The PAUSE Scholarship Foundation

# Effective Human Resource Practices in Mergers and Acquisitions

- A study on how companies create value by aligning people, organization and strategy

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**Summary**

In spite of poor outcomes on average, *mergers and acquisitions* (M&A) are a frequently used method for corporations aiming to grow the business and increase profits. The problem is that a large portion of the acquisitions does not realize the expected benefits or management's promises. *Human resources* (HR) have been frequently suggested as a potential factor in explaining M&A performance. To shed some light on how management of HR could have a positive impact on corporate transaction outcomes, this study presents theory and empirical evidence from four acquisitions made by large, multinational companies.

This study suggests a simplified framework on how to approach value creating M&A. Most importantly, companies must *understand the strategy*, to be able to accurately execute the transaction. Strategy is important since two objectives could imply two significantly different integration structures. Then, based on the underlying strategic rationale, companies must make the right *choice of structure* to support that strategy and *align HR practices* accordingly.

The observed companies showed different degree of *sensitivity* to the underlying strategy when deciding on structure and HR practices. It is unclear how and to what extent HR professionals have influenced the choice of structure and how that structure did fit the strategy. The post-acquisition performance effects are inconclusive, partly because comprehensive M&A performance measurements were not clearly defined.

It appears as if the level of HR competence from a functional perspective was very high, and that the contribution from HR people when consulted was significant. However, HR as a corporate function could add more value to the M&A process if scope and timing of their interventions were adjusted. The HR function should:

- Get involved earlier in initial strategic discussions around acquisition strategy and target selection
- Be more active in the planning phase, e.g. in the decision on integration level, and in the setting and monitoring of acquisition performance targets

- Take the lead in the execution phase, potentially by taking on central integration management duties
- Partner with corporate communications to ensure an ongoing dialogue with employees, to maintain the base business, and to facilitate integration
- Create and manage a process to learn from previous acquisitions, as part of developing long term M&A management capabilities

As M&A is likely to continue to serve as an important activity to grow businesses, the HR function can have a substantial positive impact on the outcomes of these processes by addressing some of the areas highlighted in this report.

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*Kristian Andersson*

*It is not so much what you buy, but what you do after you bought it and how well you do it that matters.* (Singh & Zollo, 1998)

## 1. BACKGROUND

Mergers and acquisitions (M&A) are an important activity, sometimes the only option, for corporations to grow the business and increase profits. The problem is that a large portion of the acquisitions does not realize the expected benefits or management's promises.

However, even if M&As fail *on average*, the performance distribution has a very broad variance (Singh & Zollo, 1998) and according to a McKinsey & Company survey companies that grow through acquisitions outperform organically growing companies (Deutsch, 2009).

Human resources (HR) have been frequently suggested as a potential factor in M&A failure (e.g., Denisi and Shin, 2004; Weber, Shenkar and Raveh, 1996). If HR is part of the explanation of failure, then part of the solution could be found in the way people issues are managed. However, empirical studies of the role of HR practices in M&A and its relationship to M&A performance remain scarce (Weber & Fried, 2008).



## 2. PURPOSE OF THE STUDY

The purpose of this study is to explore what and how HR practices could have a positive impact on M&A performance. HR practices are those activities broadly related to the management of people, performed by the HR function or by other parties within a company; leadership, compensation & benefits, competence management, communication, culture, training etc. The effectiveness of HR practices is evaluated by their impact on company performance (however measured) post-acquisition. Analyzing four major acquisitions performed by leading multinational companies the last few years, the aim is to provide insights into the reasoning and management of, in broad terms, people issues before, during and after the acquisition, and potentially what performance effects resulted from the process.

## 3. METHOD

The research project was conducted in two different phases: the *pre-study* and the *main study*. This section provides an overview of the methodology used in these phases.

### 3.1. The pre-study

To gain deeper knowledge about *practical* M&A and integration challenges as well as to help narrow down the research project scope, I had informal discussions with people knowledgeable in the area. Among the persons I consulted from September through December of 2008, were senior HR executives at my employer at the time (Volvo Group), senior leaders from the major accounting firms involved in transaction services (PricewaterhouseCoopers, KPMG and Ernst & Young), as well as people within the PAUSE network.



### 3.2. The main study

The main study was conducted in the USA, at the Center for Human Resources at the Wharton School of the University of Pennsylvania, in Philadelphia, Pennsylvania. The work was conducted on-site in Philadelphia from January to July of 2009 and in Sweden from July to December.

Most of the academic research on M&A performance is based mainly on financial data, where a large number of companies and information about them, are put into a database to calculate different statistical values, e.g. using multivariate regression analysis. Since I was more interested in the *reasoning* behind actions taken by people within the companies, I decided to take a closer, qualitative look at a few companies that had closed significant deals the last few years.

