

## HUMAN RESOURCE ISSUES & CHALLENGES INVOLVED IN MERGERS AND ACQUISITIONS

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### **Abstract:**

Mergers and Acquisitions (M&As) have become the dominant mode of growth for firms looking out for competitive advantage in an increasingly complex and global business economy. This paper addresses the mostly neglected human side of M&A by providing an insight into the major Human Resource challenges in a Merger & Acquisition. An analytical study has been conducted on recent empirical evidence to highlight the challenges faced by HRM in terms of culture, processes, values followed, and employee retention at the Integration stage of M&A. The purpose of this paper is to articulate a systematic, people oriented approach for effectively carrying out mergers and acquisitions, from the onset to Integration and Post-Integration. We start our research by identifying the types of strategies for mergers and acquisitions and move on to the many HR issues involved. This is followed by an overview of challenges and recommendations for the HR Personnel in case of any Merger & Acquisition.

**Keywords:** Human Resource Management, Cultural difference, Merger & Acquisition, Due-Diligence

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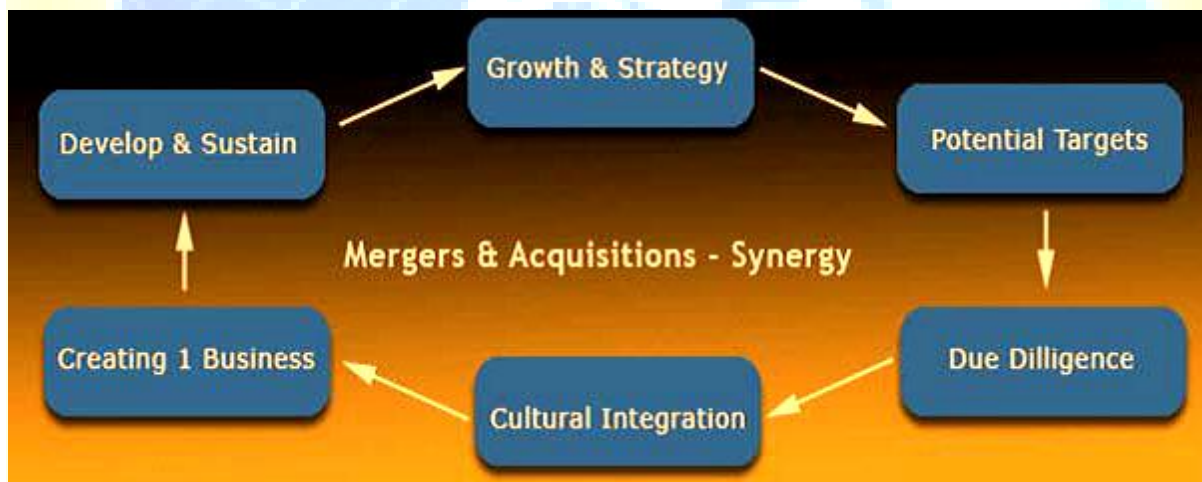
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## Introduction

Mergers and Acquisitions constitute one of the most attractive and effective Business strategies that come into picture in the current Business world. Merger can be defined as a process of combination of the assets, cultural values and management practices of two individual firms to form an altogether separate entity. As per the survey conducted in 2013, industries expected to have the highest number of M&As are Media and Telecommunications, Technology; Health Care, pharmaceuticals and life sciences; financial services; and energy. As per the studies conducted by Adomako, Gasor and Danso (2013) the last decade has witnessed a new role of HR, which is to promote HR as more of a Business Partner. It has been observed that the failures associated with M&As are attributed to the disengagement of HR managers from demonstrating knowledge and skill in the management of human capital during M&As. HR must be viewed as the background process in case of any merger or Acquisition is as depicted in fig 1.

**Figure 1: Background Process in any M&A (Jain, P. 2013)**



Aquilera and Dencker(2004) propose five different M&A strategies as stated below -:

1. **Overcapacity M&A** – when an acquiring firm seeks to eliminate excess capacity to create a more efficient firm. The acquiring firm’s goal is to achieve economies of scale to gain market share.
2. **Geographic roll-up M&A** - takes place when companies want to expand geographically, with their operating units being retained at the local level. In many cases, large firms acquire

smaller firms that they try to keep intact and therefore these firms tend to retain local managers for their day-to-day working.

