

Mergers and Their Human Side: Key Factors for an Effective Acquisition and for Surviving One

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Abstract: Mergers and acquisitions have become an increasingly common reality of organizational life. It seems that almost daily one hears of corporations - some willingly, some not - involved in such transformation as part of strategy designed to achieve corporate growth, economies of scale, vertical integration, diversification, and even provision of capital for future leveraged buyouts. From a human resource point of view, merger and acquisitions are corporate events that have the potential to create severe personal trauma and stress which can result in psychological, behavioral, health, performance and survival problems for both the individuals and companies involved.

Keywords: merger, acquisition, corporate growth, performance, human resources, economic integration

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1. Introduction

The following statement is attributed to Warren Buffet: “Our method is very simple. We just try to buy businesses with good-to-superlative underlying economics run by honest and able people and buy them at sensible prices. That’s all I’m trying to do”.

The aim of this article is precisely to consider the human dimension of mergers and acquisitions and the way these processes impact people. In the substantial body of scientific literature that exists on this topic, authors discuss the rules and “magic” formulas that lead to a successful acquisition, grounding their arguments in empirical evidence.¹ One of the first conclusions that can be drawn from examining this literature is that the authors cite a wide variety of empirical evidence in each case and that this evidence serves to support different, and even contradictory, theses concerning the key aspects and elements of company acquisitions.

Acquisitions affect everyone involved to one degree or another. They are not neutral transactions in any sense: not from a financial, tax, legal, operational or commercial perspective, and especially not in terms of how they impact the people in both companies involved and other stakeholders (i.e. shareholders, suppliers, customers).

For many companies, mergers by acquisition have become a recurrent strategy for dealing with competition, gaining market share, or simply ensuring their survival. Their impact on stock markets is noted within hours, but their consequences for the people who live through them are rarely reflected in the media.

2. Mergers and Acquisitions: Why do firms undertake them?

A merger is the creation of a new company that is formed by combining the assets and liabilities of the merged companies. As is defined by the Romanian Explanatory Dictionary merger means, “to bring together in a single homogeneous

¹ A good example is the map offered by Paine and Power in “Merger Strategy: An Examination of Drucker’s Five Rules for Successful Acquisitions,” *Strategic Management Journal* 5 (1984): 99-110.

unit at least two organizations parties” or „merger is made by absorption of one company by another or by fusion of two or more companies to compile a new one”.

According to various reports issued by major consultancy firms, over 60% of mergers end up failing in the long term, which results in the companies involved losing ground in terms of their positioning in the market, losing business, and even disappearing in some cases.

The most basic reason for undertaking a merger is to help transform a company’s business operations by incorporating new products, services or talent. In other cases, the aim is to expand certain operations in economies undergoing rapid growth and take advantage of the opportunity they present. Mergers may look like an attractive option since achieving similar results by other means would take more time and effort. In many cases, companies also see mergers as a way to increase their market share.

Whether mergers are strategic, financial or operations-related, the reasons that most frequently impel companies to undertake them can be summed up as follows²:

- ♦ Pursuit of market leadership: the speed at which certain sectors are evolving leads companies to seek new partnerships in order to acquire customers and avoid being shut out of the market.
- ♦ Geographic diversification: to test the capacity of their business model by gaining access to different sales channels and emerging markets.
- ♦ Financial reasons: to increase cash flow, improve capital structure, or reduce the cost of debt.
- ♦ As a means of increasing capital in order to write down assets and improve the company’s solvency ratio by integrating complementary products and services.
- ♦ Pursuit of production-related synergies (i.e. cost reduction, improved income from profits) or financial synergies (i.e. tax benefits, lower cost of capital).
- ♦ Access to new ideas, technologies, and talent.

² N. Zozaya, Las fusiones y adquisiciones como fórmula de crecimiento empresarial (Dirección General de Política de la PYME, 2007).

- ♦ Pursuit of opportunities to increase the welfare and security of shareholders in times of crisis.
- ♦ Personal motivations (i.e. ego, achieving power or a higher salary) or speculation by company leaders.

3. Reasons why mergers and acquisitions fail

According to Professor J. R. Pin³, “merger mania” is the excessive use of mergers and acquisitions as a means of achieving business growth and expansion. As we indicated in the preceding section, excess cash balances and an interest in pursuing continued growth are some of the reasons that drive companies to acquire other organizations.

But are such deals always profitable? Despite the expectation of resounding success that prevails during the negotiation process, the answer is no. A merger is seen as having failed when in the short term the value of the company has actually decreased rather than increasing. The standard figure given for the loss of business after a merger ranges from 5 to 10%, though in some cases it is even higher.

Why are due diligence investigations and other pre-merger reviews unable to foresee such losses? Mergers and acquisitions entail “hidden” costs or “gray areas.”