Arriving at Wharton School, and having undertaken my pre-study I had some very basic thoughts on how to proceed with my research. However, after having met with leading academics and corporate executives, as well as audited some MBA program courses, I elaborated on the theoretical framework I had tried to construct. Having what I perceived to be a reasonably stable theory in place, I went on to find companies to include in my main study.

The selection of companies was not purely coincidental, but surely a combination of opportunity and what I considered *good fit* – all four companies met the inclusion criteria of being large, multinational, leading in their industry and having closed at least one major deal the last few years. After selecting the companies, I contacted them and interviews were scheduled. All companies were generous in allowing me to discuss with them their acquisitions both in person, and on the phone before and after our interview meetings.

Since the purpose of the study is to find any *general patterns* in the effectiveness of HR practices in mergers and acquisitions, and to facilitate more upfront responses, I have chosen to omit the names of the companies.



Following a presentation of my theoretical framework are the results from the interviews. Presenting the interview results one by one will hopefully enable a good understanding of the uniqueness of each acquisition. Results will be analyzed in relation to theory. I will then conclude my findings and discuss potential implications for the management of HR.

# 4. THEORETICAL FRAMEWORK

## 4.1. Strategic rationale and acquisition performance

Let us take a look at the strategic rationale behind an acquisition. Whether or not it is to create synergies from sharing technological platforms, acquire a desired set of skills or enter a new market, the ultimate goal is to create value.

In describing the strategic rationale driving an acquisition, scholars propose different wordings and variations (e.g. Angwin, 2007; Bower, 2001), but in essence the suggested categories or types could fit into the categories suggested by Schweiger and Very (2003):

- Consolidate market within geographical area
- Extend or add products, services or technologies
- Enter a new geographic market
- Vertically integrate
- Enter a new line of business

In academic research, predominantly two categories of measures of acquisition performance (i.e. value creation) are used, namely *accounting-based measures*: ROA, ROE, sales growth, and stock *market based measures*: pre-deal share price compared to share price after the acquisition (Stahl & Voigt, 2005).

Zollo and Meier (2008) distinguish between *task level performance*: the degree to which the acquirer and the target (the acquired company) have succeeded in integrating e.g. IT systems or transferring sales practices, *transaction level performance*: the degree to which value creation objectives (the strategic rationale) has been realized, and *firm level performance*: the extent to which the base business is kept stable during the period connected to the acquisitions (keeping market shares and innovation speed etc.).



Whatever the strategic rationale, it seems as if value creation in pure financial terms is easy to measure, but it is difficult to determine what increase in value is specifically due to the acquisition. Zollo and Meier conclude that: *'[…]acquisition performance is by its nature an extremely complex concept – a concept that can certainly be approached in different ways, but for which no individual way seems to suffice'.*

Singh and Zollo (1998) highlight the *learning mechanisms* following an acquisition, as a strong determinant of M&A performance. It seems like *experience* from previous acquisitions is positive for a successful acquisition, but only if these acquisitions were homogenous. *Codifying knowledge* from previous acquisitions through creation of manuals or white books, have a very strong positive effect on performance if the acquisitions were complex and required high level of integration of the acquirer and the target. Results then suggest that if a company plans for extensive integration, they should build capabilities and tools to effectively manage the integration process.

In addition, what affects the value creation (or value destruction) of an acquisition is the value derived from synergies. Schweiger and Very (2003) mention four types of synergy: *cost* (reduction of fixed and/or variable cost), *revenue* (cross-selling or increased productivity), *market power* (elimination of competition) and *intangibles* (sharing of know-how and knowledge or brand extensions). From an organizational perspective it is worthwhile remembering that since acquisitions interfere with everyday operations, value could be destroyed (i.e. negative synergy).

The type of synergies is naturally related to the strategic rationale driving the deal. The realization of synergies depends on the different types and levels of integration between the acquirer and the target. More importantly, realization does not happen automatically, so integration must be managed wisely.



### 4.2. Structure and integration

Depending on the reason for deciding to acquire, the company can decide on different structural options, i.e. to merge (integrate) organizational entities or to leave the target as a stand-alone unit (or parts thereof). Capron (1999) found that performance is affected positively by post acquisition *reconfiguration* (i.e. replacing existing resources, or changing organizational structures, processes and/or culture). Zollo and Singh (2004) found that higher levels of integration had a positive impact on performance. Interestingly, Pablo (1994) found that companies with a tolerance for cultural diversity tend to implement lower levels of integration.

A number of integration frameworks have been proposed (Schweiger & Goulet, 2000). For the sake of this study, the definitions proposed by Marks and Mirvis (1998) are straightforward and will suffice here. They view integration from the perspective of change made in the acquirer, the target or both, and identify five approaches to the problem of structural design and integration: *absorption, preservation, best of both, transformation and reverse merger.*

Different concepts also have been suggested to describe the different phases of an acquisition: *transaction, transition* and *integration* Schweiger (1999) and *pre-combination, combination* and *post-combination (Marks & Mirvis, 1998).* The different phases implies that successful integration does not start at the integration phase – planning must commence already before the contract is signed.