3. **Product or Market Extension M&A** - involves expanding product lines or expanding geographically across borders. It occurs when the acquiring and acquired companies are functionally related in production and/or distribution but sell products that do not compete directly with one another, or when a company looks out for diversifying geographically, for example when two companies manufacture the same commodity, yet sell it in different markets. In effect, by this type of M&A, firms seek to attain long-term strategic goals by making investments in less saturated markets to obtain economies of scale necessary for global competition.
4. **M&A as a substitute for R&D** - occurs when acquisitions are used for gaining access to new R&D knowledge or technological capabilities by acquiring innovative firms rather than producing the knowledge in-house. Acquiring firms in this type of M&A tend to be larger than the acquired firm, and tend to have significant practical merger experience, as is evident in the case of Microsoft and Cisco Systems.
5. **An industry convergence M&A** - involves creating a new industry from existing industries whose business is dying down. An example of this type of M&A is the Viacom acquisition of Paramount and Blockbuster.

According to Islam, Sengupta, Gosh & Basu (2012) four attributes that contribute to the success of M&A have been identified. They are 1) extent of awareness for future growth and prospect of an employee after mergers and acquisitions, 2) extent of future growth of an industry post mergers and acquisitions, 3) extent of uncertainty of expectation of an employee after mergers and acquisitions and 4) degree of personal problem of an employee after mergers and acquisitions.

### Various Stages of any Merger & Acquisition

Traditionally the cycles of Merger and Acquisition constitute of three stages:- Pre-Merger and Acquisition stage, Due-Diligence stage, Post- Merger Integration stage (Varizani, 2013). As the other stages are obvious by their names only Due-Diligence needs to be defined and explained. Due-diligence is the process a company executives go through when evaluating a company that their firm wants to merge with or acquire. It refers to the process, the Company Executives of the acquiring firm carry out, when assessing their target firm (Marks, Mirvis & Ashkenas,

2014) The Due-Diligence team carries out a cultural assessment, studies the operational aspects and identify the extent of cultural differences (Varizani, 2013). It is expectation, as per the literature review, that the HR strategies the firm develops after the Merger, will depend on the institutional norms of the country in which the lead firm is established.

Another research by Schuler & Jackson (2004) shows a Three Stage Model of any Merger/Acquisition- The Pre-Combination Stage, The Combination Stage – Integrating the companies and Solidification & Assessment of the New Entity. A clear understanding of the roles of the HR department at the various stages helps in knowing the challenges faced by them.

**Stage I: Pre-Combination Stage** (Schuler & Jackson 2004)

HR Issues	HR Actions
<ul style="list-style-type: none"> <li>Identifying reasons for the M &amp;</li> <li>Forming M &amp; A team/leader</li> <li>Searching for potential partners</li> <li>Selecting a partner</li> <li>Planning for management of the process of the Merger/Acquisition</li> <li>Planning to learn from the Process</li> </ul>	<ul style="list-style-type: none"> <li>Knowledge and understanding need to be disseminated</li> <li>Leadership needs to be place</li> <li>Composition of team impacts success</li> <li>Systematic, well organized pre-selection and selection are essential</li> <li>Conducting Due Diligence of all areas</li> <li>Cultural assessment</li> <li>Planning for M&amp;A minimizes problems later</li> <li>Creating procedures for learning and knowledge transfer</li> </ul>

**Stage II: Pre-Combination Stage** (Schuler & Jackson 2004)

HR Issues	HR Actions
<ul style="list-style-type: none"> <li>Selecting the integration manager</li> <li>Designing/implementing teams</li> <li>Creating the new structure, related policies, leadership</li> <li>Retaining key employees</li> <li>Motivating the employees</li> <li>Managing the change process</li> <li>Communicating to and invoicing stakeholders</li> </ul>	<ul style="list-style-type: none"> <li>Selecting the appropriate candidate</li> <li>Creating team structure and selection are critical for transition and combination success</li> <li>Communicating is essential at this stage</li> <li>Deciding on who stays and goes</li> <li>Establishment of a new culture, structure, and HR policies and practices is essential</li> </ul>

- Fixing up the new HR policies and practices

**Stage 3 – Solidification and Assessment** (Schuler & Jackson 2004)

HR Issues	HR Actions
<ul style="list-style-type: none"> <li>• fixing up the leadership and staffing</li> <li>• Assessment of the new strategies and structures</li> <li>• Assessment of the new culture</li> <li>• Assessment of the new HR Policies &amp; Practices</li> <li>• Studying the concerns of stakeholders</li> <li>• Revising as per the need of the hour.</li> <li>• Learning from the process</li> </ul>	<ul style="list-style-type: none"> <li>• Leadership and staffing of the new entry are essential</li> <li>• Creation and evaluation of the new structure</li> <li>• Merging two cultures needs assessment revision</li> <li>• The doubts of all stakeholders should be addressed in the right manner.</li> <li>• The new entity must learn about the environment.</li> </ul>