According to some experts, including Shippee, these costs arise because the human element - what Shippee⁴ calls the “X factor” - is overlooked. The people who make up the organizations involved can play a key role in streamlining the process and mitigating any traumatic effects, helping to tip the scales that measure the success of a merger one way or the other. The right kind of behavior increases the chances of achieving success in the long term. The traumatic effects experienced are usually identified as “merger syndrome.” They include mixed feelings—*anxiety, frustration, disappointment and uncertainty*—as well as tension between individuals and groups in the organizations undergoing the merger. The emotional impact of the change process leads to a slow trickle of key

3 J. R. Pin, “El lado humano de las fusiones y adquisiciones: el modelo antropológico frente al culturalista”, FHN-208, IESE Business School, Barcelona, 1990. Available on IESEP (only in Spanish).

4 S. W. Shippee, “The X Factor in Successful Acquisitions: Getting the Human Side Right,” *MWorld* 13 (2014): 14-16.

people leaving the company, adversely affecting its day-to-day activity. In a climate marked by internal “noise,” lack of motivation, and a sense of unease, people focus on protecting their jobs rather than, for example, taking care of customers. These behaviors result in a loss of business (mainly customers and suppliers) and talent. At the same time, because they are afraid of making mistakes, those responsible for the merger stop taking decisions which, though they entail a degree of risk, are likely to be in the company’s best interest.

People often forget that mergers involve more than just acquiring assets or technology, increasing market share, or incorporating another company’s talent. What makes these processes so complex is the need to integrate two organizational structures and make them work, and to combine different styles, work forces, processes and cultures. This is where the human dimension of the merger becomes so important.

Leaving aside that a merger may fail because the company acquired has not been entirely truthful, a study on mergers and acquisitions carried out by KPMG⁵ identifies the main causes why such deals fail, emphasizing that a cultural mismatch between the firms involved can be one of the fundamental reasons. Other causes include lack of defined leadership, poor implementation of the merger plan, resistance to change, lack of employee motivation, poor communication, and loss of key talent.

When a merger is undertaken, the aim is to generate sufficient synergies to present the market with a clear, concise argument as to why the merged entity will be more productive and deliver better results in less time. Synergies of this kind are oriented towards cost savings, and due diligence reviews focus on identifying such synergies. Consequently, people and factors with a more qualitative component— aspects that take longer to evaluate and manage and whose economic impact is less apparent in the short term—are not given enough consideration. Capital markets seem to lack the time and patience needed to take these issues into account.

Human and cultural factors only start to become the focus of attention when the case for the synergies to be obtained from a merger has been made to the market (and this shift of focus does not occur in all cases). Yet these are the factors

⁵ KPMG (2011), “Whitepaper on Post Merger People integration,” <https://www.kpmg.com/IN/en/IssuesAndInsights/ArticlesPublications/Documents/Post%20Merger%20People%20Integration.pdf>.

most likely to cause deals of this kind to fail. Why are these issues generally not addressed in an appropriate and timely manner? Let's see what the technical director of an IT multinational has to say:

“After completing three acquisitions my company was itself acquired. All this happened in three years. The point that generated a lot of conflict was the difference in terms and conditions of employment between the two structures. When we were acquired, the incoming company had a collective agreement with more advantageous terms for employees, including better working hours, more vacation time, higher salaries, and so on. We lived with these differences for months and months, which prolonged the agony because it was a constant reminder that we were the ones who'd been acquired. It made us feel like second-class employees. I think the teams could have been integrated more quickly and effectively if, right from the early stages, they'd merged the works councils of the two companies and established a collective agreement with the same terms for all staff. It seems obvious that this was the right thing to do, but the fact is that they allowed this distinction between employees to go on for a very long time”.

Understanding how employees view the new context should not be complicated. However, despite the tools at their disposal, companies tend to:

- ♦ carry out due diligence reviews that do not include sufficient analysis of cultural and organizational factors;
- ♦ pursue complex strategies that slow down processes and hinder their definition and communication; -
- ♦ delegate management of the process mainly to experts from the financial area and specialists in legal and tax matters;
- ♦ lack the information needed to make operational decisions that contribute to shaping the new corporate structure.

4. Can a merger be made more efficient?

It is difficult to determine the exact proportion of talent that is “lost” after a merger. For one thing, the loss of talent cannot be understood simply in terms of the number of people who voluntarily leave the resulting organization during or after the process. One also needs to consider the talent that has been the “victim of

the synergies” and, most importantly, the unmotivated and disgruntled talent that stays on—that is, people who, though they feel their careers have been derailed and their expectations frustrated, decide for one reason or another not to leave the company. This is a hidden cost and often one that nobody wants to estimate.

A merger is a real test for the human resources department. Its level of involvement and performance will show whether or not it is able to rise to the occasion. The department’s role is to act as an intermediary between the company and employees and forestall the emergence of a “winners and losers” mentality. This can be accomplished by applying objective decision making criteria and proven tools for promoting integration and avoiding arbitrariness. Such criteria help people understand the reasons for the most complex decisions that need to be taken.

Productivity suffers in so far as people are unclear about their future and must, therefore, move out of their comfort zone to learn and put into practice new ways of doing things.

