptability
- Learning facilitator
- Value shaper

Figure 5 Competencies for HR Leader

- ❖ 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 M&A deals in the past and learn from these experiences when embarking on future deals. This review should focus on:
  - How to deal with inadequate information during due diligence
  - Employee communication
  - Identifying and dealing with integration bottlenecks
- ❖ M&A management can become a core competency for an HR department

Overall, with the likelihood of continued merger and acquisition activity around the world for the next several years, the future seems bright for a significant contribution to be made by the HR department and its professionals in partnership with line managers and the employees and their representatives.

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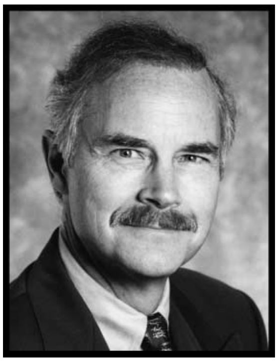

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