Human Resource plays a major role in handling the confusion and chaos when any Merger or Acquisition takes place. It is understood that there will be plenty of issues at hand in a Merger. According to Varizani (2013) the following challenges have been identified at the Integration stage of any Merger-:

1. **Structural Issues** – Post- Merger there ought to be new designations, staffing, changes in the reporting relationships of new with the right people becomes critical (Kale, Singh, Raman, 2009). According to the research available, combining of units takes place post-merger which is done to capture the combination of two firms. Decision–Making regarding which unit will close down, whom to retain , becomes very important at this stage in any Merger & Acquisition.(Vazirani, 2013)
2. **Employee related issue** – there is a mix of reactions given by employees related to a merger as per the literature review available. When the communication is handled properly by the Management the employees are usually more positive about the merger or acquisition. They consider this merger as an opportunity for success in their career. Studies done by Covin, Sightler, Kolenko and Tudor (1997) reflected that the employees of the acquired firm had significantly lower satisfaction levels in comparison to that of the employees of the acquiring firm or the ones newly hired.



3. **Managing culture integration** -: According to the study conducted in Mergers and Acquisitions, it has been found that cultural differences in the merging firms leads to failure in the success of the Merger.(Creasy, Stull & Peck, 2009). As per the studies conducted by Vazirani (2013) any Merger fails when the dominant firm makes an attempt undermine the power and authority of the acquired firm. The best way to attain success in any merger is to consider the difference in cultures very critically when embarking on a merger. Pre- merger cultural audits play a very important role in a merger taking place (Lodorfos and Boateng, 2006). Vazirani (2013) , suggested that the best ways of handling the cultural differences are:
- Making the employees accept a new set of beliefs and values, policies and procedures. HR should work towards changing the outlook towards the new set-up
  - There should be recruitment of new employees, removing those who do not fit into the new environment. Such cases should be allowed to quit voluntarily.
4. **Production of a pleasing combination of HR policies and processes**: it is quite evident from the study available that the most affected area in any Merger & Acquisition are HR functions like, compensation and benefit policies. These areas are more tangible and hence change first. Usually the technical ones are first examined by specialists and those recommendations are made accordingly.
5. **Managing the communication with the employees**: HR has the huge responsibility of being the mediator between the Management and the Employees. The role of HR in using the right medium of communication becomes very important in any Merger or Acquisition ( Galpin and Herndon , 2000).

Moreover, as per the research available, in order to consider the fit between M&A and HRM strategies, and to sense HRM challenges in the different types of M&As, three conceptual tools can be used ; Resources, Processes and Values (Acuilera, Dencker 2004). Resources would include Tangible assets like Money and People and Intangible assets like brands and relationships. Decisions about resources would include staffing and retention etc with termination issue being particularly important.

Processes refer to activities that firms use to convert the resources into valuable goods and services. In case of HR, these would be Training and Development Programmes as well as Appraisal and Rewards Systems.

Values are the way in which employees perceive an opinion about what they do and why they do it. Values shape employees' priorities and decision-making at work.

Aquilera and Dencker (2004), have identified the fit between M&A typology and HRM strategies and practices by using the resources, processes and values framework. Weber & Drori (2011), have given different propositions that break down the role of the different conceptual and analytical components of an organization and their effects on both pre-merger and post-merger processes. These components include organizational culture, culture-clash, HR challenges, autonomy removal, organizational identification, integration, and organizational identity.

### **HR and it's challenging role at the different stages in a Merger/Acquisition**

As per the research conducted by Schweiger (undated), the entire process of M&A can be divided in broadly two categories, i.e the Pre-Merger or the Planning stage and the Post-Merger or the Implementation stage. According to the research conducted by Manzini & Gridley (undated), the role of Human Resource Planners and Managers in the Merger & Acquisition Process will be reflected by the role of the Human Resource function in the Pre-Merger Organization. Human Resource issues will then not be overlooked when a merger is under consideration, if the Top Management is already accustomed to taking human resource factors into account in it's strategic planning and decisions affecting the direction of the business.

#### **Planning Stage (Pre-Merger)**

This stage occurs before the actual closing or change of ownership of the merged or acquired firm. The acquiring firm must search for the right merger or acquisition candidate firm. After the identification of it's target firm, the acquiring firm may sign-up a letter of intent i.e., an agreement to negotiate. This is followed by the due-diligence process. During due-diligence the right identification is carried out of the various aspects of the target firm. It is evident from the literature review that during the planning stage two issues must be dealt with by the acquiring firm.