The decision on integration design and the corresponding (supporting) processes must be carefully aligned with the corporate strategy, specifically the strategic rationale behind the acquisition.

### 4.3. HR practices in acquisitions

It was stated earlier that people issues could play an important role in M&A success. Therefore it is a bit surprising that they are, if not neglected, perhaps not managed according to their importance. Jackson and Schuler (2001) propose some possible reasons:

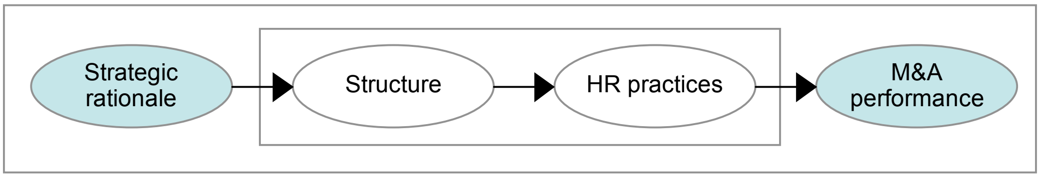
- People issues are too soft and therefore hard to manage
- Lack of awareness of the importance of people issues
- No spokesperson to articulate the people issues
- No framework or model to systematically manage these issues

Consequently, the authors claim, focus of attention in the M&A process is instead on finance, accounting and manufacturing.

During the different phases of the transaction, the acquiring firm must deal with different HR issues. During the phase preceding the deal (called pre-combination, if we use the definition of Marks and Mirvis), *understanding* the strategic rationale behind the acquisition is critical, since the choice of structure depends on the type of acquisition strategy being executed (Hrebiniak, 2005). It is the strategic rationale driving the acquisition that must be the *fundamental guiding principle* to planning and executing the acquisition and to the management of HR as part of the acquisition process.

### 4.4. Theoretical framework summarized

To sum up the theory section I propose a simplified alignment framework addressing the determinants of value creation in acquisitions. I argue that in order to realize the strategic objectives (i.e. to achieve M&A performance) driving the acquisition, the acquiring company needs to take a series of deliberate steps: understand the strategic rationale and *align the organizational structure and the HR practices* accordingly. Understanding the strategic rationale is key, since execution and approaches will be fundamentally different in terms of sourcing, valuation, due diligence and integration. Therefore, there is no "one size fits all" approach to managing HR in acquisitions – it must be tailored to the unique conditions of each deal.




## 5. EMPIRICAL EVIDENCE

As part of this study I have examined four acquisitions made by four companies in four different industries. The empirical evidence is based primarily on interviews with senior executives from the *acquiring* companies, supplemented by data from publicly available sources, such as company websites and M&A databases. The acquisitions will be presented one by one and followed by an analysis aiming at integrating the findings.

### 5.1. **Company 1 – Paper industry**

#### 5.1.1. *General acquirer characteristics*

Company 1 is an industry leader operating globally. The company deploys a holding company structure with entities operating in the same or adjacent niches of the industry. Many different cultures are merged into one, best described as diverse. Faced with increased product commoditization in the industry, Company 1 is striving to transform itself more towards customer intimacy.

### 5.1.2. *Previous M&A experience*

Company 1 has been through well over 100 transactions (acquisitions, divestments and joint ventures) since 1963. The industry structure makes it hard to pick (ideal) targets, resulting in a more opportunity-driven approach: *'though we have a wish list, we tend to be opportunity driven'.*

### 5.1.3. *M&A organization, approach and process*

With a delegated (decentralized) responsibility for acquisitions, the headquarter M&A function served in a more supporting role, ensuring compliance with the company's M&A process. Functional expertise incl. HR was involved on as needed basis.

### 5.1.4. *Transaction characteristics and strategic rationale*

Company 1 had prior to the transaction a 50/50 joint venture with the target (a joint venture here called *JVS*). The privately owned target owned the distribution channel in its market. The target's owner approached Company 1, suggesting a takeover.



The acquisition was conducted in two steps: firstly, the joint venture was expanded, and later Company 1 took full ownership of the target company.

The main strategic rationale was to expand into new market, i.e. to get market presence, not to change the product portfolio. Because of high entry barriers an acquisition was considered the only option to pursue growth ambitions: *'We know the business, it has strong brands and is a professional business – the deal really looked good…and (the target) wanted to sell /… /this was an opportunity'.*

### 5.1.5. *Post-acquisition structure*

Company 1 headquarters had a great interest in quickly implementing the company's policies around code of conduct. An HR director was hired to drive the code of conduct work. In terms of integration design, it was decided to keep the target's business autonomous: *'in this we lacked clear communications'.*

### 5.1.6. *HR practices*

The due diligence process combined (hard side) structured analysis and (soft side) sense of management credibility: *'The people issues are 'top of mind''.*

Company 1 performed a deep operations review. The caliber of the management team was thoroughly assessed. External consultants provided some assistance in management team assessment.