While it is normal for performance to be adversely affected early on, it is important to act expeditiously and take a realistic approach to managing the situation.

Reality One: There’s Always a Winner.

While the proponents of a merger argue, communicate and insist that both organizations come out ahead, the reality is usually quite different: there are, in fact, no mergers of equals, only acquisitions. The acquiring company generally imposes its policy, values, culture and rules. However, it is the acquirer that loses the most by taking this kind of approach: there is always a price to be paid for this kind of “ethnic cleansing” in terms of the mark it leaves on those who remain.

Reality 2: Pain is inevitable. nothing will be the same.

Redundancy leads to outplacements, reduction of the workforce, and labor force adjustment plans. Sometimes efforts to avoid inflicting pain turn out to be useless and simply delay the realization of cost synergies and improvements to processes.

Although the new company may end up creating jobs in the long term, in the short term there are bound to be dismissals. Change at the personal and organizational level leads to uncertainty and generates a sense of disorientation, a situation that often only improves with the passage of time.

Reality 3: Success depends largely on middle managers

Assessing key managers should be a focus of attention for senior management and one of the first items on the agenda for human resources during a merger by acquisition. It is middle managers who manage the change while also running the business.

Their involvement is essential for a merger to be effective. If they are on board, everything will go better.

Reality 4: Works councils and unions will be against the process.

Unless something is done to change the situation—such as entering into negotiations with them before the process even starts—works councils and unions will be part of the problem, not part of the solution. Effective negotiation depends on understanding their position on the personal level and at the level of the group they represent. Their critical needs must be recognized and gradually met in exchange for them providing adequate support for the progress of the merger. Finally, if a deadlock is reached, they should be offered a dignified exit.

Reality 5: Cultural integration isn't achieved only through friction.

The people involved in managing a merger by acquisition usually assume that once people from the two organizations are working together in the same place cultural integration will happen over time and with a certain degree of “friction.” However, it is not just a matter of time: companies must fully engage in the process, and management must take action based on rigorous, straightforward procedures. If the leaders of a merger act with integrity, this reduces uncertainty and pain, leading to an increase in efficiency

Reality 6: The best people have opportunities elsewhere.

The best people also tend to take the bull by the horns; they do not wait for events to unfold before negotiating with other companies. If the goal is to keep them in the company, it is important to act quickly.

5. Practical guide for surviving a merger process

Firms will continue to undertake mergers and acquisitions as a way to grow, solve internal and external problems, or feed the egos of company leaders. However, multiple factors need to be managed to avoid negative impacts.

Porter⁶ and Pfeffer⁷ emphasize that multiple external factors influence the advisability of undertaking an acquisition and the probability of success. Rumelt⁸ notes that 80% of success is due to actions taken by the acquiring company while 20% of the outcome is explained by the evolution of the sector. Academics and managers are increasingly warning that people (employees and customers) have not been properly taken into account and considered in analyses or subsequent decisions. This situation can be remedied by creating a dedicated team whose role is to thoroughly analyze the cultural issues that need to be addressed before integrating or acquiring a company.

We also recommend that HR departments be given a much greater role from the start of the process. They should be aware of and, where appropriate, involved in decision-making. Decisions should not be taken exclusively by those in charge of business operations, sales or finance because in the long term the outcome of a deal depends on what managers and employees make of it.

6. Conclusions

A proactive strategy for dealing with corporate culture and human resource issues is fundamental to the success of mergers and acquisitions. However, these issues are rarely considered until serious difficulties arise. According to Hunt⁹, the personnel function was involved in only one-third of all the mergers and acquisitions he studied: management often fails to acknowledge that culture and human resource issues can actually cause careful proactive planning by the acquiring organization to reduce the emotional fallout can ease the transition and reduce the risk of failure.

Acquisition managers must recognize that the role of people in determining merger and acquisition outcomes is in reality not a soft but a hard issue. Without the commitment of those who produce the goods and services, make decisions and

6 M. Porter, *Competitive Strategy* (New York: The Free Press, 1980)

7 J. Pfeffer and G. R. Salancik, *The External Control of Organizations: A Resource Dependence Perspective* (New York: Harper and Row, 1980).

8 R. P. Rumelt, "Evaluation of Strategy: Theory and Models," in *Strategic Management: A New View of Business Policy and Planning*, edited by D. Schendel and C. Hofer (Boston: Little Brown & Co, 1979).

9 Hunt, John W. 1987. Hidden extras: How people get overlooked in takeovers. *Personnel Management* 19(July):24-

conceive strategies, mergers and acquisitions will fail to achieve their synergizing potential as a wealth-creating strategy.

This article has highlighted the importance of considering and strategically addressing corporate culture and human resource issues concurrently with financial issues.

It has also illustrated the importance of dealing with these human resources issues before, during, and after an acquisition or merger and hopes to develop an open mind for people living standards as the first choice of any management decision, wherever the world this could be done.

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