1. First is to conduct a thorough due-diligence or review. Such a review must focus not only on finances, plant conditions and the likes but also on organizational and human resource issues and the cultural set-up of the target firm.
2. Second is to ensure that there is an appropriate and moderate amount of communication instead of grapevine and rumor-mills in the two firms involved. Unfortunately this is the

time when communication is highly restricted. This adds to the stress level of the employees and hence leads to high absenteeism, lower productivity and commitment to the organization. Instead to learning about the M&A from indirect sources the employees should be informed of the happening by the Human Resource of the firms involved. This will promote a feeling of belonging among the employees and they will not develop negative image of the merger.

Whether the top management communicates or not, the employees will look out for certain information. As a result rumor-mills heat up during this period. A typical recommendation for minimizing the rumor-mills will be for Top Management to communicate even if it means telling the employees that nothing has been decided yet.

The real challenge, though, is analyzing such sensitive and critical aspects as Culture, Decision-Making procedures, Performance differentiation and Organizational values. HR is required to assess the target organization in terms of skills of the employees, their capabilities, Employment Contracts, Total Rewards, Termination Payments and Benefits. Cultural differences & organizational culture is a major challenge as well (Bhaskar, 2012).

### **Implementation stage (Post-Merger)**

There are a number of issues that need to be managed during this stage of any Merger & Acquisition. Communication remains critical during this stage as well (Lee & Carpenter, 2010).

At the Post-Merger, one of the HR challenge includes:-

- analyzing employee compensation,
- including bonuses,
- severance liabilities,
- pensions,
- Health care reimbursements and so on.

In many M&A, one of the most valuable resources of the firm is working towards the retention of the target firm's Top Management Team (TMT) and the key employees. Though there are many reasons for acquisitions, much of the strategy research and Human Resource Management literature has focused on the TMT and the Managers/Employees of the target firm as primary motivators for making the acquisition and for generally paying some amount of the earnings to merge or acquire a target firm (Kiessling and Harvey, 2006).



The greatest challenge at this stage lies in transition from two organizations to one integrated Organization. The need for reduction in workforce is inevitable when a M&A takes place between firms. It is best to rely firstly on Voluntary Retirement Plans and then to take help of Outplacement Services. Merger sensitization workshops and meetings have been a great success. According to Buitter and Harris (2013), HR practices, such as Staffing, Training and Development, and Compensation are some of the major HR functions which act as a challenge following a Merger, as these factors influence employee perception of any Merger or Acquisition taking place. These factors can help ensure employees are in the proper jobs, have the appropriate skills and are compensated and rewarded accordingly without any negative influence of the Merger or Acquisition happening. Our findings in this study support the fact that these HR practices are challenging for an HR Team and employee perception of any Merger or Acquisition is linked to how appropriately these factors can be handled by the HR Managers.

### Conclusion

From the literature review we found that Employee Perceptions of HR practices positively influenced their perceptions of the Merger or Acquisition. As mentioned, Mergers create a high degree of uncertainty for employees. One of the main reasons of failure of any Merger & Acquisition is can be termed “soft issues” which are related to Human Resource issues like cultural differences, incongruency of leadership vision, dissimilarity in remuneration structures and Human Resource policies. Study on Mergers stated that another reason was “something loosely called culture”. When it comes to culture, employee communication and other so-called “soft issues”, the Human Resource functions have a role to play in making the M&A activity successful (Nagar, Masih & Badugu , 2012). Most experts believe that it is very important to get Human Resource involved at the very beginning of any M&A decision. It would help employees deal with the culture shock post Merger or Acquisition. HR practices can help reduce this uncertainty and anxiety by ensuring employees are prepared to function effectively in the new environment. Additionally, employees may view the HR practices as a source of organizational support, which, from a social exchange perspective, may encourage them to view the merger more favorably. Therefore, HR practices that help to reduce uncertainty may lead employees to form more positive perceptions of the Merger or Acquisition happening.

### Limitations and Future Research

In this section we outline limitations with the current study and provide recommendations for future research. The first limitation is that this study has been formulated on the basis of the literature review. Future research could be conducted by collecting the independent and dependent variables from different sources. A second limitation is the cross-sectional nature of the study. Future research could do the same by conducting a longitudinal study. In the context of a merger it would be desirable to collect data prior to the merger, during and after.

### Note:

We use the terms “mergers” and “acquisitions” interchangeably because, from a strategic management perspective, the two terms refer to the same underlying phenomenon.

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