Company 1 decided not to keep any of the target's previous HR practices: *'The target's HR practices so badly needed to change|…|it was seen as positive|…|(and) we established a completely new HR structure'*

JVS (the joint venture company that was legally and operationally integrated with the target) was well managed and somewhat reluctant to adopt Company 1's branding and policies: *'they didn't want to integrate'.*

Company 1 was (perhaps overly) sensitive to JVS's requirements, which later backfired. Learning was that intervention should have come sooner: *'we should have stepped in earlier – we let time pass and it took us longer time'.*

The due diligence review was (as perceived by senior HR executives) poor and caused a lot of surprises post-acquisition. E.g. the target's company cars' practices were driving cost. The pre-deal assessment of management was weak causing replacement of all but one of management team members. Because of poor planning, a strong management team was not in place: *'we lost 2005 and a big part of 2006'.*

The target's financial reporting and accounting practices created uncertainty: *'we didn't understand their accounting system, we had to learn as we went along' |…| 'Monthly closing was scary'.*

Compensation & benefits practices were unclear: *'we didn't know how we (they) paid people'*, as were training and job evaluation practices. Since the target was family owned there were some (inappropriate) perks to family members.

### 5.1.7. *Post-acquisition performance*

In accordance with the strategic rationale Company 1 built a position in the local market, now serving as good foundation for future growth in the region.

The decision on over-recruitment when replacing the target's management proved successful. Post-acquisition, the region started 'exporting' executives and talent to other markets, as well as to the corporate headquarters.

## 5.2. Company 2 – Automotive industry

### 5.2.1. *General acquirer characteristics*

Company 2 is an industry leader operating globally. The company deploys a holding company structure with multiple brands, with clear ambitions to achieve intra-group synergies in e.g. sourcing and technology. The matrix structure separates product companies (brands, market companies) from support units (R&D, sourcing, logistics, IT, administration).

### 5.2.2. *Previous M&A experience*

Company 2 has closed a few large deals the last decade. Other than the major deals, primarily the product companies made a number of acquisitions, with only limited corporate level involvement.

### 5.2.3. *M&A organization, approach and process*

Not considered a serial acquirer, Company 2's M&A approach was ad hoc-based and unique for each acquisition. The integration process, and corresponding responsibility for realization of strategic rationale, was decentralized and functional in accordance with its group structure.

### 5.2.4. *Transaction characteristics and strategic rationale*

Company 2 had a significantly larger market share in Europe than in Asia. The main strategic objective behind the acquisition was to increase market coverage in the Asian region. Company 2 had previously attempted a few joint ventures in the region as well as own entry, which had not proved successful. Another company within the business group, having previous relationships with the target company and its owners, facilitated the acquisition.

Though the main rationale driving the acquisition was to strengthen Company 2's position in the Asian market, the exploitation of synergies (specifically in sourcing), was an additional driver for the acquisition.

When initiating the acquisition, nothing formal was written or performed, merely some presentations made by the deputy CEO. No negatives were identified: *'(this was) a company with potential'/…/(it was) 'good timing'*, but: *'no real due diligence was performed'*.

### 5.2.5. *Post-acquisition structure*

The choice of structure was not a deliberate decision based upon reflection, rather a logical consequence of Company 2's existing organizational structure. There were no discussions around structure or integration level. This approach to post-acquisition structure was established already when another major company was acquired a few years earlier.



As soon as the legal issues were resolved, the target's organizational entities were matched towards the current structure of Company 2. It appears that communications regarding the Company 2's intentions should have been clearer, specifically concerning future strategy and structure: *'many target-executives were shocked'*.

Responsibilities for integration were delegated to the respective organizational entities and functions: R&D, sourcing, logistics, IT, administration etc. The integration organization had a board with monthly reporting from the different organizational entities. However, potential benefits from integration were exploited without significant top-down control: '*this is truly a decentralized structure'*.

### 5.2.6. *HR practices*

A senior HR executive supported the organizational entities on issues relating to strategic HR matters.

No external support (consultants) was used in this transaction, though some assistance with compensation & benefits benchmarking data was brought in.

Though there was no active decision on integration design, process adherence was actively discussed and the HR steering committee (consisting of the top executive HR management) decided: *'that only critical processes must be aligned'.*

Some management audits were performed during the integration stage, however not as part of any pre-deal due diligence process.

The M&A approach, with a lower level of process integration, was affected by learnings from from a previous transaction: *'we thought we should use some of their processes and ways of doing things as a 'best practice' for the entire Group, but it really backfired, even though they had a large impact on the setup of a support unit within the group'.*



Company 2 considered communication to be an improvement area, and were according to a senior HR executive: '*the area where I'm the most dissatisfied'.*

### 5.2.7. *Post-acquisition performance*

The corporate level sponsor (the deal owner) pointed to two performance metrics to consider the integration completed:

- *'The finances are under control'*
- *'The organization is settled and people are transferred into 'the right boxes''*

At the same time, it was indicated that *'many target executives are still experiencing uncertainty'.*

In line with the decentralized responsibilities for integration, monitoring integration progress (and hence strategic rationale fulfillment) on a more detailed level (than the two performance metrics described), was performed by each organizational entity and reported monthly to the corporate level: *to some degree integration efforts should have been better coordinated, since it was an issue for each organizational entity'* even though *'there may be different projects 'out there' (e.g. a quality project) each reporting to a corporate level body'.*

### 5.3. Company 3 – Industrial industry

#### 5.3.1. *General acquirer characteristics*

Company 3 is an industry leader operating globally. The company is a major supplier of components to OEM's and the industrial market. Adopting a divisional structure, Company 3 has a large number of manufacturing sites and distribution locations globally.

#### 5.3.2. *Previous M&A experience*

Company 3 has closed a several major deals the last decades. Other than the major deals, primarily the product companies made a number of acquisitions, with only limited corporate level involvement. The M&A strategy appear to be more competence-based than resource-based, with no strong strategic basis for volume growth driving acquisitions.

#### 5.3.3. *M&A organization, approach and process*

There was an M&A committee on corporate level. Initiation of deals seemed opportunity-driven and bottom-up from divisions.

#### 5.3.4. *Transaction characteristics and strategic rationale*

On Company 3's market 10-15 main types of products are traded, of which 2 have about 60% of the market – this is the commodity market segment from where the target company earns 60% of its revenues. Company 3 focuses on the 40% differentiated (non-commodity) product segment.

Prior to the acquisition, Company 3 was not competitive on cost, with a material cost ratio of 40%. At the same time the target had a ratio of 80%. Correspondingly the profit margin was twice as high for the target company.

The target company started as broker: *trading 'good enough products'*, with low cost production in China, earning revenues in the US. The company was seen as flexible in the marketplace and regarded a customer-oriented company.

Company 3 needed to redefine its cost structure, because of a decrease in competitiveness. In 2005 Company 3's US operations initiated the acquisition, and the target was approached. The owner of the target on the other hand, was looking to sell, partly to manage recession and partly to enable growth ambitions, in order to: *get to the next level*. Furthermore, the deal was facilitated by the fact that the target was a tier 3 company (a company selling products to tier 2 companies; tier 2 sells to tier 1, and tier 1 sells to OEMs), while Company 3 was a tier 1 company (selling directly to OEMs), so it was prestigious to be bought by a tier 1.

Prior to the transaction the target company had a complicated structure, with multiple points of operations. In addition, the target owner had a number of joint ventures and partnerships with numerous companies. The deal was complicated and the target was asked by Company 3 to restructure its organizational and legal structure to make it 'cleaner'. Because of the structure, there was a big risk of the deal not happening.



The main strategic rationale behind the acquisition was to gain understanding on how to manage and learn from the target in how to be so cost competitive. Company 3 had an ambition to infuse the target's cost efficiency culture into its own way of working, as expressed by the CEO, to: *''(target)-ize'' Company 3'*

### 5.3.5. *Post-acquisition structure*

The acquirer board decided to keep the target as a stand-alone entity, reporting not to any of the three divisions, but directly to Group Business Development. The CEO assigned a Company 3 executive to the role of President of the acquired company.

### 5.3.6. *HR practices*

The current President was involved early, approximately 7-8 months prior to the deal contract was signed.

The culture in terms of leadership style and financial management within the target was different, mainly due to having been managed by the company owner, himself being: *'a Superman'*, and the hub for all major decision making.

Upon closing the deal the CEO came to the target site in person, clearly communicating the strategic rationale and ambition for the acquired company.

Basically all target executives stayed. Only a few employees left the target post-acquisition, whereof two were the previous owner's family members.

Company 3 replaced only a few employees, bringing a handful of key people into the target organization, e.g. specific expertise to increase production consistency.

The President actively facilitated cultural change within the target organization, transforming it from merely execution into also making decisions.

Pre-deal, compensation and benefits practices were not systematically managed and people were not paid consistently, but more based on personal relationships. Post-acquisition, changes to pay structure were not made directly. It was a deliberate decision not changing to a new performance (incentive) driven system until 2010: *'it didn't feel right changing it right away'.*

### 5.3.7. *Post-acquisition performance*

The target President foresaw two options moving forward:

- *'Market the target company under its own brand'* or
- *'Convert the target into the acquirer'* and *'have the acquirer operate as the target'*.

For the next few years the acquirer and the target will continue to operate as separate entities.

## 5.4. Company 4 – Insurance industry

### 5.4.1. *General acquirer characteristics*

Company 4 is a major insurance company operating mainly in the US market. Based on a revised strategy, it has during 2000-2006 undergone a repositioning from general insurance towards healthcare, e.g. through the divestment of a non-core business.

### 5.4.2. *Previous M&A experience*

As part of its business strategy, Company 4 continually evaluates potential acquisitions and other transactions that could enhance its competitive capabilities and provide a basis for growth and/or reduced costs. Company 4 has performed a few major acquisitions over the years. The observed acquisition in 2007 was the first major deal since 1999. However, Company 4 did perform some minor acquisitions: *'for practice'* (to acquire a technology; to establish position in a specific niche market; to enter a new line of business).

### 5.4.3. *M&A organization, approach and process*

Company 4 deployed a small M&A team dedicated full-time to run the M&A process. The M&A team acted as project manager, utilizing other functional expertise when needed. HR had one person designated to be: *'HR's first gate'* in the M&A process. The HR stream included pension, benefits, union issues etc. Additional HR-specific expertise were involved on as needed basis. External support was used e.g. for legal matters and occasionally for other specific issues.

Typically, as were the case in the observed acquisition, the M&A moved on to other activities within 3 months, as the acquisition was *"moved into 'transition management''*.

### 5.4.4. *Transaction characteristics and strategic rationale*

The target company wanted to move strategically more to towards financial services, while Company 4's strategic rationale was: *'to fill the hole in the middle market',* so when: *'we got to know (the target) was available, it was considered a good acquisition candidate'.* Furthermore, Company 4 considered it to be: *'a good match in cultures'*.

### 5.4.5. *Post-acquisition structure*

Since the main rationale for the acquisition was mainly related to establishing market presence in a new geographical region, very few cost synergies were identified and exploited. Consequently, the acquired entity was kept relatively untouched in terms of organizational structure.

### 5.4.6. *HR practices*

Though keeping structural change at a limited level, a very conscious decision was made to deploy Company 4's existing HR processes, including HR policy handbook and time off policy.

A gap analysis was conducted very consciously assessing current skills level vs. desired level, as required by the strategy going forward: *'(we do this) for M&A's as for any other reorganization'*. Furthermore: *'the M&A was an opportunity for review of our future state'*. In this process, the management team was very clear in communications: *'we will look at both acquirer and target'*.



As part of the integration work, Company 4 performed an organizational development exercise, involving executives from both the acquirer and the target.

Company 4 made retention of key talents a critical part of negotiations and the deal. Executives from the company target stayed, including a majority of the top-level HR people.

### 5.4.7. *Post-acquisition performance*

From a financial and market share perspective the M&A achieved expectations: '*(The target) has already enhanced our position in promising geographic markets [...] and improved our competitiveness and capabilities in the small business sector. It is also a solid contributor to earnings*. (Company 4 Annual report, 2008).

# 6. CONCLUSIONS AND IMPLICATIONS FOR HR MANAGEMENT

I have presented observations from four acquisitions performed by large, multinational companies that are all leading in their respective industries. I also presented some theory in the field of acquisitions and value creation, which was then summarized into a simplified alignment framework linking *strategy, structure, HR practices* and *performance*. The results are now summarized and analyzed in relation to the theoretical framework.

## 6.1. Overview

It could be noted that basically two different strategic objectives were driving the four acquisitions: Company 1, Company 2 and Company 4 all chose to *Enter a new geographic market* while Company 3 acquired to *Enter a new line of business*.

Analyzing the cases, the observed companies showed different degree of *sensitivity* to the underlying strategy when deciding on structure and HR practices. Understanding the *strategy* is important since strategic objectives can often be more complex than they appear at first. Two objectives could imply two significantly different integration structures. Though acquisitions are often driven by multiple motives, e.g. to gain presence in a new market *and* to exploit global efficiencies in production, one motive should be of paramount importance, to guide the choices around structure, HR practices, and the acquisition process itself.



## 6.2. Strategy and level of integration

According to Schweiger & Very (2003) *market entry* does require only low levels of integration, but may require high levels of standardization and coordination. In line with theory, Company 1 and Company 4 both kept integration levels fairly low, while Company 2 seem to have imposed its existing structure onto the target. Also in line with standardization requirements, Company 1 and Company 4, aligned acquirer and target HR processes (in both cases using the acquirer's processes). Company 2 made a conscious selection of HR processes that must be aligned, and others that could remain separate.

When the primary objective is to *enter a business* where the acquirer has limited experience or, as was the case for Company 3, to gain a deeper understanding about certain cost-efficient practices, the level of consolidation should be very low (Schweiger & Very, 2003). Accordingly, Company 3 chose to keep the target as a stand-alone entity reporting into Company 3's structure.

Exploiting an opportunity and deploying a step-wise approach, Company 1 made the acquisition to gain market presence, expanding into a new geographical region. We know from theory that when entering a new market the expected cost synergies are normally low, since there are few overlaps between acquirer and target. Consequently, the level of integration in terms of consolidating resources will be low, while the need for coordination is likely to be significant. In line with theory, Company 1 decided to keep the target's organizational structure relatively unchanged, but failed to clearly convey this message to the organization.

The joint venture entity that was part of the acquisition was reluctant to integrate with Company 1, a resistance that was made possible by passive or not strong enough intervention by the acquirer. Company 1 did perform a due diligence review and an assessment of management, but failed to detect issues that later caused problems and deferred the realization of the acquisition objective. The lack of clarity in communication and the delayed intervention seem to have prolonged the integration process, as did the poor due diligence, specifically the assessment of the target's management team.

As did Company 1, Company 2 acquired to enter a new geographical market. Similarly, the due diligence performed prior to the transaction was seemingly weak. Surprisingly, no active decision was made around the choice of structure, specifically the level of integration. The lack of analysis and discussion appear to have created difficulties both in communicating the deal motives and intentions, as well as complicated the execution of the integration.

### 6.3. M&A performance management

Partly explained by its organizational structure, separating product companies from support units in a matrix, and its culture of decentralization, Company 2 had no strong top-down control of the execution of the deal. Though deploying a corporate level 'integration board', monitoring a range of decentralized integration projects, coordination was weak, potentially missing out on expected synergies and/or creating negative synergies.

Ultimately, companies acquire other companies to create value. Other than financial metrics such as accounting or stock market based measures, task, transaction or firm level performance measurements could be used to evaluate the progress (and ultimately the outcome) of M&As. Financial metrics are by definition lagging (historical) indicators. In addition, as objectives may change as a consequence of learning during the acquisition process, so must also the corresponding performance measurement system and its metrics. Having clear objectives, and actively monitoring progress, enables learning and corrective actions. All the researched companies could have benefited from developing and monitoring clearer task, transaction and firm level measurements.

## 6.4. **Specific HR practices**

### 6.4.1. *Management priorities*

When entering a region where you have no previous presence, it is important to quickly take control of some critical elements of the local operations. Despite the extended period of weak governance due to not having a strong management team in place, Company 1 did successfully establish a new HR structure and quickly hired an HR professional to implement policies around code of conduct. Company 2 was selective in decisions around what HR processes must be harmonized immediately, and what could wait, an approach that seems to have reduced friction in executing the integration.

Company 4, as did Company 1 and Company 2, acquired to establish itself in a new geographical market. In line with what is expected from theory, few cost synergies were identified, and the target's structure was kept relatively intact. In contrast, a deliberate decision was made to replace the target company's HR processes with Company 4's. Interestingly, the observed M&A process was actively used as a vehicle for change, providing an opportunity to review the current state for the company. In this process, the top management enabled a less biased assessment of competencies and skills, stating that acquirer and target should be treated alike.

### 6.4.2. *Talent management*

Whether or not a company acquires to *Enter a new geographic market* (Company 1, Company 2 and Company 4) or to *Enter a new line of business* (Company 3) the retention of key personnel is critical. Company 4 made retention of key talents a central part of negotiations and the deal. Based on an understanding of future strategy and the corresponding requirements on management capabilities, Company 1 decided to hire people beyond what was needed for the current operation.

Replacement of management occurred post-acquisition in Company 1. According to Singh & Zollo (1998) *replacement* of top management has a negative effect on performance, indicating that improvements that a new management can introduce are offset by disruptions in the business. Though the performance effects directly related to Company 1's replacement of management are inconclusive, the approach of over-hiring proved valuable.



Company 3 decided to acquire a commodity-product focused company in order to gain a better understanding of certain management practices, specifically concerning cost competitiveness. When the main motive behind an acquisition is related to getting access to specific knowledge or different management perspectives, retention of key people is critical. Company 3 made a clear decision to preserve the target company as an autonomous entity, operating under its own brand, not integrating it structurally into Company 3's divisional structure but directly to a central, corporate level body. Retention of key people in the target company was critical, and proved successful.

Retention of key talents then implies two things: Firstly, you need to understand the strategy driving the deal to accurately determine what skills and capabilities are required to execute that strategy. Secondly, you need to have systems and processes in place to keep track of your people's current (and planned future) skills profiles.

#### 6.4.3. *Communication*

All researched companies stressed the importance of *communication* in M&A processes, and all of them seem to have had some challenges relating to communication. Regardless of rationale driving the acquisition, and choice of integration level, it is critical to communicate – to employees within both the acquirer and the target – acquisition motives, ambitions and consequences. Poor communication could be due to lack of clarity in the acquisition strategy or a much too speedy transaction process.

Company 3 had reasonably long period before actually closing the deal, potentially enabling better and more prepared communication. It seems that the more *clarity* there is around strategic rationale, choice of integration level, and process adherence, the easier is the communication task. Company 3, being very clear on motive and integration design appears to have succeeded in minimizing negative synergy by clearly communicating the logic of the acquisition. On the other hand, the plan for transferring knowledge, i.e. the main rationale for the acquisition is still very much unclear. This illustrates the fact that the level of integration in a way reflects the *tradeoff* between positive and negative synergies, and that it is a very difficult task balancing the beneficial and dysfunctional consequences of integration.

### 6.5. The role of the HR function

All the researched companies had central (and small) corporate M&A teams, involving additional functional expertise (such as HR) in the acquisition process when requested. None of the observed companies relied heavily on the support from external consultants. External expertise was brought in mainly for expert services such as legal or compensation benchmarking.

None of the observed companies have HR (as a function) represented on a permanent basis on the central M&A team. Instead HR is brought in, often 'after the fact', to provide expertise in the due diligence phase and/or to assist in the integration phase. Because of this structural fact, HR tends to be involved much too late in the process, and HR issues are dealt with in a more reactive than proactive way. Given the importance of wisely managing integration, which is essentially about people, HR should take on a bigger responsibility not only in the execution of the M&A process, but also in the planning activities preceding the deal.

It seems as if synergies are often overestimated, while the potential from transformation and learning is underestimated. HR should play a role in this context, helping articulate and manage expectations on what is reasonable given the organization's capability to realize expected benefits and perhaps help shifting focus from primarily addressing the transaction process and benefits related to cost synergies, towards the *long-term transformational* opportunities from integration of acquirer and target entities. As did Company 4, the M&A process could be utilized to re-evaluate the situation and serve as a starting point for organizational renewal and change.

### 6.6. Learning from experience

Though all acquiring companies had performed several deals before, they had no *systematic* process to learn from them. Given the potentially positive effect on M&A performance, they should take actions and find methods to *codify learnings* from transaction experience. HR should take the initiative to develop and manage the process of building a corporate M&A capability, including the learning dimension relating to previous deals. Jackson & Schuler (2001) propose that companies should review previous M&A processes emphasizing 1) how to deal with inadequate information during due diligence 2) employee communication and 3) identifying and dealing with integration bottlenecks.

### 6.7. The theoretical framework put to work

The alignment framework proposed in the theory section, stressed that in order to achieve M&A success, HR practices must be logically aligned to organizational structure and the strategy driving the acquisition. Therefore, the starting point must be an understanding of the motives for the acquisition and its implications. Then the M&A process can be adapted to the unique requirements of that specific transaction.

It is difficult to determine from interviews and available data to what extent the underlying strategy was fully understood, and how that understanding affected the choice of approach to integration.

It is also unclear to what extent HR professionals have been instrumental in the choice of post-acquisition structure. Though observed data shows that different types of checklists are used to guide HR's activities in the acquisition process, there are no indications that these *systematically* cover the interrelations with strategy and structure.

Regarding the post-acquisition performance effects, findings are inconclusive. Company 1 gained market presence in the new market, but seemingly later than planned because of poor planning. Company 2 did also succeed in establishing in their target market, but without clear and quantified objectives, combined with the decentralized responsibility for realization, determining performance with great certainty is difficult. Company 3 was successful in taking control of the acquired company, as well as to retain key personnel, but the objective of knowledge transfer was still not achieved. The acquisition made by Company 4 proved successful in financial terms, while HR was seemingly reactive in the acquisition process.

### 6.8. Concluding remarks and recommendations

All of the observed companies have engaged in corporate transactions before, and they have deployed similar structures to the management of M&As, with a central team of professionals engaged in initial analysis and target selection, and with functions like HR being involved in the M&A process upon request. It appears as if the level of HR competence from a functional perspective was very high, and that the contribution from HR people when consulted was significant.

However, HR as a corporate function could add more value to the M&A process if scope and timing of their interventions were adjusted. The HR function should:

- Get involved earlier in initial strategic discussions around acquisition strategy and target selection

- Be more active in the decision on structure (i.e. the integration level)
- Help the organization set and manage expectations, carefully balancing benefits and dysfunctions from integration, and do this already in the planning phase
- Assist in the setting and monitoring of acquisition performance targets, balancing financials, and task, transaction and firm level metrics
- Take the lead in the execution phase to realize the acquisition objectives, potentially by taking on central integration management duties
- Build confidence in HR's capabilities internally by prioritizing the M&A process, staffing with the best
- Partner with corporate communications to minimize disturbances to the base business, and to facilitate integration, by ensuring an ongoing, structured dialogue with employees
- Develop a structured acquisition management approach with effective tools based on the value creating alignment of strategy, structure and HR practices
- Create and manage a process to learn from previous acquisitions, as part of developing long term M&A management capabilities



Acquisitions are likely to continue to serve as an activity to grow businesses. By addressing some of the areas highlighted in this report, the HR function can have a substantial positive impact on the outcomes of these processes.

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